# New preface to Charles Kindleberger, The World in Depression 1929-1939

|  |  |
| --- | --- |
| [J. Bradford DeLong](http://www.voxeu.org/index.php?q=node/2382) [Barry Eichengreen](http://www.voxeu.org/index.php?q=node/101) 12 June 2012 | [**Print**](http://www.voxeu.org/index.php?q=node/8082) [**Email**](http://www.voxeu.org/index.php?q=forward&path=node/8082) [**Comment**](http://www.voxeu.org/index.php?q=node/8082#comments) [**Republish**](http://www.voxeu.org/index.php?q=node/87) |

|  |
| --- |
| *Charles Kindleberger’s classic book on the Great Depression was originally published 40 years ago. In the preface to a new edition, two leading economists argue that the lessons are as relevant as ever.*  The parallels between Europe in the 1930s and Europe today are stark, striking, and increasingly frightening. We see unemployment, youth unemployment especially, soaring to unprecedented heights. Financial instability and distress are widespread. There is growing political support for extremist parties of the far left and right.  Both the existence of these parallels and their tragic nature would not have escaped Charles Kindleberger, whose World in Depression, 1929-1939 was published exactly 40 years ago, in 1973.[1](http://www.voxeu.org/index.php?q=node/8082#fn) Where Kindleberger’s canvas was the world, his focus was Europe. While much of the earlier literature, often authored by Americans, focused on the Great Depression in the US, Kindleberger emphasised that the Depression had a prominent international and, in particular, European dimension. It was in Europe where many of the Depression’s worst effects, political as well as economic, played out. And it was in Europe where the absence of a public policy authority at the level of the continent and the inability of any individual national government or central bank to exercise adequate leadership had the most calamitous economic and financial effects.[2](http://www.voxeu.org/index.php?q=node/8082#fn2)  These were ideas that Kindleberger impressed upon generations of students as well on his reading public. Indeed, anyone fortunate enough to live in New England in the early 1980s and possessed of even a limited interest in international financial and monetary history felt compelled to walk, drive or take the T (as metropolitan Boston’s subway is known to locals) down to MIT's Sloan Building in order to listen to Kindleberger’s lectures on the subject (including both the authors of this preface). We understood about half of what he said and recognised about a quarter of the historical references and allusions. The experience was intimidating: Paul Krugman, who was a member of this same group and went on to be awarded the Nobel Prize for his work in international economics, has written how Kindleberger's course nearly scared him away from international macroeconomics. Kindleberger's lectures were surely “full of wisdom", Krugman notes. But then, “who feels wise in their twenties?" (Krugman 2002).  There was indeed much wisdom in Kindleberger’s lectures, about how markets work, about how they are managed, and especially about how they can go wrong. It is no accident that when Martin Wolf, dean of the British financial journalists, challenged then former-US Treasury Secretary Lawrence Summers in 2011 to deny that economists had proven themselves useless in the 2008-9 financial crisis, Summers's response was that, to the contrary, there was a useful economics. But what was useful for understanding financial crises was to be found not in the academic mainstream of mathematical models festooned with Greek symbols and complex abstract relationships but in the work of the pioneering 19th century financial journalist Walter Bagehot, the 20th-century bubble theorist Hyman Minsky, and "perhaps more still in Kindleberger" (Wolf and Summers 2011).  Summers was right. We speak from personal experience: for a generation the two of us have been living – very well, thank you – off the rich dividends thrown off by the intellectual capital that we acquired from Charles Kindleberger, earning our pay cheques by teaching our students some small fraction of what Charlie taught us. Three lessons stand out, the first having to do with panic in financial markets, the second with the power of contagion, the third with the importance of hegemony.  First, panic. Kindleberger argued that panic, defined as sudden overwhelming fear giving rise to extreme behaviour on the part of the affected, is intrinsic in the operation of financial markets. In The World in Depression he gave the best ever “explain-and-illustrate-with-examples” answer to the question of how and why panic occurs and financial markets fall apart. Kindleberger was an early apostate from the efficient-markets school of thought that markets not just get it right but also that they are intrinsically stable. His rival in attempting to explain the Great Depression, Milton Friedman, had famously argued that speculation in financial markets can’t be destabilising because if destabilising speculators drive asset values away from justified, or equilibrium, levels, such speculators will lose money and eventually be driven out of the market.