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Charles P. Kindleberger. *Essays in History: Financial, Economic, Personal.* Ann Arbor: University of Michigan Press, 1999. xvi + 245 pp. \$49.50 (cloth), ISBN 978-0-472-11002-5.

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Charles P. Kindleberger, perhaps the leading financial historian of our time, has also been a prolific, entertaining, and insightful commentator and essayist on economics and economists. If one were to use Isaiah Berlin's celebrated dichotomy between hedgehogs that know one big thing and foxes that know many little things, Kindleberger would certainly appear at or near the top of the list of economist foxes. Although Kindleberger himself never invokes Berlin's distinction between hedgehogs and foxes, many of Kindleberger's observations on the differences between economic theory and economic history, the difficulty of training good economic historians, and his critical assessment of grand theories of economic history such as Kondratieff long cycles, are in perfect harmony with Berlin.

So it is hard to imagine a collection of essays by Kindleberger that did not contain much that those interested in economics, finance, history, and policy – all considered from a humane and cosmopolitan perspective – would find worth reading. For those with a pronounced analytical bent (who are perhaps more inclined to prefer the output of a hedgehog than of a fox), this collection may seem a somewhat thin gruel. And some of the historical material in the first section will appear rather dry to all but the most dedicated numismatists. Nevertheless, there are enough flashes of insight, wit (my favorite is his aside that during talks on financial crises he elicits a nervous laugh by saying that nothing disturbs a person's judgment so much as to see a friend get rich), and wisdom as well as personal reminiscences from a long and varied career (including an especially moving memoir of his relationship with his student and colleague Carlos F. Diaz-Alejandro) to repay readers of this volume. Unfortunately the volume is marred somewhat by an in-

ordinate number of editorial lapses and mistaken attributions or misidentifications such as attributing a cutting remark about Paganini's virtuosity to Samuel Johnson (who died when the maestro was all of two years old).

As the subtitle indicates, the essays, most of which are drawn from earlier published work, are arranged into three categories. The financial essays begin with perhaps the most substantial analytical essay of the collection, "Asset Inflation and Monetary Policy," though the analytical reflections are presented in the course of a historical survey of the role of monetary policy in generating or restraining financial inflation. The notion that monetary policy has a systematic effect on the level of asset prices is an old one and generated a considerable literature in the 1920s when there was a widespread feeling that a) monetary ease had contributed to the speculation that underlay an irrational boom in stock market prices, and b) that it was the duty of the monetary authority to counteract such speculation. This view seems to have been critical in the decision of the Federal Reserve Board to tighten monetary policy in 1929. The aftereffects of that particular change in monetary policy are well known and have generally not been interpreted in a way favorable to the theory linking monetary policy to asset inflation. But Kindleberger calls our attention to other episodes of what he calls asset inflation, especially the Japanese real estate and stock market boom of the 1980s, and questions whether there may not indeed be some connection between monetary policy and asset price inflation. Originally published in 1995, Kindleberger's discussion predates the great bull market of 1995-99. One wonders what Kindleberger would make of our most recent (and ongoing?) episode of asset inflation.

The upshot of his discussion is that given the complexity of the real world, it would be a mistake to impose a fixed rule on the monetary authority that precluded it from taking policy actions based on the possibility of a linkage between monetary policy and asset inflation. But, in the end, Kindleberger does not persuade me that there is a systematic relationship between monetary policy and asset inflation that could ever provide a useful rationale or basis for the conduct of monetary policy. Certainly there is no compelling theoretical argument for such a relationship. One fairly well-known theory that might provide such a rationalization is the Austrian theory of the business cycle, but Kindleberger is not otherwise sympathetically disposed toward that particular theory. If monetary policy were to have an impact on the level of asset prices, one possible channel would appear to be through an effect on expectations. But to have a significant effect on expectations of real variables, a pretty sizeable change in monetary policy would seem to be required. There must be something radically wrong with the conduct of monetary policy before or after such a change.

Of course, asset inflation may be viewed as a bubble (a phenomenon usually presumed to be a manifestation of irrationality but which can also be reconciled with strict rationality), a topic about which Kindleberger has written extensively. But if asset inflations are bubbles, especially irrational ones, what is the mechanism that links monetary policy with irrational exuberance? Presumably, the expectations on which asset prices are based are influenced by monetary policy. But it is hard to see what role monetary policy might have in accounting for irrational exuberance. The problem with all theories of asset prices is that they are so profoundly dependent on inherently subjective expectations. There are no fundamentals only perceptions. It is misleading to suppose that there is or can be a single correct rational expectation of the present discounted value of the future net cash flows associated with a particular asset. There may be some expectations that are irrational because there are no conceivable states of the world in which those expectations would be realized. But there may be a whole range of expectations that are potentially realizable. And the realizations may (indeed, likely do) in turn depend on the distribution of expectations at large about that asset. Expectations often do tend to be self-fulfilling, and actual outcomes are rarely independent of expected outcomes. As we become increasingly attuned to the pervasiveness of network effects in economic life, we may well come to view large swings in asset values as reflecting some-

thing other than excess volatility – perhaps the inherent volatility of asset values in which expectations about the future are mutually interdependent and reinforcing.

In two other essays, Kindleberger evinces an unexpected (to me) interest in the theory of free banking, a topic about which I have written on occasion. Kindleberger is none too sympathetic to the theory, and attempts to discredit it by recounting the widespread currency debasements in the Holy Roman Empire in the late sixteenth and early seventeenth centuries. The Empire set up a large number of independent local mints that were authorized subject to some degree of imperial oversight to mint coinage more or less without restriction. Kindleberger views the historical record as a conclusive refutation of the free banking theory that competitive issuers compete not by depreciating their monies but by maintaining their values. However, Kindleberger fails to take any note of a fundamental factual issue that is critical to his argument, which is whether it was possible to identify the specific mint from which any particular coin had been issued. The fundamental argument of the free banking school is that issuers compete to maintain the purchasing power of their moneys if there is a mechanism by which an issuer's misconduct could be related to the coin or money it had issued. Kindleberger simply ignores the point. On the other hand, he properly observes that there is an externality associated with maintaining a stable unit of account, so that money issuers do not necessarily have the appropriate incentive to assure the optimal variation over time in the value of the unit of account. But this is an issue different from and more subtle than whether free banking is inherently disposed to inflation or debasement. It is at least as likely that the free market would generate excessive deflation as excessive inflation. But as I have argued in a book on free banking (*Free Banking and Monetary Reform*, Cambridge University Press, 1989, chapter 10), there is no inherent reason why a free banking system could not be coupled with a governmentally supplied unit of account whose value over time would be constrained to vary in a socially optimal manner. There may be compelling arguments against free banking, which would involve questions about banks' propensities to take ill-advised risks and the necessity for a lender of last resort to prevent a cumulative breakdown in the payments system and in the financial infrastructure generally. Kindleberger has provided valuable historical and theoretical insights into these issues in his voluminous past writings. Unfortunately, Kindleberger in this volume seems to have concluded that the case for free banking can be dismissed

just a bit too easily. Both supporters and opponents of free banking would have been better served if he had not approached the subject quite so casually.

Other readers, I am sure, will find nits of their own to pick with Kindleberger. We all like to find fault with our elders and betters. But that will be just one of the enjoyments gained by reading this volume.

(The views expressed in this review do not necessar-

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