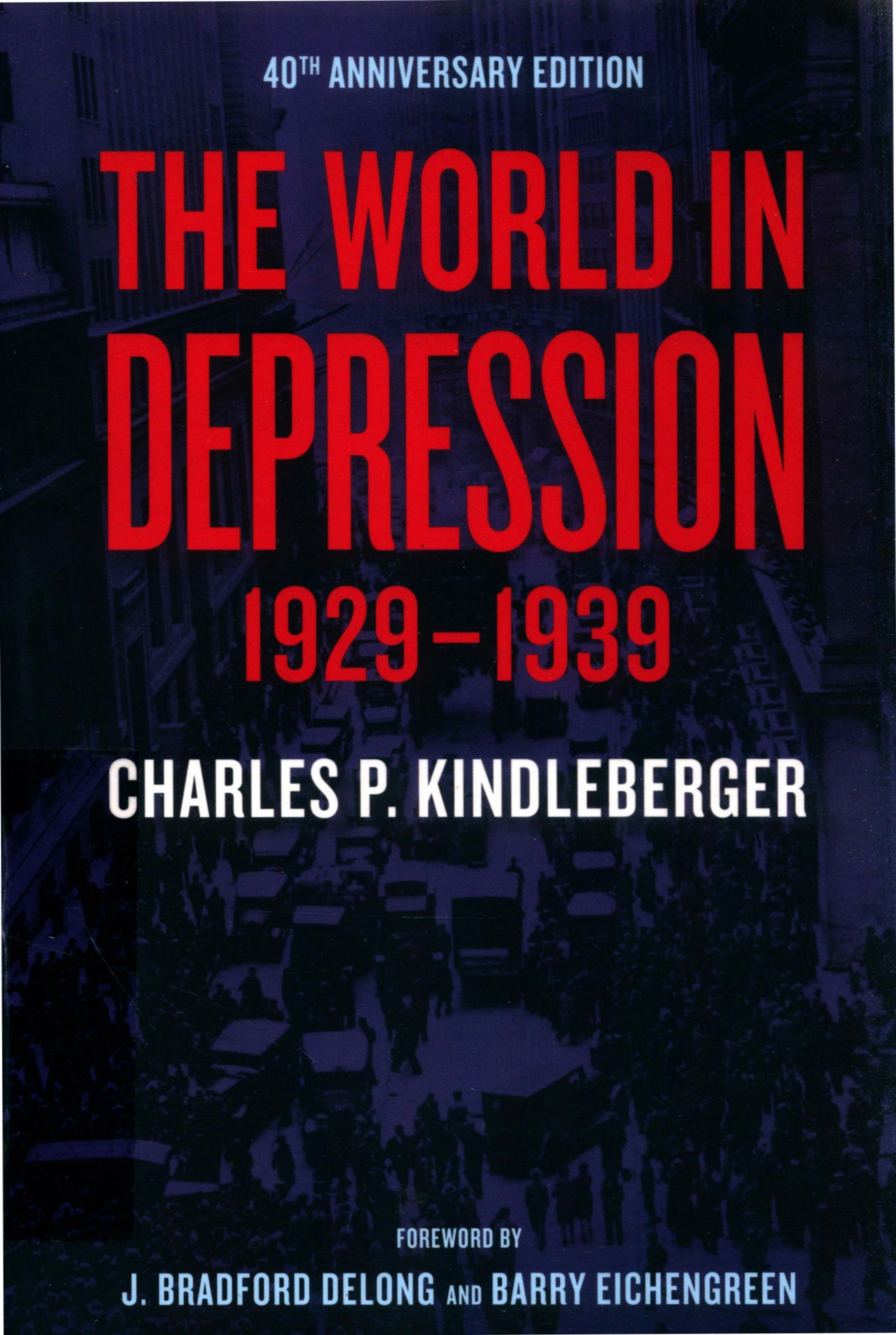

40TH ANNIVERSARY EDITION

THE WORLD IN DEPRESSION 1929–1939

CHARLES P. KINDLEBERGER

FOREWORD BY

J. BRADFORD DELONG AND BARRY EICHENGREEN

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Foreword

The parallels between Europe in the 1930s and Europe today are stark, striking, and 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.

