Minsky and Kindleberger:
Fellow Travelling Theorists of National and International Financial Instability

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By his own account, Kindleberger's attention was first brought to Minsky (1919-1996) by Martin Mayer, author of The Bankers (1974). "Martin Mayer put me on to the Minsky model" (1978, xi), says Kindleberger (1910-2003) in the Acknowledgments to his Manias, Panics, and Crashes: A History of Financial Crises (1978, xi), written after his mandatory retirement from MIT in 1976 at age 65. "The general validity of the Minsky model will be established in detail in the chapters that follow" (p. 20).

After the publication of MPC, Kindleberger and Minsky had repeated direct intellectual contact. Both were participants in a colloquium, "Financial Crises and the Lender of Last Resort", held at Bad Homburg, Germany, May 21-23, 1979 (Kindleberger and Laffargue 1982). They interacted again at a seminar on "Banking and Industry in the Inter-War Period", held at MIT October 23-24, 1981, the proceedings of which were subsequently published in the Journal of European Economic History (Minsky 1984, Kindleberger 1984). And then, after Kindleberger was elected president of the American Economic Association, he specifically asked Minsky to organize a session on "The After-Keynes Cambridge Contributions to Theory" which was published in the subsequent AER Papers and Proceedings (May 1985). Finally, when Minsky retired, Kindleberger wrote a paper for the festschrift conference held April 20-21, 1990 in St. Louis (Kindleberger 1992).[1] "I owe a large intellectual debt to Hyman Minsky who got me to think about instability in financial markets" (p. 71).

So there is no question that there is some connection between Kindleberger and Minsky, but there is less clarity on the matter of exactly what that connection is. DeLong and Eichengreen, for example, in their foreword to the 40th Anniversary Edition of Kindleberger's World in Depression state: "The Minsky paradigm emphasizing the possibility of self-reinforcing booms and busts is the implicit organizing framework of The World in Depression" (2013, 7), but this cannot be right. Kindleberger

[1] As it happens, I was in attendance at that conference, but not invited to contribute as I was then just starting my own academic journey.

never cited Minsky in that book, nor even in the revised edition issued in 1986. Even more, Kindleberger (1984) explicitly points out the limitations of the Minsky model for explaining the Depression: "It is limited to the United States. There are no capital movements, no exchange rates, no international commodity prices, nor even any impact of price changes on bank liquidity for domestic commodities. All assets are financial" (p. 16).

But let me not single out others; I was myself for a long time under a false impression on the matter. Kindleberger, I thought, was guilty of domesticating Minsky's radical message about the inherent financial fragility of capitalism, more or less the same kind of thing that the MIT Keynesians more generally were thought guilty of with regard to Kalecki, not to mention Keynes himself. If you want the real thing, read Minsky, I thought, not Kindleberger, and so I did. And when I did, Minsky further appealed to me as an obvious heir to the American institutionalist tradition on money that I had traced in my first book (Mehrling 1997).[2] My biographical essay written after Minsky's death makes that case explicitly (Mehrling 1999), and that explains why it was from Minsky that I started my subsequent project to reconstruct the "money view" (Mehrling 2000, 2015).[3]

It was a long journey, but finally in Fall 2012, INET funded the filming of the resulting money course, which was published a year later on the Coursera platform. This was in the aftermath of the global financial crisis (GFC) of 2008-9. The Minsky path had led me to understand the GFC as a stress test of the emerging market-based credit system, so-called "shadow banking", which it certainly was (Mehrling 2011). But it was also a stress test of the global dollar system, and for that Minsky was no help. For that it turned out that I needed Kindleberger, and once I turned my attention to him I soon discovered that he was not at all the person I had thought he was (Mehrling 2022). In retrospect, I

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[2] The book followed three generations: Allyn Young, Alvin Hansen, and Edward Shaw. I consider Minsky as a fourth, following after Shaw, and Kindleberger similarly, as will become apparent.
[3] The best full-length treatment of Minsky's thought, in my view, is Neilson (2019). See also Wray (2016) and Konings (2018).

should have realized it earlier; it was his student Marcia Stigum who wrote the book that I had come to use as the text in my money course (Stigum 1990).

The important thing to appreciate is that Kindleberger was just as much a product of the pre-war American institutionalist tradition as was Minsky, maybe even more so. Nine years older than Minsky, Kindleberger completed his PhD well before the war, whereas war interrupted Minsky's studies and he finished only after the war. Even more, whereas Minsky was formed by the University of Chicago (Simons) and Harvard (Schumpeter), Kindleberger was a student of Willis and Angell at Columbia, then the center of institutionalism under Wesley Clair Mitchell, and he was also an indirect student of John H. Williams through his lifelong friendship with Emile Despres. Once I began to dig into Kindleberger's corpus, I recognized him as another obvious heir to the American institutionalist tradition on money, albeit quite completely focused on the international dimension.

