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PART I

Theoretical and Historical Foundations

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1 *Economic Ideas in Political Time: Construction, Conversion, and Crisis*

1.1 Introduction: The Problem and Argument

Economic policy is marked by a recurring paradox: stability and order often lead to instability and crisis. Consider the United States over the past century, as it has been marked by shifts from the recurring construction of economic policy orders – or sets of ideas, institutions, and interests – to their collapse in moments of instability and crisis.[1] Over the foundational Progressive era, through the rise of mid-century Keynesianism, and to the more recent Neoliberal era, regulatory frameworks that initially restrained abuses of market power and speculative excesses have repeatedly eroded, as deregulation and overconfidence in macroeconomic fine-tuning have enabled the reemergence of market power, speculation, and crises. First, while the Progressive order enabled the construction of basic macroeconomic institutions such as the Federal Reserve, it would collapse as overconfidence in monetary fine-tuning fueled the bull market of the 1920s, the Great Crash, and the Great Depression. Similarly, while the Keynesian order that emerged from the 1930s initially enabled postwar stability, overconfidence in the fiscal fine-tuning of the 1960s eventually led to the emergence of the wage-price spirals and Great Stagflations of the 1970s. Finally, even as the Neoliberal order that emerged in the early 1980s set the stage for the Federal Reserve's monetary fine-tuning of the 1990s, overconfidence in a Greenspan-era "Great Moderation" would see the subprime bubble collapse in the Global Financial Crisis. Over each era, stability has fueled instability, spanning shifts from order construction to crisis in "political time."[2]

[1] On a similar view of orders as ideas and interests embedded in institutions, see Skowronek (1993; 2011).
[2] On political time, defined with respect to the stages of a political order, see Skowronek (1993; 2011).

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What explains the rise and fall of such orders, and to what extent has stability itself caused instability and crisis? In recent decades, economists have widely stressed the innate instability of markets, casting them as prone to waves of psychological overreactions and self-reinforcing collapse. In the tradition of scholars such as John Maynard Keynes, John Kenneth Galbraith, and Hyman Minsky, these analyses have held that "stability breeds instability," as fading memories of risks eventually prompt revived risk taking.[3] For example, writing from a historical perspective, Carmen Reinhart and Kenneth Rogoff have stressed the importance of recurring enthusiasms for new technologies and production possibilities, while behavioral economists such as George Akerlof and Robert Shiller have focused on the psychological bases of Keynesian-styled "animal spirits."[4] In policy debates, such views have been espoused even by market enthusiasts such as former Federal Reserve Chairman Alan Greenspan and Treasury Secretary Timothy Geithner. For example, Greenspan argued that where "a surge of exuberance … causes people to reach beyond the possible," market bubbles ensue – at least until "reality strikes home" and exuberance "turns to fear," which precipitates "a severe falloff of economic activity."[5] Similarly, addressing the Global Financial Crisis, Geithner argued that "stability can produce excessive confidence, which produces the seeds of future instability."[6]

Yet, even as such economic analyses offer useful insights, they are limited where they obscure shifts in *political* orders, as ideas and institutions that initially restrain market power and stabilize expectations come to obscure new sources of market power and speculative excess. To highlight such overlooked political dynamics, I integrate in this book insights from constructivist and discursive institutionalist perspectives, offering a *social psychological institutionalism*. This approach moves beyond a rationalist stress on the construction and institutionalization of policy orders to emphasize the sources of their diminishing stability, as agents *repress* shifting types of information in

[3] Galbraith (1954); Keynes (1936a; 1937); Minsky (1986; 1992); see also MacKay (1841).
[4] Akerlof and Shiller (2010); Reinhart and Rogoff (2009).
[5] Greenspan (2007, 17, 466).
[6] Geithner (2014, 67–69, 392); see also Yellen (2009; 2014) on Minsky, risk and crisis.

