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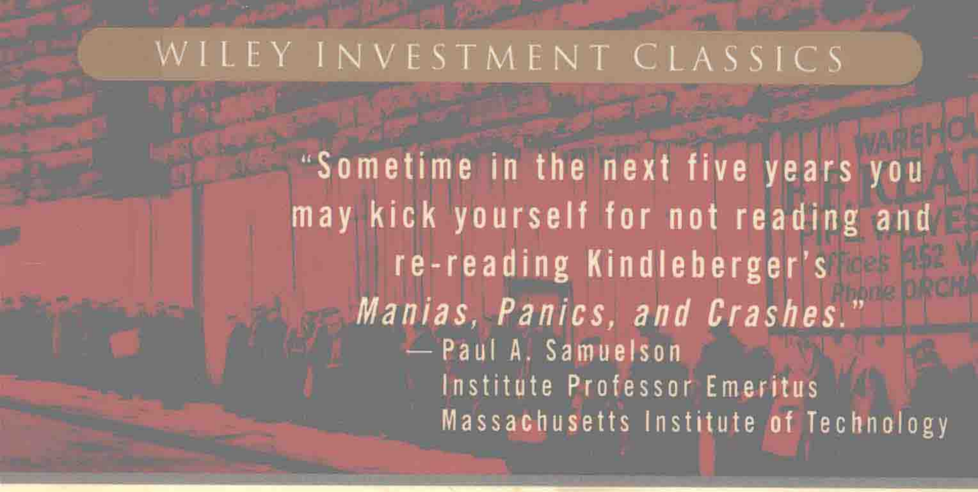
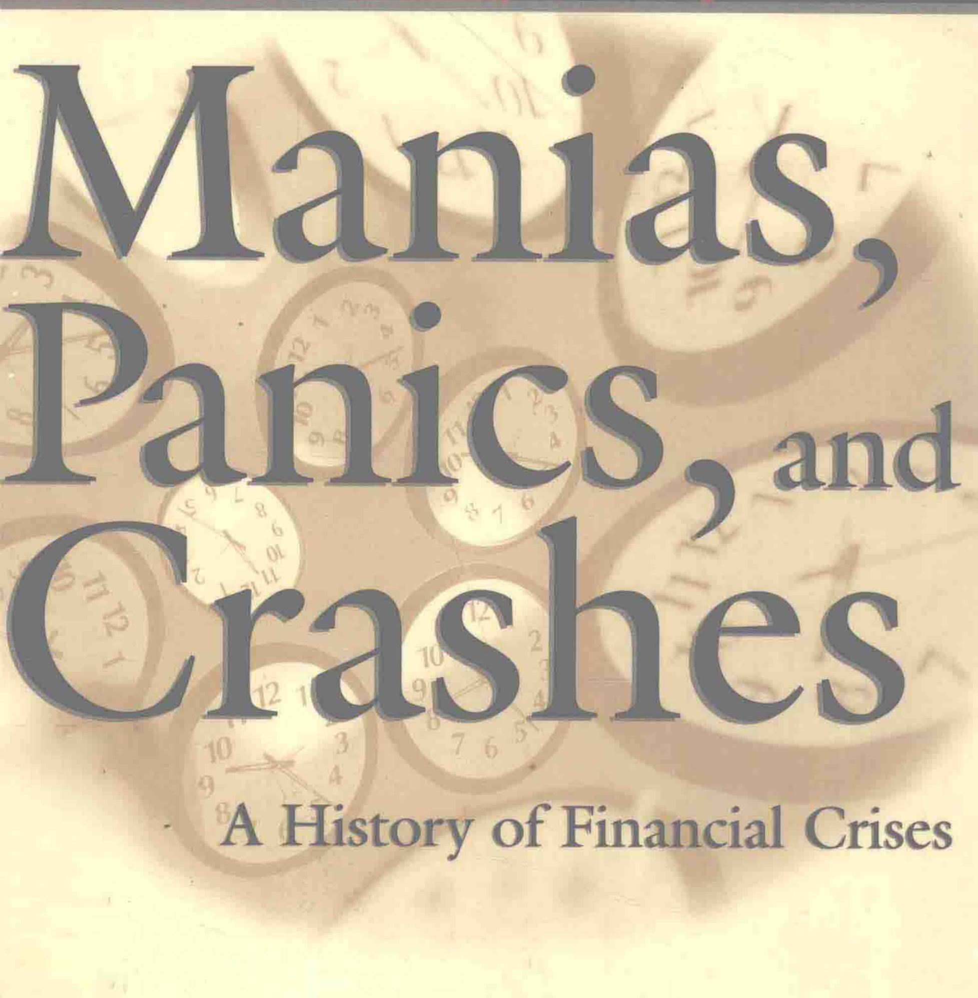