Pre-WWII intellectual formation meant that both Minsky and Kindleberger were increasingly outsiders in post-WWII economics, which organized itself around mathematical and statistical modelling, specifically the famous IS/LM model as a key component of the so-called "neoclassical synthesis". Both men rejected that framing of the monetary side of the economy, and both sought in their own work to build something better. In this regard, they were definitely fellow travelers. As I read their biographical intersection, Kindleberger felt some responsibility to support the home team, and that led him to hold back from open criticism of his MIT colleagues, whereas Minsky felt no such constraint, and as a consequence was much more of an outsider. But Kindleberger also felt some responsibility to support his fellow traveler, and that explains the multiple public engagements; in retirement, he was using his own greater academic visibility to bring visibility to Minsky.

A central source of misunderstanding about the Minsky-Kindleberger connection is a misreading of what Kindleberger was trying to do in Manias, Panics, and Crashes (1978), and therefore of how he was using Minsky. When he speaks of "the general validity of the Minsky model", he is quite explicitly framing that model as “a lineal descendent of a model set out with personal variations, by a host of classical economists including John Stuart Mill, Alfred Marshall, Knut Wicksell, and Irving Fisher” (p. 15). It is that tradition that is generally valid, not so much Minsky’s own personal variation. Indeed the “Minsky model” that Kindleberger goes on to exposit is more accurately described as Kindleberger’s own “personal variation” of that tradition, as will be elaborated below, perhaps inspired by Minsky but differing from him in significant ways.

Just so, Kindleberger continues: “According to Minsky, events leading up to a crisis start with a ‘displacement,’ some exogenous, outside shock to the macroeconomic system.” His citation is to Minsky’s “Financial Instability Revisited: The Economics of Disaster”, a work published in 1972 but actually written much earlier in 1966 as Minsky himself makes clear (Minsky 1972, 96, 134).[4] The word “displacement” does appear in that paper, but the emphasis throughout is elsewhere. “The theory developed here argues that the structural characteristics of the financial system change during periods of prolonged expansion and economic boom and that these changes cumulate to decrease the domain of stability of the system.” (p. 97) “Our questions are of the form: ‘What is the maximum displacement that can take place and still have the system return to a particular initial equilibrium point?” (p. 118). For Minsky, apparently, “displacement” is the pinprick that collapses a fragile financial system at the end of an expansion, not the shock that begins the expansion. The latter is Kindleberger, not Minsky.

Indeed, at Bad Homburg, it seems that Minsky (1982) did not say what Kindleberger had expected him to say. Here is Kindleberger: “Minsky, who insists on the fragility of the financial system, and elsewhere emphasized an exogenous shock leading to euphoric expectations, in Chapter 2 attributes the crisis to unstable debt structures built by years of tranquility…” (Kindleberger and

[4] Significantly, this early piece makes no mention at all of the “financial instability hypothesis” which Minsky himself considered to be the centerpiece of his contribution. That would come later (Minsky 1975). In 1966, Minsky was still trying to work within the confines of the standard multiplier-accelerator model. It was this early work that got Kindleberger started, though he would move beyond it, even as Minsky did as well.

Laffargue 1982, p. 2, my emphasis). Minsky himself notes that it is Kindleberger who coined the term "Minsky model" whereas he himself always preferred "financial instability hypothesis" (Minsky 1982, 37, footnote 1). Nonetheless, Kindleberger persisted. In Financial History of Western Europe (1984, 271), he again points to the importance of the initial "displacement", now citing Minsky (1982) where the word does not even appear. And he does it again in his festschrift contribution (1992, 82).

It is not just a matter of words, but also of substantive concepts. Minsky's financial instability hypothesis is about the in-built dynamic toward financial fragility—from hedge, to speculative, to Ponzi finance as he says—that comes from the premium on liquidity. Banks are more willing to lend short term than long term, and so companies that have long term capital needs are incentivized to mismatch the pattern of cash commitments and expected cash flows, ever more so as time goes by and the inevitable need to roll over short term debt repeatedly goes smoothly. Indeed, through a Kaleckian channel, the more investment rises the more profit rises, so validating the debt that financed the investment.

The boom is thus not at all a matter of irrationality, but rather of profit seeking, of firms looking to reduce financing costs in competition with other firms which are also looking to reduce financing costs. Over time, as financing arrangements get ever more fragile, in the end it takes very little to prick the bubble and shift everything into reverse. Investment halts so profit halts; debts come due and cannot be paid, but also cannot be rolled as banks look to restore their own liquidity. Minsky's financial instability hypothesis is thus a financial theory of business fluctuations first and foremost. Government spending can help to stem the downturn by supporting business profits, but in doing so it also prevents liquidation of debts, so that each new cycle starts from a more fragile place than the one before. It's a theory of business fluctuations, driven by bank credit, specifically devised to explain U.S. conditions (Minsky 1986).