The existence of these parallels and their tragic nature would not have escaped the late Charles Kindleberger, whose *The World in Depression, 1929–1939* was published exactly forty years ago.[1] 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 United States, Kindleberger emphasized that the Depression had a prominent international and, in particular, European dimension. It was Europe where many of the Depression's worst effects, political as well as economic, played out. And it was 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]

1. The first edition of *The World in Depression* was published by University of California Press in 1973. A revised and expanded edition was then published, also by University of California Press, in 1986. The second edition differed mainly by responding to the author's critics and commenting on some subsequent literature. We have chosen to reproduce the "unvarnished" 1973 Kindleberger, which makes the key points in unadorned fashion.

2. Kindleberger's book was commissioned for a series on the economic history of Europe, with each author writing on a different decade. One might ask why the title was not, instead, Europe in Depression. The answer is presumably that the author and his publisher wished to acknowledge that the Depression was not an exclusively European phenomenon and that the linkages between Europe and the United States, in particular, were critically important.

These were ideas that Kindleberger impressed upon generations of students and 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 MIT's Sloan Building in order to listen to Kindleberger's lectures on the subject.[3] Members of those audiences understood about half of what he said and recognized about a quarter of the historical references and allusions. Paul Krugman, who was a member of this same group and went on to be awarded the Nobel Memorial Prize for his work in international economics, has written about 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?"[4]

There was indeed much wisdom in Kindleberger's lectures: about how markets work, about how they are managed, and about how they go wrong. It is no accident that when Martin Wolf, the dean of the British financial journalists, challenged then-former U.S. treasury secretary Lawrence Summers in 2011 to deny that economists had proved 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 formulas but in the work of the pioneering nineteenth-century financial journalist Walter Bagehot, the twentieth-century bubble theorist Hyman Minsky and "perhaps more still in Kindleberger."[5]

Summers was right. We speak from personal experience: for a generation the two of us have been living—quite well, thank you—on the basis of the rich dividends thrown off by the intellectual capital that we acquired from Charles Kindleberger, earning our paychecks by teaching our students some small fraction of what he taught us. Three lessons stand out, the first having to do with panic in financial

3. Including both authors of this preface.

4. Paul Krugman, "Remembering Rudi Dornbusch," www.pkarchive.org, 28 July 2002.

5. Martin Wolf and Lawrence Summers, "Larry Summers and Martin Wolf: Keynote at INET's Bretton Woods Conference 2011," www.youtube.com, 9 April 2011.

markets, the second with the power of contagion, and the third with the importance of hegemony.

First, panic. Kindleberger argued that panic, defined as sudden overwhelming fear giving rise to extreme behavior 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 panics occur and then make financial markets fall apart. Kindleberger was an early apostate from the efficient-markets school of thought, which argues that markets not only get it right but are also intrinsically stable. His rival in attempting to explain the Great Depression, Milton Friedman, had famously argued that speculation in financial markets can't be destabilizing, because if destabilizing speculators drive asset values away from justified, or equilibrium, levels, they will lose money and eventually be driven out of the market.[6] Kindleberger pushed back by observing that markets can continue to get it wrong for a very long time. He girded his position by applying and elaborating the work of Minsky, who had argued that markets pass through cycles of, first, self-reinforcing boom, next crash, then panic, and finally revulsion and depression. Kindleberger documented the ability of what is now sometimes referred to as the Minsky-Kindleberger framework to explain the behavior of markets in the late 1920s and early 1930s—behavior about which economists might otherwise have had little of relevance or value to say. The Minsky paradigm emphasizing the possibility of self-reinforcing booms and busts is the implicit organizing framework of *The World in Depression*. It comes to the fore in all its explicit glory in Kindleberger's subsequent book and summary statement of the approach, *Mania, Panics and Crashes*.[7]

6. Friedman's great work on the Depression, coauthored with Anna Jacobson Schwartz, *A Monetary History of the United States, 1867–1960*, Princeton University Press, Princeton, 1963, was in Kindleberger's view too monocausal, focusing on the role of monetary policy, and too U.S.-centric. Friedman's work on the scope of destabilizing speculation is "The Case for Flexible Exchange Rates," in *Essays in Positive Economics*, University of Chicago Press, Chicago, 1953.