[3](http://www.voxeu.org/index.php?q=node/8082#fn3) Kindleberger pushed back by observing that markets can continue to get it wrong for a very, very long time. He girded his position by elaborating and applying the work of Minsky, who had argued that markets pass through cycles characterised first by self-reinforcing boom, next by crash, then by panic, and finally by revulsion and depression. Kindleberger documented the ability of what is now sometimes referred to as the Minsky-Kindleberger framework to explain the behaviour of markets in the late 1920s and early 1930s – behaviour about which economists otherwise might have arguably had little of relevance or value to say. The Minsky paradigm emphasising the possibility of self-reinforcing booms and busts is the organising framework of The World in Depression. It then comes to the fore in all its explicit glory in Kindleberger’s subsequent book and summary statement of the approach, Mania, Panics and Crashes.[4](http://www.voxeu.org/index.php?q=node/8082#fn4)  Kindleberger’s second key lesson, closely related, is the power of contagion. At the centre of The World in Depression is the 1931 financial crisis, arguably the event that turned an already serious recession into the most severe downturn and economic catastrophe of the 20th century. The 1931 crisis began, as Kindleberger observes, in a relatively minor European financial centre, Vienna, but when left untreated leapfrogged first to Berlin and then, with even graver consequences, to London and New York. This is the 20th century’s most dramatic reminder of quickly how financial crises can metastasise almost instantaneously. In 1931 they spread through a number of different channels. German banks held deposits in Vienna. Merchant banks in London had extended credits to German banks and firms to help finance the country’s foreign trade. In addition to financial links, there were psychological links: as soon as a big bank went down in Vienna, investors, having no way to know for sure, began to fear that similar problems might be lurking in the banking systems of other European countries and the US. In the same way that problems in a small country, Greece, could threaten the entire European System in 2012, problems in a small country, Austria, could constitute a lethal threat to the entire global financial system in 1931 in the absence of effective action to prevent them from spreading.This brings us to Kindleberger’s third lesson, which has to do with the importance of hegemony, defined as a preponderance of influence and power over others, in this case over other nation states. Kindleberger argued that at the root of Europe’s and the world’s problems in the 1920s and 1930s was the absence of a benevolent hegemon: a dominant economic power able and willing to take the interests of smaller powers and the operation of the larger international system into account by stabilising the flow of spending through the global or at least the North Atlantic economy, and doing so by acting as a lender and consumer of last resort. Great Britain, now but a middle power in relative economic decline, no longer possessed the resources commensurate with the job. The rising power, the US, did not yet realise that the maintenance of economic stability required it to assume this role. In contrast to the period before 1914, when Britain acted as hegemon, or after 1945, when the US did so, there was no one to stabilise the unstable economy. Europe, the world economy’s chokepoint, was rendered rudderless, unstable, and crisis- and depression-prone. That is Kindleberger’s World in Depression in a nutshell. As he put it in 1973:  *“The 1929 depression was so wide, so deep and so long because the international economic system was rendered unstable by British inability and United States unwillingness to assume responsibility for stabilising it in three particulars: (a) maintaining a relatively open market for distress goods; (b) providing counter-cyclical long-term lending; and (c) discounting in crisis…. The world economic system was unstable unless some country stabilised it, as Britain had done in the nineteenth century and up to 1913. In 1929, the British couldn't and the United States wouldn't. When every country turned to protect its national private interest, the world public interest went down the drain, and with it the private interests of all…”*  Subsequently these insights stimulated a considerable body of scholarship in economics, particularly models of international economic policy coordination with and without a dominant economic power, and in political science, where Kindleberger’s “theory of hegemonic stability” is perhaps the leading approach used by political scientists to understand how order can be maintained in an otherwise anarchic international system.