Manias, Panics and Crashes

Also by Charles P. Kindleberger

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A History of Financial Crises

Charles P. Kindleberger

Foreword by
Peter L. Bernstein

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To the MIT Old Guard of the 1940s

MAA, RLB, ECB, CAM, PAS, RMS

and the memory of

REF, HAF, WRMcL, MFM, and DST

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 drame financier de 1924–28

I can feel it coming, S.E.C. or not, a whole new round of disastrous speculation, with all the familiar 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*

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Introduction

The first edition of this book, published in 1978, dealt with financial crises that were, for the most part, before World War II. Black Monday, October 19, 1987, along with more research on earlier troubles, indicated, at least to me, a need for a second look. The third edition had its stimulus in the Japanese crash of January 1990. That was some time ago.

A fourth edition is perhaps not needed by readers but only as occupational therapy for the writer. The push comes partly from the Mexican crisis of 1994–95, but more especially from the East Asian difficulties of 1997–98, which are still not far behind us. Again, as earlier, some gaps in history have been made up by other economists and historians, and more or less absorbed to extend the discussion backward as well as forward. This version may be of greatest interest to younger readers, as most mature ones continue to refer to the original edition. Once a book is read and the main point seized, the incentive to keep up with its extensions is typically minimal.

This is especially apposite in the present instance as my interest and research have been confined largely to Europe, Western Europe at that, and the United States; my familiarity with and knowledge of Latin America, Russia, and Asia are limited. Some readers, moreover, are likely to be drawn to the subject by its relevance to the future and to be less taken by history. The first edition started with the South Sea and Mississippi bubbles in the early eighteenth century; successive ones went back a century at a time, and this time I have done some work—from secondary sources only, as in all cases—on the minor financial revolution of the 1550s, but I do not bring the troubles of Henry VIII, François I, the Fuggers, and the Genoese into the account.[1] I have recently seen and mislaid the title of a book on Venetian banks of 1200 to 1500, with the word "panics" in it. An attempt to go farther back than 1600 is mostly beyond my depth.

In addition to adding accounts of crises, earlier and later than 1990, it seems useful to address the criticism of the International Monetary Fund (IMF) as a lender of last resort and the demand in a number of quarters for a drastic change in "world financial architecture." As it happens, I am not persuaded that there is sufficient agreement on a new design to make another Bretton Woods meeting productive; like the World Economic

Conference of 1933, when consensus was lacking, a return to square one in present conditions seems bound to fail. The IMF is changing its approach in a number of details on timing, transparency, conditionality, and assigning responsibilities. My advice is *"ne tirez pas le pianiste"* (don't shoot the piano player); he is doing the best he can.

A minor concession to public taste is to change the spread of financial crises from "propagation," in earlier editions, to "contagion." This locution has the advantage of putting emphasis on psychology and herd behavior that lie to a great extent behind purely economic factors like monetary policy, capital movements, exchange rates, and trade.

Finally I have recently absorbed what is to me, but not to the world, a new concept. In refereeing blind a paper on a financial crisis, I learned that in this sort of trouble I am regarded as a "lumper," that is, a taxonomist who thinks that the specimens under study are mostly alike. Once sensitized to the concept, I learned in an obituary that an English historian on agriculture in northern India was not a lumper but a "splitter," one who emphasized the differences among specimens.

A few weeks later I ran across an essay by Anne Fadiman who said "George (her husband) is a lumper. I am a splitter." *The Shorter Oxford English Dictionary* states that the terms go back to the middle of the nineteenth century, though they are new to me if not to my historian daughter. I find myself challenged to decide where in the taxonomy of financial crises I belong. Chapter 2 points to lumping; the tour of the horizon in Chapter 3 leans toward splitting. I suspect that most social scientists are lumpers, looking for repetitive patterns, while historians dealing with particular circumstances tend to focus on the unique. As I proceed with extensions of the earlier work, I am pleased to have a new concept to think about (new to me, that is, and to most of the colleagues I have raised it with).

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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 9 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 four 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

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