Charles P. Kindleberger

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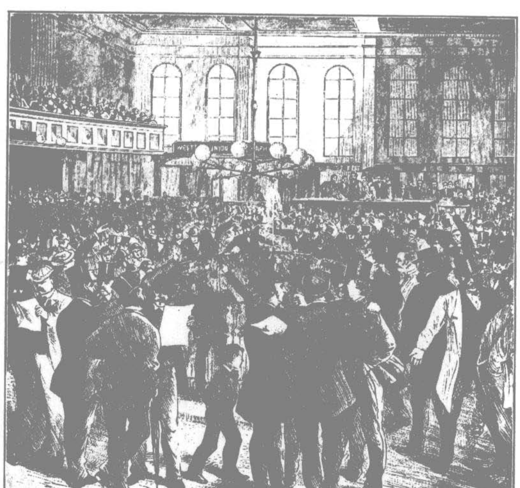

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To the M.I.T. Old Guard of the 1940s

MAA, RLB, ECB, HAF, CAM, PAS, RMS, DST

and the memory of REF, WRMacL, and MFM

in gratitude for support and friendship

Much has been written about panics and manias, much more than with the most outstretched intellect we are able to follow or conceive; but one thing is certain, that at particular times a great deal of stupid people have a great deal of stupid money. . . . At intervals, from causes which are not to the present purpose, the money of these people —the blind capital, as we call it, of the country—is particularly large and craving; it seeks for someone to devour it, and there is a "plethora"; it finds someone, and there is "speculation"; it is devoured, and there is "panic."

—Walter Bagehot
"Essay on Edward Gibbon"

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Inevitably, in working on a subject over a number of years, one accumulates valuable leads and ideas through conversation, correspondence, and discussion following seminars or lectures, without always recalling exactly what is owed to whom. The present circumstances constitute no exception. Martin Mayer put me on to the Minsky model. Hal Varian tried unsuccessfully to instruct me in catastrophe mathematics (which, for the most part, remains a blur). For discussion at M.I.T., I am especially indebted to Peter Diamond, to Rudiger Dornbusch, and to Stanley Fischer, who also read the manuscript. At Brigham Young University in January 1977, I had several discussions with Larry Wimmer and at Princeton with Lester Chandler and Dwight Jaffee. My files contain useful letters from Jacob Frenkel, the late Harry G. Johnson, Roland McKinnon, Edward S. Shaw, and Allan Sproul. Lectures on various aspects of the subject were given at the Eastern Economic Association, the Pacific Northwest Regional Economics Association, the Export-Import Bank conference on debts of developing countries, and seminars at the University of California, Brigham Young, Harvard, the Institute for Advanced Studies, Lewis and Clark College, Oregon, Princeton, Stanford, Utah, and Utah State.

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CHARLES P. KINDLEBERGER

Massachusetts Institute of Technology
November 1977

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Manias, Panics, and Crashes

CHAPTER 1

Financial Crisis: A Hardy Perennial

There is hardly a more conventional subject in economic literature than financial crises. If few books on the subject have appeared since World War II, following the spate of the 1930s, it is because the industry of producing them is anti-cyclical in character, and recessions from 1945 to 1973 were few, far between, and exceptionally mild. More recently, with the worldwide recession of 1974–75, the industry has picked up. This work thus reflects a revived interest in an old theme.

Financial crises are associated with the peaks of business cycles. We are not interested in the business cycle as such, the rhythm of economic expansion and contraction, but only in the financial crisis that is the culmination of a period of expansion and leads to downturn. If there be business cycles without financial crises, they lie outside our interest. On the other hand, financial crises that prove so manageable as to have no effects on the economic system will also be neglected. The financial crises we shall consider here are major both in size and in effect and, as a rule, international in scope.

The issues to be probed are several. Are markets so rational that manias—irrational by definition—cannot occur? If, on the other hand, such manias do occur, should they be allowed to run their course, without governmental or other authoritative interference? Or is there a salutary role to be played by a "lender of last resort," who comes to the rescue and provides the public good of stability that the private market is unable to produce for itself? And if the services of a lender of last resort are provided nationally, by government or by such official institutions as a central bank, what agency or agencies can furnish stability to the international system, for which no government exists?

