Comparative Political Economy

A Retrospective

Charles P. Kindleberger

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A Retrospective

Charles P. Kindleberger

The MIT Press
Cambridge, Massachusetts
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In Memory of S. M. K.
Who Tolerated These Interests

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1 Introduction

Painters who are mature, and even on occasion dead, have retrospective shows of work that has been exhibited before, assembled to demonstrate something—perhaps a change in styles, perhaps the gradual evolution of his or her interests. If the artist is extant and participating in the selection, the collection may represent simply favorites of the artist, rather than those of a curator or gallery viewers. The essays assembled in these pages have been exhibited (published) before, most twice and a few anthologized. They also reflect in a broad way a shift in interests from foreign exchange to international trade, economic growth, economic history, and, especially, financial history. In addition, they contain an element that was unintentional, or at least subconscious: the admixture with economics (and history) of dollops of sociology and especially political science. These "foreign" elements produce misgivings. My self-image is economist, economic historian, or, best, historical economist, who tests economic propositions against the historical record in more than one setting. To have attracted the attention of political scientists, as has happened to an extent, makes me uneasy, as if I were in danger of being expelled from my club. "Political economy" in the book's title is chosen to sooth such concerns.

Seventeen of the twenty-one papers originally appeared in a variety of outlets, scholarly journals, pamphlets, public lectures, and *Festschriften*, and then were reprised in one of the eleven volumes of collected papers that publishers have been generous or weak enough to take on in the past. I have selected nothing from the first of these collections—*Europe and the Dollar* (1966)—because the thoughts in two papers that strike me today as interesting are better treated in later work that I have chosen. The argument against flexible exchange rates, written in 1960 for the Commission on Money and Credit, is trumped by chapter 3 below, which appeared in 1969. Similarly, chapter 9, also 1969, extends the argument of the 1965 "Balance-of-Payments Equilibrium and the International Market

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for Liquidity" in *Europe and the Dollar*, and uses simple equations for exposition rather than substantives ranged "above" and "below the line," the form favored by Fritz Machlup when he was editor of the Princeton Institute of International Finance publications.

Except for "Competitive Exchange Depreciation . . . ," chapter 2, the first paper I published some 64 years ago, I am not especially interested in whether a paper is earlier or later. But chapter 2 of 1934 was a term paper in a course taught by Benjamin Beckhardt in my first semester of graduate work at Columbia, and therefore a ground-breaker (for me). It can readily be seen from the illustrations that I should have taken the seasonals out of the trade data in Danish and New Zealand exports of butter to Britain, but my course in statistics had not been finished. If pressed, I might argue that competitive exchange depreciation has relevance today to the financial troubles in the Far East with the Thai baht, the Malaysian ringgit, the South Korean won, and the Indonesian rupiah all depreciating and the Hong Kong and Chinese currencies under pressure. The comparison should not be carried too far, however, since the Danish and New Zealand depreciations were intentional acts of policy, to gain trade advantages, whereas the Eastern troubles came from mismanaged domestic policies, reckless foreign lending, and overvalued currencies offering opportunities to foreign speculators.

(Parenthetically, the three other collections of papers not represented here are) *Multinational Excursions* [1984], on the multinational corporation, a subject in which I have lost research interest; *Marshall Plan Days* [1987], with excessive autobiographical content; and *Essays in History: Financial, Economic, and Personal* [1999], which had gone to press elsewhere before this project was launched.)

The reader should not make much of the division of the twenty-one papers into five unbalanced sections of ostensible changing interest: foreign exchange, international trade, economic growth, finance, and political economy. Each paper, or at any rate most, ranges broadly over topics other than the one under which it is categorized. Most are strong on comparison (within Western Europe for the most part, or on relations between Europe and the United States), on economic or financial history, and on social science beyond the confines of economics. Chapter 4, on "Group Behavior in International Trade," published next in time in this collection, leaves a gap of seventeen years. The delay was caused by three years of graduate study, ten of work in banking, the military, and government service before starting teaching in 1948. On arriving at MIT I wrote a book to justify U.S. aid to Europe and developing countries, rashly

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entitled *The Dollar Shortage* (1950). When dollars became abundant in the 1960s I suffered as seminar chairmen would twit me about the title. If I had called it "Persistent Disequilibrium in Balances of Payments" I would have been better protected, since history reveals that balances of payments do not always automatically correct themselves.