7. Kindleberger, *Manias, Panics and Crashes*, Norton, New York, 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.

Kindleberger's second key lesson, closely related, is about the power of contagion. At the center of *The World in Depression* is the 1931 financial crisis, arguably the event that turned a serious recession into the great economic catastrophe of the twentieth century. It began, as Kindleberger observes, in a relatively minor European financial center, Vienna, but when left untreated it leapfrogged, first to Berlin and then, with even graver consequences, to London and New York. This is the twentieth century's most dramatic reminder of how quickly financial crises can metastasize. In 1931 they spread through a number of different channels. German banks held deposits in Vienna. Merchant banks in London had extended credit to German banks and firms to help finance the country's foreign trade. In addition to financial links, there were psychological ones: 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 United States. 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 nation-states. Kindleberger argued that at the root of Europe's and the world's problems 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 stabilizing the flow of spending through the global or at least the North Atlantic economy, and to do 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 adequate for the job. The rising power, the United States, did not yet realize that the maintenance of economic stability required it to assume this role. Europe, the choke point, was rendered rudderless, unstable, and crisis- and depression-prone. That is Kindleberger's *The 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 stabilizing 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 stabilized 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.

Over the years, these insights have stimulated a considerable body of scholarship in economics, particularly in models of international economic policy coordination with and without a dominant economic power, and in political science, where what came to be called "Kindleberger's theory of hegemonic stability" is perhaps the leading approach to understanding how order can be maintained in an otherwise anarchic international system.[8]

It might have been hoped that something was 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. Once more, Europe lacks a hegemon. The European Central Bank does not believe it has the authority to be one: its mandate, the argument goes, requires it to mechanically pursue an inflation target—which it defines in prac-

8. A sampling of work in economics on international policy coordination inspired by Kindleberger includes Barry Eichengreen, "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,* Brookings Institution, Washington, D.C., 1987, pp. 255–98; and Andrew Hughes Hallett, Peter Mooslechner, and Martin Schuerz (eds.), *Challenges for Economic Policy Coordination within European Monetary Union,* Boston, Kluwer Academic Publishers, 2001. Three important statements of the relevant work in international relations are Robert Keohane, *After Hegemony,* Princeton University Press, Princeton, 1984; Robert Gilpin, *The Political Economy of International Relations,* Princeton University Press, Princeton, 1987; and David Lake, "Leadership, Hegemony and the International Economy: Naked Emperor or Tattered Monarch with Potential?," *International Studies Quarterly* 37 (1993), pp. 459–89.

tice as an inflation ceiling. It is not empowered, it argues, to act as a lender of last resort to distressed financial markets—the indispensability of such a lender in times of crisis being another powerful message of *The World in Depression.* The European Union, 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 when it does achieve something approaching a consensus, the wheels turn slowly, too slowly compared to the crisis, which turns very fast.

The Federal Republic of Germany, 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 that it is ready to assume joint responsibility, along with its European Union partners, of some fraction of their collective debt. But Germany still thinks of itself as the steward of a small, open economy. It repeats at every turn that stabilizing the European system is beyond its capacity: "German taxpayers can only bear so much." Unilaterally acting to stabilize the European economy is not, in any case, its responsibility, as the matter is perceived. The European Union is not a union in which big countries lead and smaller countries follow but, at least ostensibly, a collection of equals. Germany's difficult history also makes it hard for the country to assert its influence and authority and for its EU partners, even those that most desperately require it, to accept such an assertion.[9] Europe, everyone agrees, needs to strengthen its ability and will to take collective action. But in the absence of a European hegemon, this is easier said than done.

The International Monetary Fund, meanwhile, is not sufficiently well capitalized to do the job—even were its non-European members to let it, which remains doubtful. The view from Asia, and, for that matter, Capitol Hill, is that Europe's problems are to be solved in Europe. More concretely, the belief is that the money needed to resolve Europe's economic and financial crisis should come from European taxpayers. The U.S. government and Federal Reserve System, for their part, have no choice but to view Europe's problems from the

9. The European Union was created, in a sense, precisely in order to prevent the reassertion of German hegemony.

sidelines. The cash-strapped U.S. government lacks the resources to intervene big-time in Europe's affairs as it did in 1948. There will be no twenty-first-century analogue of the Marshall Plan, whereby the United States, through the Economic Recovery Program, of which the young Kindleberger was a major architect, extended a generous package of foreign aid to help stabilize an unstable continent. Today, in contrast, Congress is not about to permit Greece, Ireland, Portugal, Italy, or Spain to incorporate in Delaware as a bank holding company and join the Federal Reserve System.[10]

Kindleberger predicted all this, in a sense, in 1973. He saw the ability and willingness of the United States to bear the responsibility and burden of sacrifice required for benevolent hegemony as likely to falter in subsequent generations. He saw three positive and three negative branches on the future's probability tree. The positive outcomes were: "[a] revived United States leadership . . . [; b] 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 potential fillers of the leadership breach, although in practice the Chinese authorities have been reluctant to do that] . . . ; or [c] cession of economic sovereignty to international institutions." Here Kindleberger had both global and regional—meaning European—institutions in mind. He concluded that "the last"— a global solution—"is the most attractive, but perhaps, because difficult, the least likely." The possible 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; and (c) each retaining a veto . . . without seeking to secure positive programmes."