The reader is owed an immediate confession. In an earlier work, *The World in Depression, 1929–1939*, I reached the conclusion that the 1929 depression was so wide, so deep, and so prolonged because there was no international lender of last resort.[1] Exhausted by the war and groggy from the aborted recovery of the 1920s, Great Britain was unable to act in that capacity and the United States was unwilling to do so. This interpretation of the Great Depression has not gone unchallenged.[2] The present work is nonetheless an attempt to extend the analysis in time and space, back to the beginning of the eighteenth century and to Western Europe.

Speculative excess, referred to concisely as a mania, and revulsion from such excess in the form of a crisis, crash, or panic can be shown to be, if not inevitable, at least historically common. And the role of the lender of last resort is fraught with ambiguity and dilemma. Commenting on the behavior of the Bank of England in the crisis of 1825, Thomas Joplin said, "There are times when rules and precedents cannot be broken; others, when they cannot be adhered to with safety."[3] Of course. But breaking the rule establishes a precedent and a new rule, which should be adhered to or broken as occasion demands. In these circumstances, intervention is an art, not a science. General rules that the state should always intervene or that it should never intervene are both wrong, a fact abundantly demonstrated by contemporary questions of whether or not, or how, to rescue Lockheed, Penn Central, New York City, the Eastern bloc, and developing countries with their mountains of debt. This list of questions, moreover, suggests that the problem of financial crisis is still with us despite what the world has learned about economic stability from Keynes, so amply put into effect in the last thirty years.

This book, as already remarked, is not concerned with the business cycle, except insofar as failure to take action at the upper turning point may or may not prolong subsequent depression. Our concern is with speculative booms in the cycle and in the crises at the peak, and especially with their financial aspects. By no means is every upswing in business excessive, leading inevitably to mania and panic. But the pattern occurs sufficiently frequently and with sufficient uniformity to merit renewed study.

What happens, basically, is that some event changes the economic outlook. New opportunities for profits are seized, and overdone, in ways so closely resembling irrationality as to constitute a mania. Once the excessive character of the upswing is realized, the financial system experiences a sort of "distress," in the course of which the rush to reverse the expansion process may become so precipitous as to resemble panic. In the manic phase, people of wealth or credit switch out of money or borrow to buy real or illiquid financial assets. In panic, the reverse movement takes place, from real or financial assets to money, or repayment of debt, with a crash in the prices of commodities, houses, buildings, land, stocks, bonds—in short, in whatever has been the subject of the mania.

The monetary aspects of manias and panics are important, and we shall later examine them at some length. A monetarist view of the matter—that mania and panic would both be avoided if only the supply of money were stabilized at some fixed quantity, or at a regular growing level—is rejected. While better monetary policies would moderate mania and panic in all cases, and doubtless eliminate some, I contend that even optimal policies would leave a residual problem of considerable dimensions. Even if there were exactly the right amount of liquidity in the system over the long run, there would still be crises, and need in crisis for additional liquidity to be provided by a lender of last resort. This view can be generalized to commodity markets. Markets generally work, but occasionally they break down. When they do, they require government intervention to provide the public good of stability.

This position is widely at variance with the views at either of two extremes: that financial and commodity markets work perfectly in all times and places, or that they always work badly and should be replaced by planning or governmental assignments. On the contrary, I contend that markets work well on the whole, and can normally be relied upon to decide the allocation of resources and, within limits, the distribution of income, but that occasionally markets will be overwhelmed and need help. The dilemma, of course, is that if markets know in advance that help is forthcoming under generous dispensations, they break down more frequently and function less effectively.

It may be well to fix the limits in time and place of the panics we shall consider. We start with the South Sea bubble in London and the Mississippi bubble in Paris in 1719 and 1720. (Manias such as the Lübeck crisis 100 years earlier, or the tulip mania of 1634, are too isolated and lack the characteristic monetary features that come with the spread of banking after the opening of the eighteenth century.) Although I say "we start with the South Sea bubble," there will be no chronological history of crises. Rather, we shall attempt an analytical treatment using materials from crises going back to 1719 and coming up mainly to 1929, but in a few cases up to the recession of 1974–75.* In space, the major connected financial markets were Holland, Britain, Germany, and France in the eighteenth century; and Britain, Germany, France, and (beginning in 1819) the United States in the nineteenth century. Italy is of interest in connection with the crisis of 1866 and that of 1907, for which a particularly useful monograph exists.[4] For the rest, Italy plays only a modest role until after World War II.