The exchange-rate theme surfaces in later chapters as well. My 1969 paper, given at a conference and making the case for fixed rates, drew in comment a formidable debater, Milton Friedman. He started his remarks by telling the audience that they were lucky to hear only the mistakes I emitted orally, as there were many more in the written version given him in advance. With my peaceable nature, I seem to invite this egregious form of scholarly discourse. In a seminar in Princeton in 1948, I defended the Marshall Plan and drew from Professor Frank D. Graham the first question, or rather comment: "I cannot recall having heard so much nonsense in such a short space of time." Looking back from the 1990s, I believe that the cases for fixed exchange rates and the Marshall plan have not been wholly invalidated.

"Group Behavior…" came about as I took on a moonlighting assignment to teach a year-long course on the economy of Europe at Columbia University, two hours a week in term time. I would go to New York Tuesday night in a sleeper train called "The Owl," teach Wednesday morning from 10 to 12, and return to Boston either on the "Yankee Clipper" at 1 o'clock or, if I had something to do in New York, on the "Merchant" at 5. Having lived in England for a year and a half in the war (plus a year in France, Belgium, and Germany), and worked on the German and French economies during the war, and on the German economy and the Marshall plan from 1945 to 1948, I was fairly well equipped to teach the second term of the course on modern times, but needed to make up gaps in European economic history for the first. In the course of intensive reading, much on the train from New York to Boston, I discovered that a number of European countries had not reacted to the sharp fall in the world price of wheat in the 1880s, as economic theory would predict, and found myself starting down the tracks of comparison, history, and drawing other social sciences into economic analysis. Chapter 5, on "The Rise of Free Trade in Western Europe, 1820–1875," was a much later complement to "Group Behavior…."

There is another long delay in the Table of Contents after the 1951 paper until 1965 when chapter 8, written with Emile Despres and Walter Salant, appeared in the *Economist*. A number of papers were written, including those in *Europe and the Dollar*, plus two textbooks, *International*

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Economics (1st ed. 1953, 5th 1973), and *Economic Development* (1st ed. 1958, 2nd 1965). In addition there was a series of monographs dealing with the terms of trade, trade in relation to the national economy, and economic growth. An attempt at another textbook, explicitly directed to political economy—*Power and Money: The Politics of International Economics and the Economics of International Politics*—came later, in 1970. It failed, falling intellectually between two stools, and written for courses that did not exist.

Interest in economic growth had begun with France, and participation in a seminar at the Harvard Center for International Affairs, which produced a symposium, *In Search of France* by Stanley Hoffmann et al. (1963). I was one of the *alii* with a paper on "The Postwar Resurgence of the French Economy," which was a strong but unsuccessful contender for inclusion here. I also wrote a book, *Economic Growth in France and Britain, 1851–1950* (1964). A term at the stimulating Institute for World Economy in Kiel, West Germany, led to a two-part article, here telescoped into one, "Germany Overtaking England, 1806–1914" (chapter 6). The exercise developed an interest as to which country at a given time is the leading economic power (with responsibilities for stabilizing the world economy) which finally culminated in a monograph, *World Economic Primacy, 1500–1990* (1996). An epistomologist might be interested in noting that my work in history started in the nineteenth century, as chapters 4, 5, and 6 demonstrated, and then went back in time a century per decade. A paper on financial innovation in the sixteenth century is included in *Essays in History* (1999) and hence excluded from this compilation. The temporal retrogression has not been linear, to be sure; interest in the twentieth century, now coming to a close, has not been abandoned.

Chapter 7, on "The Aging Economy," was a Harms lecture, again at the Institute of World Economy in Kiel. I cannot now recall when I first developed an interest in economic decline. I once thought of learning Spanish and studying that country, which declined from the seventeenth century to the twentieth but has lately been rejuvenated. The monograph on *World Economic Primacy* tries to combine growth and decline into something akin to the human life-cycle, but without death and with allowance for second births. "The Aging Economy" was written as I thought the United States, like Britain before it, was slowing down, although I made allowance for, and now recognize, its acceleration in the late 1990s.

"Standards as Public, Collective, and Private Goods" (chapter 8) is perhaps misplaced under Economic Growth and belongs in Political Economy. If I am allowed, however, with so many papers in the last section,

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and few in this, I choose a place that more nearly balances the proportions. The paper was originally given in a seminar at the University of Stockholm when I spent a term there in the fall of 1982. From a local economist it received a comment that amused and somewhat irritated me: "An interesting paper but you should mathematize it." Perhaps I should have warned readers earlier, if they are not familiar with the fact, that I don't do mathematical models, and feel little need for them.