Kindleberger, by contrast, is centrally trying to understand international financial crises, and the operation of international lender of last resort. Most histories of crisis (including Minsky) are national histories, simply because historians typically specialize in their own countries, but the phenomena are quite typically international, because capital and money markets are international. A further difference from Minsky, the swings that interest Kindleberger are not so much swings in income and output as they are in asset prices, driven up by the inherent instability of credit, and then down again when the bubble bursts.[5] MPC is organized around the stages of that process: "Speculative Manias," "Fueling the Flames: Monetary Expansion," "The Emergence of Swindles," "The Critical Stage," and "International Propagation."[6]

The pattern is this: some kind of "displacement" gets the thing going initially; the ensuing "mania" is then a speculative bubble fueled by credit expansion, with "financial distress" emerging at the peak; followed possibly by "panic" in which the bubble bursts and credit contracts. The monetary dimension of the process comes from the fact that typically some of the credit expansion involves creation of money substitutes, and typically the panic then involves a flight from speculative assets and the new forms of money into money proper issued by a central bank. On the bright side, it is this feature of financial crisis that offers the central bank an opportunity to allay the panic by timely and forceful lender-of-last resort intervention, basically by taking the other side of the panic trade.

For Kindleberger, the central point is that international crisis requires an international lender of last resort, and that is much less reliable than lender of last resort at the national level, which is why the crises we observe are so commonly international. If they were merely national, they could more easily be nipped in the bud. In this vein, Kindleberger's Financial History of Western Europe (1984) tells a story of the co-evolution of international money and capital markets with the institution of international

[5] In Kindleberger, demand fluctuations are a consequence of these price fluctuations.
[6] This sentence and the following paragraph are lifted bodily from Mehrling (2022, 204-5).

lender of last resort since 1750. In Kindleberger's telling of that story the most significant displacement is war, and sometimes also its financial aftermath in the form of indemnities or reparations.

It's a see-saw story, of successive expansion and collapse, but the overall tendency is expansion. The part of the story that happened in Kindleberger's own lifetime was primarily about connecting the United States and Europe (1984, Parts 4 and 5). If Kindleberger were writing today, he would likely point to the subsequent expansion to Asia, an expansion punctuated by the Asian financial crises, and he would point also to the post-GFC expansion to the Global South, an expansion currently being tested by tight money at the center (McCauley 2021). Zero interest rates in the Global North, the policy response to the GFC and then also Covid, cut new channels for capital flow to the Global South, many of which will remain even after the current stress test, which will also likely produce innovation in the institutional arrangements that presently serve as international lender of last resort (Mehrling 2021).

Apparently Minsky and Kindleberger are not at all the same model, and the difference goes beyond national versus international. But they are recognizably in the same family, even more so when compared with standard economics, and that is exactly Kindleberger's point. The pattern Kindleberger finds in the history of financial crises is not so much a vindication of the specifics of the Minsky model, but rather of an entire tradition of economic thought, "held by many economists prior to 1940 [including some of Kindleberger's own teachers], that has unaccountably slipped into disrepute during the Keynesian revolution and then monetarist counterrevolution. A notable up-to-date exception is Hyman Minsky" (1978, 72).

Kindleberger's <u>World in Depression</u> was meant to bring the Friedman-Schwartz explanation (i.e. "the Fed did it") into contact with the actual facts, in order to discard it (Friedman and Schwartz 1963). In the second edition of the book, the standard Keynesian explanation came under scrutiny as well, the purpose being to discard that as well (Temin 1976). This is the background we need to understand <u>MPC</u>. Once having discarded the standard monetarist (and Keynesian) account, there was room for nonstandard accounts, such as Minsky. In MPC Kindleberger was doing exactly the same thing he had done in WID, bringing a theory into contact with the facts, now not just the facts of the Great Depression but also of the entire history of all the international crises he can find. And now the theory is the one he had learned from his teachers, a theory that today apparently only Minsky espouses. In MPC, by contrast to WID, the facts are found to be consistent with the theory, and it is this that creates room for the book he considered his "chef d'oeuvre", A Financial History of Western Europe (1984).

In economics, the saying goes, you need a model to beat a model. Given the reception of WID, Kindleberger seems to have realized that he needed a model, and Minsky fit the bill. Obviously he must have recognized that the "model" he presented in MPC was not the same as Minsky's—it is entirely literary, for one, and hence would not be recognized as a model by most economists. No matter. Minsky was a way for Kindleberger to get his foot in the door, to get an audience for his own "personal variation" of the theory, which he then used as the frame for FHWE.