"Sometime in the next five years you may kick yourself for not reading and re-reading Kindleberger's *Manias, Panics, and Crashes.*"
— Paul A. Samuelson
Institute Professor Emeritus
Massachusetts Institute of Technology

Manias, Panics, and Crashes

A History of Financial Crises



CHARLES P. KINDLEBERGER

Manias, Panics and Crashes

A History of Financial Crises

Charles P. Kindleberger

Foreword by
Peter L. Bernstein

Third Edition

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MANIAS, PANICS AND CRASHES

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To the MIT Old Guard of the 1940s

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

and the memory of REF, WRMacL, MFM, and DST

in gratitude for support and friendship

Introduction to the Third Edition

The reason or excuse for a third edition is not only the Japanese boom and bust of 1988–90 which a friend thought justified a new version, or the fact that an editor was "mustard keen" for one. There have been other bursts of speculative enthusiasm and financial crises since the 1989 edition, which was inspired by Black Monday, October 19, 1987, when the Dow-Jones industrial average dropped 508 points: especially mutual funds in "emerging markets," the foreign-exchange attacks on sterling and the lira in 1992, and what looks, in the fall of 1995, suspiciously like a bubble in technology stocks. But academic reasons serve better to academicians. Since 1987 there has been an enormous outpouring of literature, for and against bubbles in financial markets. Much of it is highly technical, of an econometric sort that my professional formation of the 1930s prevents me from understanding deeply, but that reminds me of the concert-goer on leaving the hall who said, "I don't know much about modern music, but I know what I like."

One paper denying the existence of manias was addressed to this book.[1] Against my usual practice, and largely because of the urgings of the periodical's editor, I replied.[2] Of deeper importance was the appearance of the book by Robert Flood and Peter Garber, with a forceful presentation in a number of papers of the conclusion that the null hypothesis of no bubbles could not be rejected by econometric tests (a triple negative), and in particular in Garber's paper, "Tulipmania," that the high price of tulips in the Dutch Republic, which soared from the fall of 1636 to February 1637, was not a mania, for the higher-priced bulbs at least, but a rational market response to fundamentals.[3] The issue presents a classic test as to whether economic theory 360 years after an event can invalidate its interpretation by the participants and general historians. Two economists, who used newly-assembled but partial statistics to demonstrate that France in 1789 (before the Revolution) enjoyed the same per capita income as Britain, dismiss the abundant evidence to the contrary of contemporary travelers as superficial.[4]

In addition to these controversies which, to the best of my ability, I shall discuss in non-polemical terms, my own research has pushed deeper into the subject in a couple of directions. Back slightly further in time than the

"Tulipmania," I have learned more about the *Kipper- und Wipperzeit* than the casual and somewhat misleading reference I gave it in the second edition. The episode, acute from 1619 to 1622, has interest in its own right and because some scholar, whose name and work I can no longer recall, asserted that financial crises occurred in Europe only after the rise of banking and bank notes. Even with metallic money, however, it was possible to have a sharp crisis as princes, abbots, bishops and even the emperor of the Holy Roman Empire established more mints, and debased the coins used in daily transactions by raising denominations or lowering the weight and/or fineness of the metal. The purpose was to add revenue (seignorage) to pay for mercenary troops as the Thirty Years War broke out.[5] At the other end of the period, in a paper on "Asset Inflation and Monetary Policy," I explored the possible "displacement," as discussed in Chapter 3, of cheap money leading to a stock-market and real-estate bubble when monetary authorities feel safe in lowering interest rates because general prices (of goods and services) are steady.[6] The issue is especially relevant to the 1929 Wall Street crash, and the boom and bust in the Nikkei index in Tokyo from 1988 to 1990.