[5](http://www.voxeu.org/index.php?q=node/8082#fn5)  It might be hoped that something would have been learned from this considerable body of scholarship. Yet today, to our surprise, alarm and dismay, we find ourselves watching a rerun of Europe in 1931. Once more, panic and financial distress are widespread. And, once more, Europe lacks a hegemon – a dominant economic power capable of taking the interests of smaller powers and the operation of the larger international system into account by stabilising flows of finance and spending through the European economy. The ECB does not believe it has the authority: its mandate, the argument goes, requires it to mechanically pursue an inflation target – which it defines in practice as an inflation ceiling. It is not empowered, it argues, to act as a lender of the last resort to distressed financial markets, the indispensability of a lender of last resort in times of crisis being another powerful message of The World in Depression. The EU, a diverse collection of more than two dozen states, has found it difficult to reach a consensus on how to react. And even on those rare occasions where it does achieve something approaching a consensus, the wheels turn slowly, too slowly compared to the crisis, which turns very fast.  The German federal government, the political incarnation of the single most consequential economic power in Europe, is one potential hegemon. It has room for countercyclical fiscal policy. It could encourage the European Central Bank to make more active use of monetary policy. It could fund a Marshall Plan for Greece and signal a willingness to assume joint responsibility, along with its EU partners, for some fraction of their collective debt. But Germany still thinks of itself as the steward is a small open economy. It repeats at every turn that it is beyond its capacity to stabilise the European system: “German taxpayers can only bear so much after all”. Unilaterally taking action to stabilise the European economy is not, in any case, its responsibility, as the matter is perceived. The EU is not a union where big countries lead and smaller countries follow docilely but, at least ostensibly, a collection of equals. Germany’s own difficult history in any case makes it difficult for the country to assert its influence and authority and equally difficult for its EU partners, even those who most desperately require it, to accept such an assertion.[6](http://www.voxeu.org/index.php?q=node/8082#fn6) Europe, everyone agrees, needs to strengthen its collective will and ability to take collective action. But in the absence of a hegemon at the European level, this is easier said than done.  The International Monetary Fund, meanwhile, is not sufficiently well capitalised to do the job even were its non-European members to permit it to do so, which remains doubtful. Viewed from Asia or, for that matter, from Capitol Hill, Europe’s problems are properly solved in Europe. More concretely, the view is that the money needed to resolve Europe’s economic and financial crisis should come from Europe. The US government and Federal Reserve System, for their part, have no choice but to view Europe’s problems from the sidelines. A cash-strapped US government lacks the resources to intervene big-time in Europe’s affairs in 1948; there will be no 21st century analogue of the Marshall Plan, when the US through the Economic Recovery Programme, of which the young Charles Kindleberger was a major architect, extended a generous package of foreign aid to help stabilise an unstable continent. Today, in contrast, the Congress is not about to permit Greece, Ireland, Portugal, Italy, and Spain to incorporate in Delaware as bank holding companies and join the Federal Reserve System.[7](http://www.voxeu.org/index.php?q=node/8082#fn7)  In a sense, Kindleberger predicted all this in 1973. He saw the power and willingness of the US to bear the responsibility and burden of sacrifice required of benevolent hegemony as likely to falter in subsequent generations. He saw three positive and three negative branches on the then-future's probability tree. The positive outcomes were: "[i] revived United States leadership… [ii] an assertion of leadership and assumption of responsibility... by Europe…” [sitting here, in 2013, one might be tempted to add emerging markets like China as potentially stepping into the leadership breach, although in practice the Chinese authorities have been reluctant to go there, and] [iii] cession of economic sovereignty to international institutions….” Here, in a sense, Kindleberger had both global and regional – meaning European – institutions in mind. “The last”, meaning a global solution, “is the most attractive”, he concluded,” but perhaps, because difficult, the least likely…" The negative outcomes were: "(a) the United States and the [EU] vying for leadership… (b) one unable to lead and the other unwilling, as in 1929 to 1933… (c) each retaining a veto… without seeking to secure positive programmes…"  As we write, the North Atlantic world appears to have fallen foul to his bad outcome (c), with extraordinary political dysfunction in the US preventing its government from acting as a benevolent hegemon, and the ruling mandarins of Europe, in Germany in particular, unwilling to step up and convince their voters that they must assume the task.  