Charles P. Kindleberger, *The World in Depression 1929-1939*, Chapters 1 and 14

Chapter 1

Kindleberger rejects both Milton Friedman's moncausal explanation of the depression—erroneous monetary policy in the United States—and Paul Samuelson's unsatisfying explanation—the depression as the result of a series of historical accidents. The depression would have resulted even in the presence of a perfect monetary policy, and depressions have occurred in the past, both in the U.S. and in Europe. A parallel between the 1848 European depression and the 1929 Depression represented "failures of the economic system at a transitional stage from one set of institutions and forms to another." In the failures of Friedman's and Samuelson's explanations, the remaining questions are not only what produced the trouble but also why did the economic system—either the policy-making or the automatic market mechanism—fail to respond to deal with the trouble. Failure of economic policy is easy. Deflationists were everywhere—Hoover, Brüning, Snowden, Laval. Britain and Japan returned to the gold standard; U.S. tried to raise the commodity prices; Blum experimented with the forty-hour work week (see page 23). Often economic policy was constrained not by economic principles but by public attitudes (e.g. America's dogmatic desire to collect war debts). The automatic market mechanism has received less attention, but the *operation*—not the system per se—of the gold standard has been usually blamed. The design of the gold standard is supposed to have depressive factors counter expansive factors and vice versa. Thus, an explanation is necessary as to why the expansionary force failed to counter the depressive factors. Kindleberger argues, however, that symmetrical system with rules for counterbalancing may fail because of incentives to use beggar-thy-neighbor policies (i.e. tariffs, currency devaluation, foreign-exchange control), which increase a country's welfare at the cost of its partners' welfare. In short, macroeconomic policy coordination is a Prisoner's Dilemma. (Page 27 gives the empirical examples.) No equitable solution is possible in either finance (debt/reparations) or trade; both are wiped out. Now here's the future hegemonic-stability theory's thesis: "In these circumstances, the international economic and monetary system needs leadership, a country which is prepared, consciously or unconsciously, under some system of rules that it has internalized, to set standards of conduct for other countries; and to seek to get others to follow them, to take on an undue share of the burdens of the system, and in particular to take on its support in adversity by accepting its redundant commodities, maintaining a flow of investment capital and discounting its paper" (page 28). Britain performed this till 1913; the U.S. does after the Second World War. Britain was unable to after 1913 and the U.S. unwilling till 1936.

Chapter 14: An Explanation of the 1929 Depression

"The 1929 depression was so wide, so deep, and so long because the international economic system was rendered unstable by British inability and U.S. unwillingness to assume responsibility for stabilizing it by discharging five functions:"
(1) maintaining a relatively open market for distress goods; (2) providing countercyclical, or at least stable, long-term lending; (3) policing a relatively stable system of exchange rates; (4) ensuring the coordination of macroeconomic policies; (5) acting as a lender of last resort by discounting or otherwise providing liquidity in financial crisis. Kindleberger argues that a single country that assumes responsibility for the system will carry out these tasks. Kindleberger further maintains that the depression resulted from the considerable latent instability in the system and the absence of a stabilizer. OPEN MARKET: the leader should keep the import market open in periods of stress. Britain did this even after 1873 when it was declining. The Smoot-Hawley Tariff Act of 1930 contrasts Britain's action. COUNTERCYCLICAL LENDING: In the 19th century, Britain lent countercyclically—domestic recession simulated foreign lending, while a boom at home caused both lending to be cut back and imports to be expanded. Such lending stabilized the system. In the 1920s, U.S. lent cyclically. STABLE ER: In the 19th century exchange rates were stable because the gold standard system was internalized and thus legitimate. After the inflation of the WWI, exchange rates were restored without making allowance for structural changes that have taken places. The underlying differentials put stress on the system. Beggar-thy-neighbor policies such as competitive devaluations took place. COORDINATION OF POLICIES: Macroeconomic policies were coordinated almost automatically under the gold standard in the 19th century. During the interwar period, U.S. and France sterilized their gold accumulation and the gold standard system broke down. Monetary policies were uncoordinated and conducted for domestic purposes only. LENDER OF LAST RESORT: At the international level, unlike at the domestic level, the LLR was not missing. Britain lent alone to Austria in 1931, then stood aside as U.S. and France lent to Germany "too little too late." France had also attached stringent conditions. BRITISH LEADERSHIP: It was not clear until 1931 that Britain could not lead anymore. At the World Economic Conference (WEC) in 1933, Britain turned away from leading, cultivating the Commonwealth and freedom to manage sterling. Britain left it to U.S. to devise a world program. LACK OF U.S. LEADERSHIP: Some interest in a leadership role existed in the U.S. financial community, but the isolationist sentiment was dominant. U.S. also distrusted Britain in international negotiations. U.S. bankers opposed "sending good money after bad" to help other countries. COOPERATION: Mere cooperation among countries would not have built the institutions and policies of the OCED, G-10, BIS, IMF, GATT, etc. WEC 1933 did not lack ideas—just a leader. One form of cooperation could have been Britain-U.S. cooperative leadership, but that possibility was hampered by the prisoners' dilemma. SMALL COUNTRIES AND FRANCE: Since small countries could not affect great outcomes, they had incentives to protect their private national interest, which contributed to the worldwide deflation. France, on the contrary, while not big enough to have responsibility forced on it, was not small enough to afford the luxury of irresponsibility. *KINDLEBERGER'S ANSWER: For the world economy to be stabilized, there has to be a stabilizer—one stabilizer.* RELEVANCE TO THE 80S AND 90S: Kindleberger fears that the tripartite division among the U.S., Europe and Japan would lead to similar shirking of responsibility and stalemates as in the 1920s. He thus advocates an effective cession of economic sovereignty to international institutions—a world central bank, a world capital market, and an effective GATT.