As we write, the North Atlantic world appears to have fallen into Kindleberger's bad outcome (c), with extraordinary political dysfunction in the United States preventing the country from acting as a

10. The point being that the United States, in contrast to Europe, 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 many quarters would view this as peculiar and inappropriate. The Fed has a full plate of other problems. And intervening in European bond markets, the argument goes, is properly the responsibility of the leading European monetary authority.

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 that "in these circumstances, the third positive alternative of international institutions with real authority and sovereignty is pressing."

Indeed it is, never more so than now.

J. Bradford DeLong and Barry Eichengreen
June 1, 2012

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Preface

'This is where I came in.' When Dr Wolfram Fischer asked me to write on the world economic history of the 1930s, I was delighted to comply. This was partly because of the surging intellectual interest in the world depression which may be encountered among scholars everywhere. It was also partly to work out for myself the complex events of my youth and early professional life: events which brought me and many others into economics.

The October 1929 crash of the stock market strikes no chords in my memory. With the rest of the world, I was aware of it, but to a sophomore in college it meant little. The family's few stocks were owned outright rather than on margin. Despite the decline of business, and with the help of an uncle in shipping, I got a job the next summer working on a freighter delivering heavy equipment from Copenhagen to Leningrad and bringing back woodpulp from Kotka, Raumo and Kemi in Finland. I don't think this was ordinary dumping, but I don't know. It was not the kind of exchange-dumping which occurred after 1932 and is discussed in Chapter 8. It was memorable mainly for the fact that one could drink beer and spirits against one's pay after the ship reached Copenhagen. (My wages as a deck-boy were $20 a month.) The trip cultivated an interest in international trade and a taste for Tuborg beer which have lasted all my life. (A friend of mine got a job working on ships in 1940 through his uncle. The uncle who helped me was a vice-president of a shipping company; his was vice-president of a seamen's union. Nepotism continued through the 1930s, but its locus shifted.)

Falling family income was still sufficient to pay both college expenses and my fare to Europe in the summer of 1931 to take advantage of a summer scholarship to the Students International Union. Salvador de Madariaga, who normally ran the seminar, had just been appointed ambassador to the United States from Spain, so we undergraduates from the United States and Europe were thrown in with older students at the Geneva School for International Studies, run by Professor (later Sir) Alfred Zimmern. It was an exciting experience, from the visiting lecturers to the farewells for Patrick Sloan at the end of the summer as he made his way, equipped with stacks of toilet paper and needles, to spend a year in the Soviet Union.

I cannot say, however, that I formed a very clear idea of the events described in Chapter 7. I have run across a notebook I kept that summer, which records lectures by Paul Douglas, E. M. Patterson from the United States, Maurice Bonn, Henri Hauser, Douglas Copland and a host of others. There is even an outline of a seminar I myself gave in the economics group, entitled 'Economic Conditions in the United States'. None of these scribbles were helpful in what follows. I was aware of the Bank for International Settlements mainly because of a young employee who came down frequently from Basle to court one of the delightful Smith girls among the American colony in Geneva.

In February 1932, after graduating from college, I had the strengthening experience of being unemployed, but only for a limited period of eight or ten weeks. Again through influence, I got a job as an office boy (complete with B.A. honours and a Phi Beta Kappa key), in what I am now, as a Keynesian, ashamed to reveal was the National Economy League, a pressure group founded by Archibald Roosevelt and other conservatives to insist on balancing the national budget. In July 1932, again through nepotism, I obtained another job as office boy with Johnson & Higgins, marine insurance brokers. The two memorable incidents of the next year in that capacity included the increase in first-class postage from 2c. to 3c., which induced the firm to shift its downtown Manhattan communication system from the United States post office to its own staff (it was my first and painful acquaintance with an elastic demand schedule); and a slip of paper from the office manager stating that because of N.R.A. (the National Recovery Administration) – and, I could read between the lines,