A separate paper held forth on the international propagation of financial crises, the subject of Chapter 8 below, in a book on *The Risk of Economic Crisis* which includes a discussion by Lawrence Summers of scenarios of future financial crises, following the "canonical" model of Chapter 2.[7] I take perhaps undue pride in the fact that the 1978 edition of this book coincided with what may prove to be a bubble in the economic literature on financial crises, helped, to be sure, by the inflation of the 1970s and 1980s.

Since the second edition there has been a French translation.[8] Manias could not be translated as *manies* in the title because, the French publisher said, it does not convey the English meaning exactly, though that is not clear from my French dictionary. Two items in the translation interested me: *go-go* for "sucker," and the "widow of Carpentras" for the very unsophisticated investor. *Go-Go* happens to be in the *Nouveau Petit Larousse*, defined as a "credulous capitalist, easy to deceive." (John Brooks understood this in the early 1970s, calling his book on the financial excitement of the 1960s, *The Go-Go Years*[9]). I asked knowledgable friends about the widow of Carpentras, a small town in Provence, and was told that the reference was not to a person but to an ideal-type, as sociologists put it, like "the little old lady from Peoria in tennis shoes." For those interested in the first of these matters, I have long understood another slang word in French for "sucker," *une poire*, a pear, used for persons who pay their income tax. Here the dictionary gives the slang as *imbécile, naïf.*

The introduction to the second (revised) edition is kept in the interest of intellectual history. I discard the acknowledgements of the first, without reducing in any way my gratitude to those there listed. To them I would add Robert Z. Aliber, who thought a third edition with emphasis on the Japanese bubble was called for, and T. M. Farmiloe, publishing director of Macmillan in England, who lent encouragement.

CHARLES P. KINDLEBERGER

Preface to the Second Edition

Three reasons prompt a revision of this book, originally published in 1978. First and least is that in continued reading in the decade or more since it was originally finished, I have added evidence to support the analytical framework. In working on *A Financial History of Western Europe*,[1] first published in 1984, I read a series of major works of the nineteenth century: the six-volume *Enquête* of 1867 into French money and credit;[2] three volumes of Lord Overstone's correspondence;[3] three volumes of Walter Bagehot's collected works on economic and financial questions;[4] Michel Chevalier's letters from North America;[5] plus much more. From these I culled snippets of evidence, accumulating a file that reinforces my original analysis and cries out for employment. Some of this research has already been put to use in separate papers—a chapter on financial crises in *A Financial History*, for example, or papers collected on *Keynesianism vs. Monetarism*,[6] or those in *The International Economic Order: Financial Crises and International Public Goods*.[7] A European conference on financial crises, organized with Jean-Pierre Laffargue, grew out of the first edition of the present book and added to my knowledge.[8]

A second and more important reason for this revision is that the analysis of the first edition proved to be somewhat prescient: a series of financial crises has been unfolding since 1978. I refer not only to Black Monday, October 19, 1987, when the New York Stock Exchange lost a record 508 points on the Dow-Jones industrial average in one day, but to a series of other critical episodes too numerous to itemize. Included in this list would be the Penn Square failure, the rescue of the Continental Illinois National Bank, Third World debt, the bubble and bust in farmland prices, gold, silver (the Hunts' attempt to corner the world supply), the dollar, oil, Texas real estate (especially Houston office buildings), and so on, and so on. A number of these crises were foreshadowed in the 1978 edition, and one reader, "Adam Smith" (aka George Goodman), complained in a review that I did not sufficiently pursue that line of inquiry.[9] In addition, I have probed a little deeper into a couple of financial crises of the 1970s of which I was inadequately aware at the time: the London real estate boom that produced the troubles of the so-called fringe banks and the spectacular banking manias and crashes in Latin America that were almost certainly a response to deregulation. The contemporary world is very much on my mind as I work on my revision in the summer of 1988: news about failing banks and insolvent institutions breaks almost daily. I propose to bring these events into the discourse where they fit naturally, but not otherwise.

