Economic Ideas in Political Time

Over the past century, the rise and fall of economic policy orders have been shaped by a paradox, as intellectual and institutional stability have repeatedly caused market instability and crisis. To highlight such dynamics, this volume offers a theory of *Economic Ideas in Political Time*. The author counters paradigmatic and institutionalist views of ideas as enabling self-reinforcing path dependencies, offering an alternative social psychological argument that ideas which *initially* reduce uncertainty can *subsequently* fuel misplaced certainty and crises. Historically, the book then traces the development and decline of the Progressive, Keynesian, and Neoliberal orders, arguing that each order's principled foundations were gradually displaced by macroeconomic models that obscured new causes of the Great Depression, Great Stagflation, and Global Financial Crisis. Finally, in policy terms, Widmaier stresses the costs of intellectual autonomy, as efforts to "prevent the last crisis" have repeatedly obscured new causes of crises.

WESLEY W. WIDMAIER is an associate professor of Political Science at Griffith University, in Brisbane, Australia, where he has advanced parallel research agendas into the construction of economic crises and wars as mechanisms which drive large-scale change. Over the past decade, his research has been published in such journals as *International Studies Quarterly, Review of International Political Economy, New Political Economy, Review of International Studies*, and *the European Journal of International Relations*. Dr. Widmaier served as 2014 Program Chair and 2015 Section Chair of the International Political Economy Section of the International Studies Association, and is Lead Editor of *Review of International Political Economy*.

Advance Praise for *Economic Ideas in Political Time*

"One of the rediscovered wisdoms of the financial crisis was Hyman Minsky's line that 'stability breeds instability.' The line was good, but the puzzle was why that should be the case? Minsky's answer was the growth of Ponzi finance. Wes Widmaier gives us another: that periods of institutional construction marked by a politics of principle inevitably give way to a politics of technocratic maintenance that mistakes stability in models for stability in the world. These disjunctures in political time, between models and the world, generate regime-changing crises. Minsky has just been given political microfoundations."

Mark Blyth, Eastman Professor of Political Economy, Brown University

Economic Ideas in Political Time

The Rise and Fall of Economic Orders from the Progressive Era to the Global Financial Crisis

WESLEY W. WIDMAIER
Griffith University, Queensland

CAMBRIDGE
UNIVERSITY PRESS

CAMBRIDGE
UNIVERSITY PRESS

University Printing House, Cambridge CB2 8BS, United Kingdom

Cambridge University Press is part of the University of Cambridge.

It furthers the University's mission by disseminating knowledge in the pursuit of education, learning, and research at the highest international levels of excellence.

www.cambridge.org
Information on this title: www.cambridge.org/9781316604571

First published 2016

A catalogue record for this publication is available from the British Library.

Library of Congress Cataloging-in-Publication Data
Names: Widmaier, Wesley, author.
Title: Economic ideas in political time: the rise and fall of economic orders from the progressive era to the global financial crisis / Wesley W. Widmaier.
Description: New York: Cambridge University Press, 2016. |
Includes bibliographical references and index.
Identifiers: LCCN 2016010904 | ISBN 9781107150317 (hardback) |
ISBN 9781316604571 (paperback)
Subjects: LCSH: Economic history. | Economic policy. |
Economic development. | Global Financial Crisis, 2008–2009. |
BISAC: POLITICAL SCIENCE / Economic Conditions.
Classification: LCC HC21.W53 2016 | DDC 330.1–dc23
LC record available at https://lccn.loc.gov/2016010904