Historical economics of a comparative sort relies on secondary sources, and cannot seek for primary material available only in archives. Accordingly, it follows the historical literature, which is most abundant for Britain and then for France, Germany, and the United States. The writer must confess, moreover, that his historical focus has been more on Europe than on the United States, at least for the period before World War I. To the extent that an abundance of work on a given country accurately reflects its importance in the international financial system, as it largely does, major attention to Britain is appropriate for the nineteenth century, if less so for the eighteenth, when Amsterdam matched or outstripped London in financial power. Inability to read Dutch has cut me off from most of at least one frequently cited monograph on the crisis of 1763,[5] but there is a considerable literature on Amsterdam in this period in more accessible languages, notably English.

This book is an essay in what is derogatively called today "literary economics," as opposed to mathematical economics,

* After 1720 there is a long gap until we come to the international crisis of 1763 at the end of the Seven Years War. A crisis and panic in London in 1745, when the Young Pretender landed in Scotland and advanced on England from the north until he was stopped at Carlisle, fall outside the interest of this work, since they were largely nonmonetary and were limited to a single market. A number of well-known financial crises, such as that following the City of Glasgow Bank failure in 1878 or the panic of 1893 in New York will be explored for particular aspects but are too parochial to merit intensive examination for present purposes.

econometrics, or (embracing them both) the "new economic history." A man does what he can, and in the more elegant—one is tempted to say "fancier"—techniques I am, as one who received his formation in the 1930s, untutored. A colleague has offered to provide a mathematical model to decorate the work. It might be useful to some readers, but not to me. Catastrophe mathematics, dealing with such events as falling off a height, is a new branch of the discipline, I am told, which has yet to demonstrate its rigor or usefulness. I had better wait. Econometricians among my friends tell me that rare events such as panics cannot be dealt with by the normal techniques of regression, but have to be introduced exogenously as "dummy variables." The real choice open to me was whether or not to follow relatively simple statistical procedures, with an abundance of charts and tables. In the event, I decided against it. For those who yearn for numbers, standard series on bank reserves, foreign trade, commodity prices, money supply, security prices, rate of interest, and the like are fairly readily available in the historical statistics. My thesis does not rest on small differences in quantities, however—or so I believe. It seemed to me to bog the argument down, as well as involve an inordinate amount of work, with greater costs than benefits. The result is an essentially qualitative, not quantitative, approach.

Chapter 2 provides the background to the analysis. It consists of a model of speculation, credit expansion, financial distress at the peak, and then crisis, ending in panic and crash. It is patterned after early classical ideas of overtrading, followed by revulsion and discredit, as expressed by Adam Smith, John Stuart Mill, Knut Wicksell, Irving Fisher, and others, but most recently by Hyman Minsky, a monetary theorist who holds that the financial system is unstable, fragile, and prone to crisis. It is not necessary to agree with him about the current monetary system of the United States to recognize that his model may have great explanatory power for past crises in this country and especially in Western Europe.

The analysis itself, with copious historical illustration, begins with Chapter 3, which focuses on speculation, the mania phase of the subject. The central issue here is whether speculation can be destabilizing as well as stabilizing—whether, in other words, markets are always rational. The nature of the outside, exogenous shock which sets off the mania is examined in different historical settings: war, the end of war, a series of good harvests, a series of bad harvests, the opening of new markets, innovations, and the like. The objects of speculation are listed: commodity exports, commodity imports, agricultural land at home or abroad, urban building sites, new banks, discount houses, stocks, bonds (both foreign and domestic), glamour stocks, conglomerates, condominiums, shopping centers, office buildings. Moderate excesses burn themselves out without damage. A difficult question to answer is whether the euphoria of the upswing endangers financial stability only if it embraces two or more objects of speculation, a bad harvest, say, along with a railroad mania or an orgy of land speculation.

Chapter 4 deals with the monetary dimensions of both manias and panics. We shall note occasions when boom or panic has been set off by monetary events—a recoinage, a discovery of precious metals, a change in the ratio of the prices of gold and silver under bimetallism, and the like. More fundamentally, however, we shall stress the difficulty of getting the monetary mechanism right at any one time, and the impossibility of keeping it right. Money is a public good; as such, it lends itself to private exploitation. Banking, moreover, is notoriously difficult to regulate. Modern monetarists insist that much, perhaps most, of the cyclical difficulties of the past are the consequences of mistakes of understanding. That such mistakes were frequent and serious cannot be denied. The argument advanced in this chapter, however, is