The third reason for the new edition concerns methodology in economics and especially the role of economic history. A good number of economic theorists have dismissed this sort of work as being outside the bounds of economics: it conveys suggestions of irrationality, whereas for them economics rests solidly on the axiom that man is rational, knows his mind, and maximizes, or at least optimizes, his utility or well-being. A book in which the first word of the title suggests insanity is hence off the reservation. Moreover, to the extent that its ideas are expressed in words rather than in mathematical symbols and that it uses historical episodes—labeled pejoratively as "anecdotes"—it may be taken to amuse, but not to edify. I object strenuously to these attitudes. I have been quoted as saying that "economics needs history, even more than history needs economics,"[10] and I may actually have written those words though I cannot recall where. I surely believe them. Following the banal metaphor of the *QE* II at thirty knots: economics turns around slowly. But I think signs of such turning are visible in its wake. On the one hand, there is Donald McCloskey extolling economics as discourse[11] and Paul David and Peter Temin illustrating the usefulness of history to economics by telling "stories."[12] On the other hand, "catastrophe mathematics," mentioned in the introduction to the first edition, does not seem to be going much of any place and has been joined, or perhaps superseded, by "chaos theory," which suggests that the course of events in the world is unpredictable.

"The best defense is a good offense." I thought for a time of expanding the discussion of rationality in Chapter 3 at that stage of the argument, but decided it would be a diversion. Instead, I have added a new appendix, "Irrationality in Economics." In an earlier effusion, I wrote on "Rational Expectations vs. Collective Memory."[13] That drew some blood. But the dismissal of conventional explanations of historical events with the remark that they violate the assumptions of economic analysis is infuriating. Like Margaret Fuller, who "accepted the universe," it is time that economics accept reality.

In writing this sort of history there is a grave danger of getting caught up in epigraphs. I spent time most agreeably finding aphoristic quotations for each chapter of *A Financial History*. I shall not try that exercise here. But the original epigraph from Bagehot has been joined by two more, one from the real Adam Smith, the other from a Frenchman who engineered the squeeze against those who speculated against the franc in 1924. Thus I was not completely successful in resisting the temptation.

Finally, I hope the reader will not think me vainglorious if I suggest that

H. G. Wells in 1933 foresaw the appearance of this book some forty-five years later. He got my name wrong, and the title of the book as well. The date of publication was one year off. *His* book purported to have been written in 2016, and a passage about Karl Marx and Henry George refers to a conflict between the past and the future "which runs through all history." It continues:

> We need only refer to the recorded struggles of Republican Rome and Judea between debtor and creditor . . . to the English statute of Mortmain; to Austen Livewright's lucid study of *Bankruptcy through the Ages* (1979) to remind him [the student] of this perennial struggle of life against the creditor and the dead hand.[14]

CHARLES P. KINDLEBERGER

Examine the record of history, recollect what has happened within the circle of your own experience, consider with attention what has been the conduct of almost all the great unfortunate, either in private or public life, whom you may have either read of, or heard of, or remember; and you will find that the misfortunes of by far the greater part of them have arisen from their not knowing when they were well, when it was proper for them to sit still and be contented.

—ADAM SMITH
The Theory of Moral Sentiments

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"

I permit myself to note in this connection the words said to me by a very high personage of the Republic: "I know my country well. It is capable of supporting anything with calm except a financial crisis."

—RAYMOND PHILIPPE
Un point d'histoire: Le drâme financier de 1924–28

I can feel it coming, S.E.C. or not, a whole new round of disastrous speculation, with all the familar stages in order—blue-chip boom, then a fad for secondary issues, then an over-the-counter play, then another garbage market in new issues, and finally the inevitable crash. I don't know when it will come, but I can feel it coming, and damn it, I don't know what to do about it.