ISBN 978-1-107-15031-7 Hardback
ISBN 978-1-316-60457-1 Paperback

Contents

Preface

Just as generals are often criticized for "fighting the last war," economic policymakers often remain focused on "preventing the last crisis." Consider that in June 2008, just three months before the collapse of Lehman Brothers and onset of the Global Financial Crisis, Federal Reserve Chairman Ben Bernanke raised alarms regarding a possible revival of 1970s-styled stagflation – in which rising oil prices could fuel a renewed wage-price spiral. Testifying before the Senate Committee on Banking, Housing, and Urban Affairs, Bernanke warned of an "increase in upside inflation risk" and expressed concerns that "inflationary impulses from commodity prices are becoming embedded in the domestic wage- and price-setting process."[1] Such concerns for wage-price pressures reflected the Federal Reserve's continued reliance on models that stressed the interplay of unemployment and inflation, while obscuring the concentrations of financial market power and speculative dynamics that would bring on the Global Financial Crisis.[2] Nevertheless, Bernanke would later argue that nothing had been wrong with prevailing models – they simply had not been designed to prevent financial crises. Looking back, Bernanke would concede that "standard macroeconomic models … did not predict the

[1] Bernanke (2008b).
[2] Echoing the 1960s Phillips curve, which charts an unemployment-inflation trade-off, the 1990s witnessed the rise of a Taylor rule, which balanced concerns for growth and inflation in devising a rule governing interest rate targets. On the Phillips curve, see Samuelson and Solow (1960); on the Taylor rule, see Taylor (1993; 2009); on links between the Phillips curve and Taylor rule, see Koenig, Leeson, and Kahn (2012); and on the policy relevance of the Taylor rule, see Greenspan (2004a) and Yellen (1996; 2012). For an analysis that stresses the need to apply the rule with discretion, see Bernanke (2015). Significantly, just ten days after Bernanke's July 2008 testimony, Federal Open Market Committee (FOMC) (2008a, 111) deliberations would see Taylor rule arguments used by FOMC member Janet Yellen as a justification for considering a shift toward raising interest rates.

crisis, nor did they incorporate very easily the effects of financial instability." Indeed, posing the question of whether "these failures of standard macroeconomic models mean that they are irrelevant or at least significantly flawed," Bernanke offered "a qualified no," arguing that

> economic models are useful only in the context for which they are designed. Most of the time, including during recessions, serious financial instability is not an issue. The standard models were designed for these non-crisis periods, and they have proven quite useful in that context.

Despite their flaws, Bernanke accordingly lauded such models for having "helped deliver low inflation and macroeconomic stability … during the two decades that began in the mid-1980s."[3]

In advancing such claims, Bernanke can be seen as evincing the main argument of this book – that ideas which *initially* reduce uncertainty and enable stability can *subsequently* fuel misplaced certainty, instability, and renewed crisis. In the case of the Global Financial Crisis, ideas stressing the potential reemergence of the long-vanquished wage-price spirals of the 1970s obscured the asset-price instability that had brought the economy to the brink of collapse. Yet, such dysfunctional dynamics have been obscured where Political Economy debates have been premised on rationalist assumptions that agents use information efficiently – in ways that have led scholars to overrate the scope for self-sustaining stability and to underrate the inefficiencies that can fuel self-reinforcing instability and crisis.[4]

In this volume, I redress such oversights by offering a "social psychological institutionalist" model, one which assumes that even as economic ideas can initially limit uncertainty and enhance stability, agents

[3] Speaking to this stress on macroeconomic variables, George W. Bush (2010, 453) would recall being "surprised by the sudden crisis. My focus had been kitchen-table economic issues like jobs and inflation. I assumed any major credit troubles would have been flagged by the regulators or rating agencies." Echoing Bernanke in heralding prevailing models, Paul Krugman would laud an "MIT style" that entails the "use of small models applied to real problems, blending real-world observation and a little mathematics to cut through to the core of the issue" (Miller and Ryan, 2012). Put simply, one might argue that Bernanke and Krugman effectively reduce the scope for economic policy debate to what can be fit within macroeconomic models. Quote in text from Bernanke (2010c).

