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Lessons of the Great Depression: An Interview with Dr. Peter Temin

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Peter Temin is Elisha Gray II Professor Emeritus of Economics at the Massachusetts Institute of Technology. He is an economic historian who provides an integrated view of the Great Depression, covering experiences in Britain, France, Germany, and the US. In doing so, he discusses the causes, why it was so widespread and prolonged, and what brought about the world's eventual recovery. He also finds parallels between the Great Depression and current policies that are recommended and sometimes followed by governments.

disclosure Interviewers: Karla Encalada-Falconi and Lilian Milanés

DC: We were interested in knowing why you decided to study economics. What inspired you to study economics?

PT: I was an undergraduate at Swarthmore College, outside of Philadelphia, and it ran something called the honors program where you only took two seminars a semester there. With it being a small college, there were student-faculty teas, and I was persuaded by a friend of mine to go to one of them. By the time of this student-faculty tea, I had had some economics, and at this event I met an economics teacher that I thought was totally fascinating. I wanted to take one of his seminars. But because there were so few seminars, in order to get a seminar from him I had to become an economics major. So I became an economics major.

DC: Wow, just to take a class with him. What was the name of the professor?

PT: His name was William Brown. He died prematurely. I had always been a math major with an economics and a history minor, but then I became an economics major with a math and a history minor. I studied economics to take his seminar—which was wonderful; it was well worth it. And when I decided what I wanted to do later, economics had really attracted me and I decided to go further into economics. Good teachers are the key to everything.

DC: To go along with the social theory theme, how do you see your work as part of social theory?

PT: Well I am an economist, but I am also a historian. Thus, I look at both economy and history, but I am not totally sure what social theory is. I am aware that the models of economists capture only part of the experience of people and therefore one needs to bring in other factors for further explanations of things. For
example, my presidential address to the Economics History Association was entitled, ‘Is it Kosher to Talk About Culture?’ Thus I try to broaden out a bit.

DC: So, which is your theoretical approach, or how do you place yourself within economics and history, if it is possible?

PT: As an economist, I tend to approach things from the point of view of economists, looking at data, prices, and evidence about how people are acting. But I am also aware of the political and cultural context in which people are operating. I try to consider that economics is embedded (what may be considered a loaded or dangerous term to use) in society.

DC: Well, the themes of this year’s class is ‘Market Failures, Famines and Recessions’ And we were interested on hearing your perspective on, in theory, what is a market failure?

PT: A market failure is where people are not able to do what they want at the existing prices. The purpose of a market is to bring people who want to supply goods and services, together with people who want those goods and services. When the market works you get an equilibrium, where supply equals demand, and a price in one form or another. A market failure is when the suppliers and demanders cannot get together to make that agreement. What I am going to talk about this afternoon is unemployment, people who want to work at the existing wage but cannot find jobs.

DC: Can the market self-regulate? Or is this an assumption of liberal economics? How does this idea affect our understanding of what a market failure means?

PT: The market is a very abstract concept. I will make a bold statement but there will be exceptions to this. When I say markets, I do not mean all markets, I mean generally markets. Markets are not self-regulating; markets need some kind of control because in our society, most people are socialized to follow the rules in markets. But there are also other people, we call them criminals, crooks, who do not want to follow the rules. So, think about Target and the credit cards being stolen. Those are people who are not following the general rules. They are trying to get money without selling the goods, which is what Target does. The question is how do you control the people and the market that Target is trying to have? You look for goods, find what you want, find the price you want, and you buy them, while co-existing with these other people (rule breakers). I use the word criminals because we have a legal system which says that what Target does is legal, and what these other people are doing is illegal. And if we catch them we put them in jail. This is a form of market regulation. My argument is that most markets need some kind of regulation. Legal regulation is what you do in a big
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case, in much smaller cases there may be social recognition, or political decisions that affect how much markets can work, etc. I think the better way to phrase the question is not whether markets need regulation, but what kind of regulation is appropriate for any given market.