It was fear of this future that led Kindleberger to end The World in Depression with the observation: “In these circumstances, the third positive alternative of international institutions with real authority and sovereignty is pressing.”  Indeed it is, more so now than ever. References Eichengreen, Barry (1987), “Hegemonic Stability Theories of the International Monetary System”, in Richard Cooper, Barry Eichengreen, Gerald Holtham, Robert Putnam and Randall Henning (eds.), Can Nations Agree? Issues in International Economic Cooperation, The Brookings Institution, 255-298.  Friedman, Milton (1953), “The Case for Flexible Exchange Rates”, in Essays in Positive Economics, University of Chicago Press.  Friedman, Milton and Anna J Schwartz (1963), A Monetary History of the United States, 1967-1960, Princeton University Press.  Gilpin, Robert (1987), The Political Economy of International Relations, Princeton University Press.  Keohane, Robert (1984), After Hegemony, Princeton University Press.  Kindleberger, Charles (1978), Manias, Panics and Crashes, Norton.  Krugman, Paul (2003), “Remembering Rudi Dornbusch”, unpublished manuscript, [www.pkarchive.org](http://www.pkarchive.org/), 28 July.  Lake, David (1993), “Leadership, Hegemony and the International Economy: Naked Emperor or Tattered Monarch with Potential?”, International Studies Quarterly, 37: 459-489.  Wolf, Martin and Lawrence Summers (2011), “Larry Summers and Martin Wolf: Keynote at INET’s Bretton Woods Conference 2011”, [www.youtube.com](http://www.youtube.com/), 9 April.  1 Kindleberger passed away in 2003. A second modestly revised and expanded edition of The World in Depression was then published, also by the University of California Press, in 1986. The second edition differed mainly by responding to the author’s critics and commenting to some subsequent literature. We have chosen to reproduce the ‘unvarnished’ 1973 Kindleberger, where the key points are made in unadorned fashion.  2 The book was commissioned originally for a series on the economic history of Europe, with each author writing on a different decade. This points to the question of why the title was not, instead, “Europe in Depression.” The answer, presumably, is that the author – and his publisher wished to acknowledge that the Depression was not exclusively a European phenomenon and that the linkages between Europe and the US were also critically important.  3 Friedman’s great work on the Depression, coauthored with Anna Jacobson Schwartz (1963), was in Kindleberger’s view too monocausal, focusing on the role of monetary policy, and too U.S. centric. See also Friedman (1953)  4 Kindleberger (1978). Kindleberger amply acknowledged his intellectual debt to Minsky. But we are not alone if we suggest that Kindleberger’s admirably clear presentation of the framework, and the success with which he documented its power by applying it to historical experience, rendered it more impactful in the academy and generally.  5 A sampling of work in economics on international policy coordination inspired by Kindleberger includes Eichengreen (1987) and Hughes Hallet, Mooslechner and Scheurz (2001). Three important statements of the relevant work in international relations are Keohane (1984), Gilpin (1987) and Lake (1993).  6 The European Union was created, in a sense, precisely in order to prevent the reassertion of German hegemony.  7 The point being that the US, in contrast, does possess a central bank willing, under certain circumstances, to acknowledge its responsibility for acting as a lender of last resort. Nothing in fact prevents the Federal Reserve, under current institutional arrangements from, say, purchasing the bonds of distressed Southern European sovereigns. But this would be viewed as peculiar and inappropriate in many quarters. The Fed has a full plate of other problems. And intervening in European bond markets, the argument would go, is properly the responsibility of the leading European monetary authority. |

Top of Form

Bottom of Form

Comments (0) | [Login to post comments](http://www.voxeu.org/index.php?q=user/login&destination=comment/reply/7058#comment-form)

VoxEU.org

[**Copyright**](http://www.voxeu.org/index.php?q=node/87) [**Contact**](http://www.voxeu.org/index.php?q=node/86)

Comments (0) | [Login to post comments](http://www.voxeu.org/index.php?q=user/login&destination=comment/reply/7051#comment-form)

VoxEU.org

[**Copyright**](http://www.voxeu.org/index.php?q=node/87) [**Contact**](http://www.voxeu.org/index.php?q=node/86)