[4] On policy orders – broadly defined as sets of ideas, institutions, and interests – see Skowronek (1993; 2011); on rationalist assumptions regarding efficiency in the use of information, see Fearon and Wendt (2002).

can also refine such ideas in ways that engender a misplaced certainty, instability, and renewed crises.[5] Developing a staged model, I argue first that the *principled construction* of economic policy orders often sees interpretive leaders issue value-laden appeals for regulatory restraints on market power and speculative abuses. Second, I argue that where these efforts succeed, the resulting stability can ironically enable the *intellectual conversion* of principled restraints into Bernanke-styled "standard models" that guide fiscal or monetary fine-tuning. Finally, I argue that as such refined models fuel *misplaced certainty* regarding policy effectiveness, they can obscure new sources of market power and speculative excess that culminate in crises. Having developed this approach, I apply it to offer insight into economic policy development over the past century – distinguishing Progressive, Keynesian, and Neoliberal orders, as each saw stability yield to instability in ways that brought on the Great Depression, Great Stagflation, and Global Financial Crisis. The result is to highlight a recurring paradox, as stability causes instability – and efforts at "preventing the last crisis" help to bring on the next one.

[5] On constructivism, see Best (2005; 2008) and Blyth (2002); on discursive institutionalism, see Schmidt (2008; 2010); for social psychological insights into fast and slow thinking across time, see Kahneman (2011).

Cambridge University Press
978-1-107-15031-7 - Economic Ideas in Political Time: The Rise and Fall of Economic Orders from the Progressive Era to the Global Financial Crisis
Wesley W. Widmaier
Frontmatter
More information

Acknowledgments

No book is truly a solo project, and I owe a range of intellectual debts to colleagues who have provided key insights. These include David V. Edwards, James Galbraith, Alexander Wendt, Jacqueline Best, Andrew Baker, Mlada Bukovansky, Rawi Abdelal, Jeff Chwieroth, Colin Hay, Rodney Bruce Hall, Eric Helleiner, David Andrews, Vivien Schmidt, John Ravenhill, Juliet Johnson, Cornell Ban, Ben Clift, Andrew Ross, Oddny Helgadottir, Robert H. Cox, Martin Carstensen, Daniel Mügge, Matthias Matthijs, Manuela Moschella, Orfeo Fioretos, Kate Weaver, Susan Park, Charlotte Epstein, Jason Sharman, Jarrod Hayes, Ian Hall, Renee Jeffrey, Juan Wang, Luke Glanville, Sara Davies, Jacquie True, Juanita Elias, Stephen Bell, Steven Feng, Frank Smith, Dennis Grube, Alex Bellamy, Patrick Weller, Haig Patapan, Giorel Curran, Elizabeth Van Acker, John Kane, Cosmo Howard, Yi-Chong Xu, John Parkinson, Shannon Brincat, Duncan McDonnell, Luis Cabrera, and Andrew O'Neil, as well as participants in seminars at the Griffith Asia Institute and Griffith Centre for Governance and Public Policy. One of the earliest iterations of this project came in a seminar through the "Warwick Manuscript Development" (WMD) initiative led by Leonard Seabrooke – who offered feedback on the entire manuscript. For their insights at this WMD seminar, I also owe thanks to James Brassett, Lorraine Elliott, Lena Rethel, and Eleni Tsingou. Finally, like anyone working in the field of Political Economy, I owe thanks to Mark Blyth – for having advanced debate and for his insights regarding this project. For financial support, I owe thanks to the Griffith Asia Institute and the Griffith Centre for Governance and Public Policy, as well as the John F. Kennedy and Lyndon B. Johnson Presidential libraries, and the Australian Research Council for ARC Discovery Project grant DP130104088, with Dr. Richard Eccleston and ARC Future Fellowship FT100100833. Finally, I owe a huge debt of gratitude to John Haslam, Carrie Parkinson, and Ian McIver, my editors at Cambridge, whose support and insights have been crucial to the development of this project.

On a personal note, I owe some special expressions of love and gratitude: first, to Declan and Daisy, and Henrietta, Abbey, Gigi, and Maynard – two dogs and four cats – Michelle and I miss you all. Second, I could not have written this book without the love and motivation of my three beautiful daughters, Chloe, Brynn, and Scarlett – and I now look forward to spending much more time with each of them. Finally, I owe my greatest thanks and love to my wife, Michelle, who followed me half way around the world. Without her love and support, I could not have finished this book, and so I dedicate it to her – as I have been, and always shall be, hers.