DC: In your article ‘The Gold Standard and the Great Depression,’ you argue, in collaboration with Barry Eichengreen, that the Great Depression was the result of a cultural condition, which you refer to as the ‘gold standard mentality’. So, using a parallelism, which would be the cultural condition, or mentality, that produced the financial crisis of 2007, or 2008?

PT: Yes, in 2008, the crisis started in 2007 and continued until everything fell apart in 2008. Yes, there is quite a bit of parallelism. The gold standard of course was very explicit. In this article, Eichengreen and I describe how the gold standard caused the Great Depression. The ideology back then was that the gold standard would be the way to prosperity. Similarly in 2008, the view that financial markets by themselves would increase efficiency (which I think they can) and would make everybody better off, but the markets in this particular case did not do this. Eichengreen and I did go into this, but sometimes, in teaching this, I talk about how the gold standard worked rather well before the First World War, but not so well after the First World War. Why it worked well one time and not the other, I tend to think of it mathematically. If you have an interior solution, if everybody is following the rules and is able to follow the rules, then the system works. But when you get into a situation, after the war, in which some countries could not pay their bills. Like the crooks in Target, they did not have the money, they could not follow the rules because they could not afford it, and thus the system broke down. In 2008 some of these firms were running the financial system with very little regulation, when it was supposed to be self-regulating, the way the gold standard was. These firms could not pay their bills, they had gotten themselves over extended, the way countries had gotten themselves over extended in the 1930s, thus the system crashed. It was basically an old-fashioned banking panic or currency crisis. But it did not come out looking like that, it came out as bankruptcy and government taking over, and all sorts of things.

DC: But, there was like a mentality?

PT: Exactly like the gold standard mentality.

DC: How would you call that mentality if you could put a name to it?

PT: Well, I suppose it is what now would be called a libertarian philosophy.

DC: Libertarian? What is that philosophy about?
PT: The philosophy is that people left to their own devices would operate well without having these regulations that we were talking about. The belief that regulations hold people back instead of being the grease in the wheels that allow them to work more efficiently. They are like sand in the wheels that they clog up the wheels. In wheels and gears, we say that oil and grease in gears will make it work better; sand in gears will slow it down. There is a kind of soft libertarianism and a hard libertarianism. Soft libertarian says that you just want to have less regulation, so you want to let the financial markets go, but you still want to have controls about what people can do and laws about what they do. Whereas hard libertarians say no rules, they’re really anarchists. For example in Lexington there is a rule that you drive on the right side of the road. If you drive on the wrong side of the road you can be put in jail for endangering the peace, etc. A strong or hard libertarian would say “No people would understand that you have to stay to the right, you don’t need to punish those people, etc.” I don’t think there are a lot of hard libertarians around, but there are a lot of soft libertarians around.

DC: You just discussed the idea of ideology of the Great Depression, which you also mention in your book ‘Lessons from the Great Depression’. Particularly you note: “the gold standard ideology shaped policy makers’ interpretation of the Depression.” I am curious about the definition of this concept. I am thinking of Marxism as one of the principle approaches that discussed the concept of ideology. I am curious, how do you understand and conceptualize ideology? Does your concept of ideology come from this tradition? What is the role of ideology in a market failure?

PT: Good question, but economists do not like the word ideology. That must have been something that survived, that some editor did not take it out. Barry Eichengreen and I mostly use mentality, which is a euphemism, but does not have the word ideology in it. We are in concepts that are not well defined. Let us go back to the Great Depression, we can do that simply and then we can go back to today. In the ideology, or the mentality of the Great Depression people, who believed (libertarians in this case) in this mentality, thought that the reason we had the Depression was not because the gold standard caused it, but because people had not followed the rules of the gold standard. What do we mean by the rules of the gold standard? Well, for the United States in the 1920s people were sending gold, which was the basis of the money supply to America, because it was safer—since Europe was having a lot of problems. The United States with more gold should have had more money, and should have had higher prices. However, the Fed and the Treasury decided to sterilize the gold inflow, put it down in Fort Knox and did not increase the money supply. This was against the rules of the gold standard. The argument is, if everyone had followed the rules of the gold standard then the gold standard would have worked and we would not have had...
the Great Depression. It was not the gold standard that caused the Great Depression, it was the unwillingness of people to follow the rules of the gold standard. Following the rules of the gold standard are very much part of the gold standard. People followed some rules and not other rules; that is just the way people are. You need to take the package, and get rid of the package in order to solve the problem of the Great Depression.