—BERNARD J. LASKER
Chairman of the New York Stock Exchange in 1970,
quoted in 1972 in John Brooks, *The Go-Go Years*

Foreword by Peter L. Bernstein

One never picks up a work by Charles Kindleberger without anticipating a feast of entertainment. The present volume will generously fulfill that anticipation. See, just for example, the "tailpiece" to Chapter 8 or the passage on noble gamblers in Chapter 5.

But underneath the hilarious anecdotes, the elegant epigrams, and the graceful turns of phrase, Kindleberger is deadly serious. The manner in which human beings earn their livings is no laughing matter to him, especially when they attempt to do so at the expense of one another. As he so effectively demonstrates, manias, panics, and crashes are the consequence of an economic environment that cultivates cupidity, chicanery, and rapaciousness rather than a devout belief in the Golden Rule.

In truth, Kindleberger is a seducer. By bringing colorful individuals to life, he captures the reader's interest, but his goal is to employ history to demonstrate theoretical ideas of primary importance. He himself phrases this process well when he points out that "History is particular; economics is general." The lively blend between the two is Kindleberger's unique contribution to the literature of both disciplines.

Like all of us, he holds a few strong opinions. He uses his tale of what he perceives as the madness of crowds to argue for five main themes.

First, and at the outset, he takes up the cudgels against those whose attachment to the notion of rational human behavior is so rigid that they cannot recognize irrationality and destabilizing speculation when it is in front of their faces. He names Milton Friedman right off as an antagonist and spares no punches in his attack. Here he confronts some of the most critically important issues in economic analysis and in the interpretation of history.

Second, despite his explicit distaste for mathematical economics, Kindleberger interprets his subject matter from the viewpoint of a carefully articulated model. By that I mean that he lends a clear structure to what Adam Smith describes as "folly, negligence . . . knavery and extravagance." This structure becomes visible in the course of the book through many fascinating examples of overtrading, by no means limited to the volatile world of the financial markets. Primary products, manufactured goods, and land and structures have all succumbed to the fevers of destabilizing speculation. All of these occasions, however, conform to a recognizable sequence of events that, like a Greek drama, plays itself out with easily recognizable regularities. We should note that Kindleberger finds the proximate cause of these episodes in some kind of accident, but his focus is on the natural tendency of the system to become increasingly vulnerable to an infectious calamity and then, once the process has started, to let the tragedy run its morbid course.

Third, Kindleberger places great emphasis on those few critical moments when the evocation of the Golden Rule becomes essential—when a lender of last resort must have the courage, as well as the resources, to step into the breach and attempt to stem the tide that leads to ruin. The ambiguous nature of the appropriate moment for this step fascinates Kindleberger, but it is an area of study that has received too little attention in our volatile times.

The reader should be certain to take note, and to keep in mind, the fourth and final main theme that weaves its way throughout this vivid historical analysis. Kindleberger's most strongly held opinion is that being doctrinaire is not just wrong: it is positively dangerous. Concerned as he is to separate himself from the rationalists who believe that all markets work perfectly just so long as they are unregulated, he is equally eager to reject the counterargument, namely that the system works so badly most of the time that constant government intervention is essential. The moral of the story that Kindleberger has to tell here is a simple one: "I contend that markets work well on the whole . . . but that occasionally markets will be overwhelmed and need help."

PETER L. BERNSTEIN

Contents

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 appeared during the several decades after World War II, following the spate of the 1930s, it was because the industry of producing them is anticyclical in character, and recessions from 1945 to 1973 were few, far between, and exceptionally mild. More recently, with the worldwide recession of 1974–75 and the nervous financial tension of the 1980s, the industry has picked up.[1] When it first appeared in 1978, this work thus reflected a revived interest in an old theme, a theme that became increasingly salient in the decades that followed.

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. Isolated financial crises that prove so manageable as to have no effects on the economic system will also be neglected to an extent. 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—at the risk of financial crisis and even panic that may spread through propagation by one means or another to other financial markets at home and possibly abroad? 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.[2] Exhausted by the war and groggy from