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ways that see stability yield to instability.[7] Formalizing these insights, I offer a staged model of the social construction of policy orders, their intellectual conversion, and the onset of misplaced certainty and crisis. First, addressing the *principled construction* of such orders, I stress the role of interpretive leaders in establishing the value-laden bases of regulatory restraints on market power and speculative excesses.[8] Second, shifting to their *intellectual conversion*, I argue that subsequent economic stability can enable intellectual and institutional agents to exclude principled ideas from debate, refining instead macroeconomic models that guide fiscal or monetary fine-tuning. These include the Phillips curve trade-off – which guided the postwar use of fiscal policy to strike a balance between inflation and unemployment – and the more recent Taylor rule – which weighs concerns for growth and inflation in setting interest rates.[9] Finally, I argue that as such models blind policymakers to new sources of market power and speculation, *misplaced certainty* gives rise to renewed crisis.[10]

Having advanced this model, I offer a history tracing the development of US economic policy over three stages, as the Progressive, Keynesian, and Neoliberal orders each underwent their construction, conversion, and crises. First, I address their principled construction, as Theodore Roosevelt, Franklin Roosevelt, and Ronald Reagan provided principled justifications for efforts to rebalance market power and restrain speculative expectations. Second, I address their intellectual conversion, as these principled justifications were reduced to macroeconomic models and regulatory restraints were displaced in favor of policy fine-tuning – in the Wilson-era establishment of the

[7] On constructivism, see Best (2005; 2008); Blyth (2002); Hay (1996); Ross (2006); Ruggie (1982); and Wendt (1999). On historical institutionalism, see Capoccia and Kelemen (2007); Mahoney and Thelen (2010); and Pierson (2000; 2004); on discursive institutionalism, see Schmidt (2008; 2010; 2013); on incremental change, see Baker (2013); Blyth (2013); Carstensen (2011); Helleiner (2010); Moschella and Tsingou (2013); Seabrooke (2006); and Tsingou (2014); on rationalism in materialist and constructivist approaches, see Fearon and Wendt (2002). On repression and its forms, see Kaplan (1957); Kahneman (2011)

[8] Following Keynes (1936a, 158), I use the term "speculation" to encompass monetary and financial trends driven by "the psychology of the market," as market expectations come to assume lives of their own.

[9] On the Phillips curve, see Samuelson and Solow (1960). On the Taylor rule, see Taylor (1993).

[10] On misplaced certainty, see Mitzen and Schweller (2011).

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Federal Reserve, the Kennedy-era rise of the Council of Economic Advisers, and the Greenspan-era reemergence of the Federal Reserve. Finally, I trace the destabilization of orders as misplaced certainty in fine-tuning obscured the emergence of new imbalances of market power and speculative pressures, in ways that help explain the onset of the Great Depression, Great Stagflation, and Global Financial Crisis.

1.2 Theoretical Overview: Paradigmatic and Institutional Perspectives

Stability causes instability. Over time, ideas and institutions that initially enable policymakers to limit abuses of market power and speculative excess can evolve in ways that obscure new concentrations of market power and speculative excesses. Yet, in prevailing Political Economy debates, the notion that stability causes instability represents an "impossible" contradiction, obscured by rationalist assumptions that agents make efficient use of information.[11] More specifically, rationalist assumptions have shaped two sets of paradigmatic and institutionalist debates, leading scholars to overrate the scope for self-correcting stabilization and to obscure the sources of self-reinforcing instability. On the one hand, paradigmatic debates have seen realist, liberal, and constructivist perspectives cast crises as exogenous shocks to systemic, coalitional, or ideational structures, which then spur state, societal, and norm entrepreneurs to establish self-reinforcing orders.[12] On the other hand, in institutionalist debates, rational choice, sociological, and historical institutionalist approaches have stressed not only the importance of "critical junctures" that enable the construction of orders but also the subsequent roles of distributional incentives, norms, and organizational mechanisms that can enable their self-reinforcing institutionalization.[13] Taken together, even

[11] On rationalism, see Fearon and Wendt (2002); Finnemore and Sikkink (1998); and Muth (1961).

[12] On neorealism, see Gilpin (1981); on neoliberalism, see Gourevitch (1986); on constructivism, see Finnemore and Sikkink (1998) and Wendt (1999); on the limits to paradigmatic debates, see Jackson and Nexon (2013).

[13] On historical institutionalism, see Capoccia and Kelemen (2007) and Pierson (2000; 2004); on sociological institutionalism, see DiMaggio and Powell (1991); Dobbin (1994); and Kim and Sharman (2014); on rational choice institutionalism, see Shepsle (2006); for an overview, see Fioretos (2011) and Hall and Taylor (1996).