Come back to today, people have this ideology of the market, the libertarian notion. One argument (people who favor the libertarian notion) is that there were some people who just did wrong, they made too many loans, got bad mortgages. They were doing things that the United States was doing it in the 1920s, they were not following the rules. Therefore, the financial panic was the problem of the individuals not following the rules. It was not the rules themselves. My argument about ideology is that rules and the people who follow them or do not follow them, they are all a package. You cannot say, it is not the rules, if people do not obey the rules. It is that rules are only rules when they are followed. Even with respect to the rules that you drive on the right side of the road, most people obey the rules most of the time, but some people do not. They get drunk, they are in a hurry. One of you is pregnant and somebody is trying to get you to the hospital. In fact, we have special vehicles with have bright lights on them, we call them ambulances, who can break the rules to do these things. We have tried to minimize the incentive for people to drive on the left side, on the wrong side of the road. My argument is that part of the financial system has to have regulations that do the same thing for financial activities, as we do for driving on the right side of the road.

Can I ask you a question? You see, when you are coming home late from a party and there are no people around and you come to a red light. There are no cars any place. Do you stop for the red light?

DC: Sometimes we do not. No I do not.

PT: Well, you see that is a test of whether people have internalized the rules or not. And then there’s the question of should there have been a police waiting so when you go around ‘where!’

DC: So do you?

PT: Do I? I tend to stop.

DC: You mentioned that ideology is related to specific rules. But the gold standard had specific rules that you had to follow; however, the rules that were going on at that time did not work. So, my question is, when do rules become ideologies and when are they just rules?
PT: This is why the gold standard is a very clear case. Because the gold standard is very simple. A country goes on gold by being willing to buy or sell its currency for a fixed amount of gold. There is no inflation/deflation, or anything like that in it. The rules were very simple. This notion that a country should inflate when it gets gold or deflate when it does not have gold is a very old view. It was articulated very well by David Hume in the 18th century, a very long time ago. This is not just something that comes about. Recently people have talked about the rules of the game. The rules of the game were rules that were not written down. They were not anything the governments agreed to, but people in their culture knew about these rules. That is why we called it mentality or ideology. It was a kind of view that they were supposed to have. The gold standard would work well when people had these views. Now how did it work in the earlier period?

Before the First World War, people who did not follow the rules of the game went off the gold standard. Spain never got on the gold standard because it was too rigid, Latin American countries used to go on and off gold when they had to do it, etc. But as it turned out, it was only developing countries rather than the main industrial countries which had problems. Due to the cost, the capital movements, and the complexity of the First World War, it was not just Argentina, but it was also Germany that had problems in this area after the war. That’s why the gold standard failed.

There were always people who did not follow the rules, but those would be considered isolated cases and the basic system could go. But as a result of the disturbance in the First World War, what was thought of as the center of the world economy even had problems following the rules. That is when it became destructive.

DC: One of the assumptions of policy makers during the period of the Great Depression was that the stability that the gold standard had in the past (such as before World War I) would be reproduced after the war to stabilize the future. In this sense, how does the past affect our visions of the future? And, since you are a historian, how can we conceive the past as a lesson instead of a repetition; in particular, when there is a period of economic crisis?