There is a sense in which Kindleberger can be said to have helped domesticate Minsky. By emphasizing the initial displacement, he opened up the possible interpretation that we are dealing here with a shock to a previous equilibrium situation, suggesting that the problem arises from dynamics out of equilibrium. There is an enormous academic literature exploring formal models of that sort, some of them by Kindleberger's MIT colleagues (see DeRosa 2021). But it is that literature that attempts to domesticate Minsky, not Kindleberger. Equilibrium was never a part of his toolkit; as an American institutionalist he saw the economy quite generally as an open-ended process of Darwinian institutional evolution, and credit as a central feature of this process. The displacement of war is especially important because of war finance, which he sees as a "hothouse" for financial innovation (1984, 5).

Conclusion

In his magnum opus Stabilizing an Unstable Economy (1986), Minsky concludes tellingly with a chapter titled “An Agenda for Reform” (Ch. 13). In biographical context, we might consider this to be his attempt to reconsider and update the agenda proposed by his early influence Henry C. Simons (1948). It was Simons who got him started thinking about the business-banking nexus as the source of economic instability, but Simons went too far in proposing the elimination of business credit entirely. What Minsky proposes instead is a far-reaching attempt to implement what he calls “to-the-asset” financing, which is to say forms of financing in which promised future payments are more or less lined up with future expected cash flows from the asset being financed, what he calls “hedge financing”. But this is only the third element of his agenda.

The first two elements are “Big Government” and “An Employment Strategy”. Unlike Simons, Minsky advocates for a government approximately 20% of the economy, in order that government spending be of sufficient scale to compensate for fluctuating investment spending, and he advocates further for government to be a kind of employer of last resort as a way of achieving full employment. His target in all three of these elements of his Agenda is the standard economist’s IS/LM frame, which seeks to use discretionary fiscal and monetary policy to stabilize the cycle without really understanding the business-bank financing nexus that is the underlying cause. Minsky wants instead to confront the underlying cause directly with structural reforms. And the whole point is to make room for a return to genuinely competitive capitalism, small business not large business, and small banks not large banks, which is the fourth element of the Agenda, “Industrial Policy.”

Kindleberger, by contrast, concludes World in Depression (1973) with the observation that the world needs “a stabilizer, one stabilizer” (p. 304). In biographical context, we might consider this to be his attempt to reconsider and update Bagehot’s Lombard Street (1873). The central message of that book had been that the central bank needs to act visibly and intentionally as lender of last resort.

“Money will not manage itself, and Lombard Street has a great deal of money to manage.” (p. 20) What Kindleberger is grappling with is the need, revealed in the dynamics of the Great Depression, for an international lender of last resort. But that is just the third element on his list, “discounting in a crisis”. The Depression taught us also that central banking, while crucial, is not enough. Commodity markets and long-term capital flows also need stabilizers, respectively a buyer of last resort and a creditor of last resort.[7]

In biographical context, we can understand the Minsky-Kindleberger connection as a kind of mutual exploitation. Kindleberger used Minsky as a stepping stone for his own scholarly agenda, finally free to go his own way after 1976 retirement. And Minsky used Kindleberger as a respectable ally for his own activist agenda of far-reaching reform. Both men shared origins in pre-war American institutionalism, and indeed both also were New Dealers of a kind, representing respectively the anti-globalist and globalist wings of that movement. Even more, both shared the long ancestry of authors who identify the inherent instability of credit as a central feature of the market economy, a feature that was largely invisible to the orthodoxy that dominated economic discourse after World War II. Both were outsiders to that dominant discourse, and they recognized one another as fellow travelers, outsiders together.

[7] In the revised 1986 edition he adds two more elements: “(3) Policing a relatively stable system of exchange rates; (4) Ensuring the coordination of macroeconomic policies” (p. 289). In biographical context, this can be understood as a response to the monetary instability of the flexible exchange rate period of the 1970s.

Table 1: Minsky and Kindleberger Compared

	Minsky	Kindleberger
Scope	Domestic	International
Character	Activist	Scholar
Mechanism of Instability	Fiscal: investment spending	Monetary: credit expansion
Inspiration	Simons' Financial Good Society	Bagehot's Lombard Street
New Dealer	Anti-globalist	Globalist
Legacies	"Minsky moment"; Post-Keynesianism	"Hegemonic Stability Theory"; Manias Panics and Crashes (8th edition)
Stabilizing an Unstable System	Minsky (1986, Ch. 13): Big Government An Employment Strategy Financial Reform Industrial Policy	Kindleberger (1973, 292): (a) maintaining a relatively open market for distress goods; (b) providing countercyclical long-term lending; and (c) discounting in a crisis

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