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as these perspectives have offered insights into the development of policy orders, this has come at a cost where their rationalist foundations have obscured the sources of order dysfunction and decline.

In this theoretical introduction, I advance beyond these rationalist premises by arguing for a social psychological institutionalism, building on the above-discussed insights regarding the construction and institutionalization of orders, but also stressing the inefficiencies that can see agents repress shifting types of ideas in ways that cause renewed instability. First, engaging paradigmatic debates, I note the limits of materialist and constructivist emphases on the shifts in power and ideas that shape self-reinforcing orders, as each obscures the ways in which misplaced confidence in power *or* ideas can hasten self-reinforcing collapse. However, I also highlight recent constructivist innovations that redress these limitations by directing attention to the social tensions that can fuel policy pathologies and self-reinforcing instability.[14] Second, engaging institutionalist debates, I argue that approaches which cast incentives, norms, and organizational arrangements as sources of self-reinforcing stability can similarly obscure the potential for self-reinforcing crisis. Yet, I also suggest that recent institutionalist innovations can offset such limitations – as historical institutionalists have stressed the scope for incremental change, and discursive institutionalists have stressed the tensions between different types of principled and causal ideas that can fuel renewed instability.[15] Taken together, by moving beyond rationalist assumptions, these new constructivist and institutionalist insights can enable a more social psychological analysis, premised on assumptions that principled and causal ideas shape the interests of agents, but that agents, in turn, reinforce or repress them in ways that can fuel tensions over time. In a further refinement, to stress the temporal context of such shifts, I draw on Daniel Kahneman's social psychological insights regarding shifting interpretive biases – as "fast thinking" affective interpretations yield to "slow thinking" intellectual adjustments.[16] Over the following

[14] On tensions and pathologies, see Barnett and Finnemore (2004); Best (2005; 2008); Ross (2006); and Hopf (2010). Blyth (2002, 36n) foreshadows these possibilities, suggesting the need to stress "the underlying destabilization of institutions," pointing toward a "Keynes/Kalecki/Minsky model of this uncertainty."

[15] On incremental change, see Mahoney and Thelen (2010); on discursive tensions, see Schmidt (2008; 2010).

[16] Kahneman (2011).

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sections, I develop these arguments, offering a social psychological institutionalist model of order construction, conversion, and crisis.

Paradigmatic Turns: Material and Social Structures Lead to Self-Sustaining Interests

In recent decades, political economists have engaged in paradigmatic debates over the importance of systemic, coalitional, or ideational influences on state interests. While realists and liberals offer "first cut" insights into the effects of market power on interests, constructivists offer a broader recognition of the ideas that shape varying interpretations of power and interests. Yet, where realists, liberals, and constructivists alike have overrated the efficiency with which agents interpret material *or* ideational incentives, each risks obscuring the scope for self-reinforcing instability. Redressing such oversights requires building on more recent constructivist work emphasizing the inefficiencies that fuel instability and crisis.

Realism and Liberalism: Interests as Given; Instability Obscured

Consider first realist perspectives. While stressing international rather than comparative dynamics, these place a foundational stress on the distribution of power, arguing that a hegemonic state is necessary to maintain a stable, open global economy. Such analyses stress the importance of US hegemony to the postwar Bretton Woods order – and conversely highlight the role of US decline over the 1960s and 1970s, as capital mobility impeded its ability to reconcile global growth and currency stability.[17] Nevertheless, despite their descriptive merit, they remain limited where they obscure not only the scope for variation in hegemonic interests but also the sources of hegemonic decline and crisis. First, hegemonic interests can vary – as even hegemons must interpret their interests. For example, while the British hegemony of the nineteenth century promoted a deflationary gold standard, the US hegemony of the twentieth century favored an inflationary gold-exchange standard. Second, to the extent that hegemonic stability theorists have employed rationalist assumptions, this has obscured the inefficiencies

[17] See Gilpin (1981) and Keohane (1984) on hegemony; Andrews (1994) on capital mobility.