PT: Yes, that is very difficult. I am a historian not a prophet, I do not know what is going to happen. But let me give you a historical example from the Great Depression and then we will come back to the current example. When Franklin Delano Roosevelt ran for the presidency in 1932, the Depression was terrible. He ran on a promise to balance the budget, part of this ‘rules of the game’ of the gold standard. FDR was very conventional when he was elected. He got elected and then he abandoned this rule once he got into power. He took the oath of office in March of that time (not January but March), and in April he took the United
States off of gold completely. By no longer having the constraint of the gold standard, he abandoned this ideology. If you think about Roosevelt, he was running on the mentality of the gold standard, however we do not know whether he believed it or not, because he is dead. We cannot ask him, even if we asked him he might not know or be able to tell us. But FDR used it as his slogan because he thought a lot of people who were going to vote thought that way, and he had to appeal to them. Once he got into office, in order to deal with all the unemployed, he decided that the Gold Standard ideology was not useful to him and he changed it. Went off gold, single most important thing he did in April of 1933, went off gold.

Today, people are running for office on this ideology of libertarianism (the analogue of the gold standard), saying that markets will be self-regulating and that we should leave things alone. We do not know whether they will win the election. The more interesting question is, let’s say that in 2016, instead of a democrat following President Obama, it’s a tea-party guy, Ted Cruz, Marco Rubio, whoever it turns out to be, then these people, like Roosevelt, will have run on a particular ideology. Now Roosevelt took office in March, by April (about six weeks after) he had already figured out this was no way to go, and he reversed course. Well, if these guys get elected, will they turn around and say “Oh being in the opposition we can say anything we want, but when we get into power we have got to actually do something.” We do not know the answer to that question. Some of us do not want to do the experiment to find out. But it is an open question.

DC: I was thinking about the role of history and how you have studied different disciplines, like economics, history, and math. And in the same article, ‘The Gold Standard and the Great Depression’, you discuss the history of economics in relation to this period. You argue that it does not take into account the gold standard and some of the historical explanations as a possible cause for the depression. I was thinking about the importance of interdisciplinary approaches, specifically when analyzing market failures or crises. What is the importance of studying economics not only from an economical perspective, but also a mixture of both?

PT: As an economic historian, I am interdisciplinary. I believe that it is important to have disciplines. But I also believe that it is very important to have a primary discipline. It is very important for anyone going into these kinds of interfaces or boundaries between the fields to have one field that the person really understands is important. If you think about what are the differences between economics and history, one thing that economists like are models and math. You have to know about models and math if you are an economics person. On the other hand, what do historians know? They know about sources, about using things that other
people can see so that they can go back over your work, being faithful to sources and finding out the sources. Historians believe in fitting the sources together into a pattern to describe people. Thus these are different kinds of things. It is fine to know both of them, and I think it is good. We should know these things and we can study other fields too, I just happen to know those two particular fields. It is important for your education to have at least one field, maybe you are bright enough and you can do two fields, but at least one field that you really know very well.

DC: How does interdisciplinarity help us in understanding crisis?

PT: If you have a crisis, a big crisis, like the Great Depression, or the current situation, it is pretty easy to agree that something is wrong. People who come from different views, different ideologies, disagree about what is wrong. It helps to have an interdisciplinary approach because if you want to have a new approach, you also want to have an approach that you can convince other people of. I have my own views, but that does not affect policy. Just as Roosevelt had to get himself elected; you need to have something that you can debate with people and for that you need to be able to debate with people who come at it from different points of view. The question is how do you convince people? I will be talking about that this afternoon.

DC: In your essay about the gold standard, you note that the First World War had weakened the position of European producers’ in international markets and strengthened that of other regions such as in Latin America and India. This particularly made me think of the connections between the North and South parts of America. During 2007, and even after, countries in Latin America (like Venezuela or Ecuador) were not necessarily facing a crisis but their economies were in fact growing. At the same time, these countries stopped using IMF recipes or they also rejected free trade agreements with the U.S. I am wondering do these political and economic changes in the relations between U.S. and Latin America actually produce, or were factors that influenced the crisis of 2008 in the U.S.? Is it possible to even create that connection or not?

PT: That is a really complicated question. I do not know how much time we have. That is going take us a couple hours.