Finance is next. One evening on a Public Broadcasting television panel, chaired by Professor Milton Katz of the Harvard Law School, I had an epiphany. We were discussing the United States balance of payments, its "disequilibrium" and its "deficit," about which the country had been moaning in the last years of the Eisenhower Administration and the first of Kennedy's. It came over me suddenly that the world was applying the wrong model to the U.S. payments. It was treating the United States as if it were an industrial firm, rather than a bank. Industrial firms are in trouble when their liabilities grow, banks are not when their assets grow with deposits. Two colleagues and close friends, Emile Despres and Walter Salant, and I published "The Dollar: A Minority View" (chapter 9). In our view the United States, acting like a bank, provided liquidity to the world in the form of dollar deposits. The current account was in surplus, but the world used some of the aid and capital furnished by Washington and New York to build liquidity in international money, the dollar. Just as banks are not in trouble when assets and deposits go up together, so the United States was not. In the longer run we were wrong, since the dissuasive definition of balance-of-payments equilibrium encouraged foreign central banks after a time to take additions to liquidity in gold, rather than dollars.

I cannot recall the origin of the interest in financial centers that led to the long Princeton Institute of International Finance *Study*, as opposed to *Essays*, such as chapters 10 and 17. It was written after I had finished the first edition of *The World in Depression, 1929–1939* (chapter 19), first published in German in 1971 and in the original English in 1973. That book developed the notion that world finance is organized in a pyramid, with a hierarchical leader at the peak with certain duties to keep the system stable. Within countries, as between countries, there were smaller pyramids, and the process of building them could be studied in the history of financial centers. Comparison led to a riddle: what do the Crédit lyonnais, the Dresdner Bank, the Midlands Bank, the Bank of Nova Scotia, and the First Boston Corporation have in common? Answer: Each later had its head office in a city other than the eponymous one, to wit, Paris, Berlin,

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London, Toronto, and New York, respectively, proving that banks gravitate in Darwinian fashion to form centers that bring savers and spenders together. At a recent (1997) conference of the European Association of Banking History in Madrid, I asked an economist of the Bank of Santander where the bank's head office was, hoping for another point for my scatter diagram, Madrid. Unhappily, he said Santander. But the topic of financial centers remains salient. As I write, the *Economist* of May 9, 1998, has a thirty-six-page insert (many of the pages advertising, to be sure) entitled "Capitals of Capital: A Survey of Financial Centres." Competition for top financial dog arises especially as the European Monetary Union and the euro take their places: London? Frankfurt? Paris? or still New York?

There is, however, a countermovement thought to be under way. Raleigh in North Carolina lacks the qualities of historic financial centers, but two banks there are expanding rapidly by acquiring substantial institutions in St. Louis, Detroit, and Florida. Frances Cairncross, an editor of the *Economist*, has written a book, *The End of Geography*, holding that electronic communication will allow business to be done from home and without travel. Office buildings will empty out, and air travel will shrink to college students, honeymooners, and tourists. I remain sceptical. Branch banks will continue to be needed for small business where the banker wants to look the borrower in the eye; and big business—mergers and acquisitions, initial public offerings, friendly and hostile takeovers—will need to gather groups of investment bankers, lawyers, and accountants in one place to look closely at one another's expressions and body language. It cannot be done by telephone conference calls. Face-to-face won't go away.

Equally or even more timely is the subject of financial crises, brought forward by the troubles in East Asia. After writing on the stock-market crash of 1929 and the ensuing depression, it seemed useful to pursue financial crises backward in history. This resulted in a monograph, *Manias, Panics, and Crashes: A Study of Financial Crises*, which came out in 1978. I wanted to call it "Manias, Bubbles, Panics, and Crashes," but the late Martin Kessler, then an editor at Basic Books, ruled that three substantives in a title were enough. The 1987 stock-market crash in New York led to a second edition (1989), that in Tokyo in January 1990 to a third. In each case more historical matter was added along with the proximate stimulus, such as the Tulip Bubble in Amsterdam in 1636, mentioned in the first two editions, but filled out in the third. Chapter 2 of the book, outlining the model of a financial crisis in words, not algebra, and called

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by Lawrence Summers in a National Bureau conference "canonical," is included here as chapter 12.

Gresham's Law (chapter 19) is one of four "laws" discussed in the Mattioli lectures that were given in 1980 at Bocconi University in Milan. The subject belongs to the history of thought as well as to economic history or historical economics. The law, developed especially for two precious metals or two currencies, is extended in the lecture to two financial assets that are not fixed ineluctably in price as are, for example, the $5 bill and the $10 bill. There was considerable discussion in each of these lectures, not all like that of Milton Friedman on chapter 3 above, in complete discord. The interested reader is referred to the book, which came out with considerable delay in 1989 and in paperback in 1997, *Economic Laws and Economic History.* For the curious, the other "laws" treated were Engel's law on consumption, the Iron Law of Wages, and the Law of One Price.