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that can fuel overconfidence and instability over time, forcing reliance on ad hoc exogenous shocks to explain change. This obscures the ways in which hegemonic states may overrate their ability to fine-tune the global economy, as when the diminishing effectiveness of US efforts to contain the interrelated wage, price, and currency instability of the 1960s and 1970s contributed to the collapse of the Keynesian order. Similarly, US officials overrated their abilities to contain the subprime bubble of the 2000s, in ways that presaged the Global Financial Crisis. In this light, realist analyses obscure the scope for variation in state interests and the ways in which hegemonic stability can cause instability and crises of hegemonic orders.

Offering one alternative, liberal perspectives acknowledge the scope for variation in state interests, but shift their focus to intervening domestic struggles to explain such variation. Stressing the ways in which "policy requires politics," scholars such as Peter Gourevitch and Barry Eichengreen emphasize the effects of "major downturn(s)" in the business cycle on the relative power of capital or labor, in ways that drive subsequent policy realignments.[18] From this perspective, while the Great Depression weakened the position of capital, it enabled labor support for a greater stress on wage growth and the use of Keynesian macroeconomic policy to sustain demand. Likewise, while the Great Stagflation of the 1970s weakened labor, it enabled the reemergence of capital and liberalization of financial markets. Yet, liberal approaches still remain limited in key ways. First, just as hegemonic states must interpret their interests, coalitional agents can interpret market incentives in varied ways. Consider that postwar business often *favored* wage-price regulation as it held down labor costs, while labor often *opposed* controls as impediments to collective bargaining. Second, just as realists underestimate the scope for hegemonic hubris, liberals obscure the scope for domestic overconfidence – as societal agents overrated the ability of policymakers to contain the wage-price spirals of the 1970s and the asset-price bubbles of the 2000s. In sum, liberal analyses obscure the scope for variation in societal interests and the ways in which coalitional stability can cause instability and crises of coalitional orders.

[18] Eichengreen (1992; 1996); Gourevitch (1986, 17, 20).

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Constructivism: Interests as Variable; Instability Unexplained

In contrast to realist and liberal approaches, constructivist perspectives highlight the ideas that shape state and societal interests, on grounds that material incentives must always be interpreted in social contexts – which in turn shape agents' interests. To be sure, constructivists do not suggest that material incentives do not exist – only that they do not "speak for themselves" and so can be interpreted in a range of fashions. Indeed, as Alexander Wendt argues, ideas *are* interests, or "beliefs about how to meet needs."[19] From this perspective, what matters most in explaining the rise and fall of economic policy orders are not simply material shifts, but rather changes in the ideas that give them meaning.[20] For example, addressing the postwar order, John Gerard Ruggie and Mark Blyth argue across international and comparative settings that "embedded liberal" ideas shaped US views of hegemonic purposes, leading it to construct a Keynesian order that limited pressures for austerity and promoted full employment.[21] Characterizing the emergence of such ideas, constructivists highlight their self-sustaining nature, as they acquire "lives of their own" that enable a self-reinforcing stability. For example, Martha Finnemore and Kathryn Sikkink model a "norm life cycle" in which norm entrepreneurs persuade leaders to accept new "standards of behavior." In turn, as leaders succeed in convincing broader audiences of their merit, this can set off "norm cascades" in which norms or ideas are internalized, acquiring a "taken-for-granted quality."[22] Similarly stressing self-reinforcing possibilities, Blyth casts crises as giving rise to "Knightian" uncertainty, in which "unique events" leave agents "unsure as to what their interests actually are." In such settings, agents use ideas "to reduce uncertainty, redefine their

[19] Wendt (1992; 1999, 130); see also Blyth (2002, 29–30).

[20] In economic policy terms, constructivists have the advantage of highlighting the socially constructed bases of policy orders, highlighting a wider array of policy possibilities. For example, constructivist analyses call into question notions of macroeconomic trade-offs – like the systemic "impossible trinity" of capital mobility, full employment, and monetary stability or the domestic Phillips curve trade-off between employment and inflation. Instead, constructivists counter that such trade-offs are always based in ideas which can either highlight impediments to cooperation or enable agents to recognize possibilities for shared efforts to stabilize currencies, wage-price expectations, or speculative dynamics. Widmaier (2004).

[21] Blyth (2002); Ruggie (1982).

[22] Finnemore and Sikkink (1998, 895).

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