I am reading a book at the moment, it goes back to Aristotle—that is how far back it goes and how interdisciplinary, it says that there’s something called the proximate cause, the cause that actually sets things off, and that is finance. Then there is also something called the ultimate cause, which Aristotle distinguished a very long time ago. In this book the author is arguing that the proximate cause, which everybody talks about in today’s politics, is not so important. What is
really important is the ultimate cause. His view of the ultimate cause is that it affects things like the ideology that Eichengreen and I talked about. This also goes into the changing structure of the world, as it is now. From North America we talk more about China than we do about Latin America, because we have got these trade issues with China. But there is an argument that the United States has not dealt well with its international economic relations. This argument states that it is the imbalances with these other economies that has unbalanced the American economy. I wrote a book about this, called the ‘Leaderless Economy’ and there is a book by Jeff Frieden and others called ‘Lost Decades’, there are a whole bunch of people who have written about this. Not in the terms that you ask it, but it is the same view. I like this book that I was just reading on the airplane, and how it broke it down in this Aristotelian way, that was a good way to think about it.

DC: How does this imbalance produce a crisis? Do you have some hypothesizes?

PT: I have a lot of ideas about it, and I can tell you about it. I use something called the swan diagram, which is a tool of economic analysis. The swan diagram is a simplification (that is what economists’ do), a little model of internal balance and external balance. We talk about big countries; the United States is a big country so we just talk about the internal balance. But the argument of the swan diagram is that you not only need to have internal values, you also need to have external balance to get to a reasonable equilibrium. The swan diagram is a way to put those things together. The United States is out of internal balance at the moment, but it is also out of external balance. The argument of the swan diagram leads you to the conclusion that you cannot fix the internal balance reliably in a lasting way until you also solve the external balance. I believe that.

DC: In your book that is being used for our course, you talk about unemployment and the Great Depression, and we were interested in what were the roles of workers in the creation of economic stability? And what are the consequences of diminishing the living standards of workers in a crisis?

PT: That is another complicated question that we could spend all day talking about. These are very tough questions. The costs of unemployment has not been recognized very much. There are two basic kinds of costs that have not been recognized. One is the cost to workers themselves. Extensive unemployment is really very harmful to the people being unemployed. It is terrible to lose the income, it has effects on children, etc. A lot of literature has been written on this, Mark Usen and others have written about the costs to the unemployed, and this is one kind of cost. The other kind of cost, is the cost to the stability of the political and the social system. Unemployed people, as they get more unemployed, may
threaten the stability of a political system. Where can we see this? You do not see this in the United States very much, for complicated reasons; but we do see it in the Middle East. There are a lot of young people who cannot find work, so they are unemployed. As a result, they go and say “the political system, etc. is terrible” and they revolt. It has become very hard to make the government operate when you have all these people floating around who are very unhappy with the situation that they are in. The Middle East is really very far from the United States, thus here we emphasize the cost to the individual. But we know that it is costing the individual to get large amounts of costs. Can we see signs of our approaching these Middle Eastern kinds of situations? Let us go back to the case of Target, the people who are doing this, we do not know who they are, but they are likely people who cannot find work, cannot find activities that pay them what they want to earn. Thus they turn to doing destructive things like stealing, etc. If the Target case turns out to be an isolated case, we will say “oh well that is just their problem,” but if it becomes a common problem, then the society has to change. Yesterday, there was a column in the Boston Globe saying that Target should do a smarter credit card, and so we need to fix the credit care problem to do this. But fixing the problem, then that is at society’s cost, we must go to a new technology to fix this problem. If there are more and more of these attacks, then you have to do more and more things, and as a result the society changes. Eventually (we are not close to this), you end up like the Middle East where there are so many things that needed to be changed that the whole thing collapsed. Unemployment is potentially really dangerous.

DC: What is the role of unemployment in the crisis of 2008?

PT: Unemployment is the result of the crisis of 2008. And the policies that have been followed since then. It did not cause the crisis. It may have caused another crisis in the way I just described, but unemployment is an effect of the crisis rather than a cause of the crisis.

DC: Thank you, and thank you for your time and this opportunity to meet with you.