Chapter 14, comparing British Financial Reconstruction after the Napoleonic wars with that after World War I, was published in a *Festschrift* for my old and close friend, Walt W. Rostow. In retirement at 65 years of age, I was hired at MIT half time for five years, equivalent to full time for one term of two, and available for jaunts in the off term. One such was to the University of Texas in Austin, the inspiration for which came not, as it happened, from Rostow, but from a former MIT student, Professor Hussain Askari. I did, however, attend the Rostow seminar. At one point we got entangled in a discussion of Britain's return to gold after 1815, which inspired the research. This was abetted by the fact that Texas oil money had equipped the university library with treasures not available at MIT or Harvard College, this oil money not being allowed to be spent on faculty salaries.

Going back a century of financial history per decade of mine, I got to the eighteenth century and the South Sea and Mississippi bubbles of 1720 in the first edition of *Manias, Panics, and Crashes* (1978). The seventeenth century focused on a spreading debasement of gold and silver coins primarily in the Holy Roman Empire, called in German the *Kipper- und Wipperzeit*, which peaked in 1619–1623. The name was doubtless chosen for its rhyming quality, but also because the words describe how venal money changers would jiggle their scales as they weighed debased coins to confound the peasants and small shopkeepers whom they were swindling. This paper is another also-ran, out-of-the-money candidate for inclusion here as is that dealing with the distribution of Spanish American silver arriving from "Peru" (now Bolivia) and Mexico in the sixteenth and seventeenth centuries. Some, perhaps a third, stayed in Europe; much

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moved either directly to the Far East in the Manila galleon, or eastward in ships of the East India Company or its Dutch counterpart, the Vereinige Oostindische Compagnie, around the Cape of Good Hope, or in other ships by means of the ancient path to the eastern Mediterranean and thence by caravan and dhow to India, or via Amsterdam through the Baltic to Russia and beyond.

The final item under finance (chapter 15) is on a modern topic—intermediation, and its unravelling when two parties who initially needed an intermediary to deal, acquire enough information to eliminate the market-maker and deal with one another directly. In modern guise the process goes forward in banking, with treasurers of large corporations acquiring skilled staffs and knowledge enough to go straight to institutions with savings to invest—or the institutions to them—rather than borrowing from banks where the institutions have deposited their funds. Industrial corporations issue certificates of deposit (CDs) for short-term monies, and bonds for long; insurance companies and pensions funds buy them. Loans by commercial banks dry up. Borrowers and lenders may need investment bankers as advisers, along with lawyers and accountants, but the function of banking undergoes change. The same process occurred earlier in trade to save the cost of sending goods to Amsterdam or London, and then hauling them away again. Financial intermediation outlasted that in goods because the costs of handling money are less than those of commodities.

Wile the papers under Political Economy are listed in chronological order, I prefer to start this discussion with chapter 18, the conclusion to the monograph *The World in Depression, 1929–1939* (1973). This was written for a Deutsche Taschenbuch Verlag (German pocketbook press) series on decades of world history in the twentieth century. Its theme was that world economic stability needed one major country as a stabilizer, and that in the 1930s, the British, weakened by World War I and the return to gold at an overvalued exchange rate, could no longer serve in that capacity, and the isolationist United States would not. Initially I postulated three functions for the stabilizer: keeping its markets open, maintaining the system of exchange rates and international payments, and in a crisis, acting as a lender of last resort. (In a later work I added two more functions of the hierarchical leader of the world economy [see p. 408 below]). I called the overall function one of leadership; political scientists called it hegemony, and developed a literature of their own about it. It happened, moreover, that I borrowed the notion of leadership from a paper by a pair of political scientists. Leadership has some negative over-

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tones if one thinks of *Der Führer* and *Il Duce*, but the semantics have some importance and hegemony seems to me closer to using force.

Chapter 19, on "Economic Responsibility," was a memorial lecture for Fred Hirsch of Warwick University, England, which develops the theme of leadership further. The same theme is recurred to in chapter 20, "International Public Goods without International Government," the presidential address to the American Economic Association, given in the last days of 1985 and published in March 1986. It is in fact an argument for government in general, in contrast to the school of "Public Choice," which abhors or at least decries government regulation and especially government production. The problem again is who is in charge. In ordinary quiet times on trend, nobody in charge may be good enough, and there is little need for leadership except possibly leadership by example. In crisis, however, or stressful times, more is needed. I have dealt with this theme in a slight book entitled *Centralization vs Pluralism* (1996), adding that when crises arise in a federal or pluralistic state, it may be very difficult, approaching impossibility, to shift gears to more centralized authority, as the history of the Dutch Republic classically demonstrates.

Chapter 20, on "Rules vs Men," written for a *Festschrift* for Professor Kurt Borchardt of the University of Munich, and, as in the case of Rostow, disagreeing to some extent with his position, extends the theme of quiet times and crises, and the difficulty of changing political behavior when one succeeds the other. The question arises in much of economic history, but perhaps most notably in the Weimar Republic, when Heinrich Brüning, the German chancellor, regarded his options as extremely limited, hemmed in as he was by the Versailles treaty on reparations and the Dawes plan of 1924 with its commitments to the gold standard. Even before Britain went off gold in September 1931, some economists in Germany, in government and out, thought that Brüning should break away and declare that *force majeur* required flouting the commitments that limited action. Borchardt felt Brüning had no alternative options; Carl-Ludwig Holtfrerich thought he did. To a great extent Brüning was trapped by his own political commitment to demonstrate to the world that Germany could not pay reparations, a recipe like that of Charles Lamb for roast pig that called for bringing the pig into the parlor and burning the house down. To be sure it is inconvenient to break rules or commitments openly, since once broken, new precedents are created and the old rules are hard to reinstate.

Two papers, chapters 16 and 17, have been stranded by the present tactic of starting Political Economy with chapter 18 on leadership (or hegemony). Chapter 18 deals with two episodes in which France undertook

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noncooperative action in international finance, first ignoring the impact of its action on other countries, initially Britain and then the United States, and second challenging the policy of the world leader at the time, the United States. In each case, foreign exchange was converted into gold; neither action achieved lasting success. The theme is that while large strong countries have responsibilities for world economic and financial stability, and small countries do not, middle powers are in a position to create trouble, but lack the power to overcome it. Some ''small countries'' like Canada and Sweden may lead by example, but in serious disturbances that may not help greatly. And it should be noted that if a group of small countries behave in identical fashion—as Belgium, Holland, and Switzerland did in converting dollars into gold after Britain abandoned the gold standard in September 1931—they can damage the system as can a near-great power.

Chapter 16 on the analogy between money and language—each is a medium of exchange—is a show of bravura. The gold standard can be viewed as Latin, synthetic monies like the Special Drawing Right (and the euro?) are Esperanto, and flexible exchange rates require everyone to read and speak in his or her own language and to read or listen to writers and speakers of other tongues through translations. The paper was written in 1969, and teases the French a bit. In the fall of 1997 in Switzerland I learned that the German (or Schwyzer-deitch) cantons of the country talk to their francophone fellow citizens in English, or perhaps more accurately American. The same was true, I understand of Giscard d'Estaing and Helmut Schmidt, president of France and chancellor of the Federal Republic of Germany, respectively. I have been told further that the one-time president of the Bundesbank, Otto Emminger, spoke American to his central-bank colleagues with a Southern accent, after spending some time as a prisoner of war in Texas. It is an absorbing question today how the dollar and the euro will get along—the Gresham's law issue—and if the dollar is the equivalent of English as a medium of exchange, what other language, if any, will parallel the euro.

A few remarks may be noted in closing. My interests, insofar as they can be judged from this small and skewed sample, have bounced around over a considerable period. This is not the recipe for great success, but it helps to avoid diminishing returns. Second, lectures and seminars have been given in Sweden, Italy, and Singapore, but the papers deal mainly with Western Europe and especially Great Britain, France, and Germany, with some limited attention to the United States. Third, no attempt has been made to eliminate repetition. In assembling the papers, I see I have

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used a quotation from Sir Robert Peel more than once; there are doubtless other examples. With old men, I am told, repetition happens. I regard the harm done as exiguous and not worth the cost of the surgery needed to eliminate it.

Yale Professor William Parker has reminded us somewhere of the Roman mother, Cornelia, saying about her sons, the Gracchi, "These are my jewels." (The words, Parker said, were carved into the pedestal of a statute of Cornelia in his home town around which the town hobos used to gather.) These jewels may not shine very brightly, but they may be worth collecting from their dispersion over six decades.

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17. A paper presented to the Economic History Society meeting at the University of Kent, Canterbury, England, 1972, and published in *Economic Notes* 1, nos. 2–3 Siena, 1972), 30–44. Reprinted with permission of Monte dei Paschi di Siena.

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