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The Institutionalist Roots of Macroprudential Ideas:
Veblen and Galbraith on Regulation, Policy Success and Overconfidence

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One consequence of the Global Financial Crisis has been to prompt debate over macroprudential regulation – meant to limit private risk-taking that threatens systemic stability. In this paper, we stress the roots of macroprudential ideas in the Institutionalist economics of Veblen and Galbraith in a way that highlights both unrecognized policy possibilities and underappreciated impediments to policy effectiveness, arguing in particular that regulatory success can breed overconfidence. First, we argue that while Veblen's views anticipated macroprudential arguments, they also obscured tensions between the technocratic acumen of policy 'engineers' and popular legitimacy. Secondly, we argue that while Galbraith's views similarly shaped the postwar Keynesian policy mix, they also echoed Veblen in underrating the potential for populist resentment of an intellectual 'technostructure'. We conclude that while this analysis can be seen as highlighting an overlooked century of macroprudential debate, it also demonstrates the potential for technocratic overconfidence – which can eventually undermine policy legitimacy and effectiveness.

Introduction and Overview

In the aftermath of the Global Financial Crisis, ideas justifying 'macroprudential regulation,' that were intended to prevent private choices from threatening systemic instability, rose to prominence in a remarkably short period of time (Borio 2011; Baker 2012).[1] Building macroprudential regulation has become an accepted priority in most major financial centres. New agencies for the evaluation of systemic risk have been created in the form of the Financial Stability Oversight Council in the US, the European Systemic Risk Board (ESRB) in Europe and the Financial Policy Committee (FPC) in the UK. Concerted efforts are currently underway amongst the international community of central bankers and regulators to construct functioning macroprudential policy regimes. Key macroprudential concepts such as procyclicality, herding and fallacy of composition have an obvious intellectual lineage that can be traced to Keynes, Minsky, and others, who focused on how the behavioral dispositions of those trading in financial markets increase the likelihood of "macro-level" financial instability (Baker, 2012; Datz, 2012). However, there is also a less well-known intellectual genealogy of contemporary macroprudential debates that can be traced to the Institutional economics of Thorstein Veblen and John Kenneth Galbraith. In this article, we uncover these hidden intellectual roots, effectively tracing a century of evolving macroprudential debate. In the process, we also highlight key weaknesses of macroprudential regimes, as the misplaced emphases of Veblen and Galbraith on the technocratic role of policy 'engineers' or managerial 'technostructures' hold relevance to theoretical debates over the limits to rationality and policy debates over legitimacy and effectiveness. In particular, we argue that Veblen and Galbraith each overlooked key ways in which intellectual refinement could paradoxically impede policy legitimacy, in ways that could eventually compromise policy performance itself.

In developing these themes over this paper, we first characterize the contemporary macroprudential project, as it envisions increased regulatory efforts to contain self-reinforcing asset-price spirals, yet risks diminishing legitimacy given the need for technocratic autonomy in such efforts. To encapsulate this dilemma, we then introduce a psychologically-oriented constructivist analysis, one juxtaposing the popular bases of paradigmatic beliefs with intellectual tendencies to overconfidence that can ironically erode these same popular foundations. In the third and fourth sections, we apply these insights to historical analyses of the popular bases of Veblen's and Galbraith's proto-macroprudential ideas – and their erosion, as each grew vulnerable to technocratic overconfidence: First, while Veblen's arguments accorded with Progressive regulatory debates, his faith in technocratic possibilities – e.g., as he called for the establishment of a 'Soviet' of economic 'engineers' – foreshadowed neglect of concerns for legitimacy and potential populist backlash. Second, while Institutionalist views regained influence over the postwar decades as Galbraith integrated them with Keynesian insights, Galbraith would likewise underrate concerns for legitimacy in arguing for governance by an expert 'technostructure'. Turning to the conclusion, we suggest that while Institutionalists offered important insights concerning the usefulness of regulation in the policy mix, they underrated the importance of legitimacy to sustaining such measures. To highlight these dynamics, we develop in closing Schmidt's (2012) disaggregated notion of legitimacy, as she highlights the interplay of *input* legitimacy, based in popular values, *throughput* legitimacy, based in the openness of government, and *output* legitimacy, defined with respect to utilitarian policy merit. Emphasizing their cumulative nature, we argue that where technocratic acumen obscures the need for governmental engagement, the consequent reductions in throughput legitimacy can feed back on economic output and policy performance – and so erode output legitimacy itself. More broadly, as Seabrooke (2006-2007) argues, we highlight the ways in which popular disengagement can give rise to 'legitimacy gaps' over time.

The Current Macroprudential Project: Technocratic and Populist Bases

Macroprudential regulation (MPR) is a systemic approach to financial stability that seeks to 'curb the credit cycle' through countercyclical interventions involving the imposition of restraints on the activities of private institutions to limit asset price volatility – in a way that potentially stands to reduce the need for macroeconomic restraint. More broadly, a macroprudential approach involves treating the financial system as a whole, viewing risk as a systemic and endogenous property, rather than focusing solely on the safety and soundness of individual institutions.[2] In this regard, macroprudential thinking draws on the notion of 'fallacy of composition' – recognizing that individual incentives and the courses of action that flow from these do not necessarily result in desirable aggregate or systemic outcomes (Borio 2011). Similarly, macroprudential thinking recognizes that prices in financial markets can be driven to extremes by a combination of procyclicality and herding behavior. Procyclicality involves the calculation of risk following prices, meaning that the supply of credit fuelling investment is most plentiful when least needed (when asset prices are rising) and least plentiful when most needed (when asset prices are falling) (Borio, Furfine and Lowe

2001, Borio and White 2004; White 2006; BIS 2006). Herding involves individuals deferring to the judgements of others, failing to make efficient use of information (Haldane 2010; 2011). A final macroprudential concept emphasizes the complex interconnected nature of contemporary financial systems, (what BIS economists call the cross-sectional dimension (Borio, 2011,) in which, small events can trigger a much more severe series of chain reactions (Haldane and May, 2010).

To offset such tendencies, the stated objective of macroprudential policy is to moderate credit supply over the cycle, tightening policy in a boom and lowering it in a bust (Bank of England 2011). For example, the most commonly cited macroprudential policy instrument is the counter cyclical capital buffer, a variant of which has been in operation in the Spanish banking system for some time. The idea behind a counter cyclical capital buffer is to lean against the credit cycle based on a reference path of a normalised credit to GDP ratio. Deviations above the path involve a tightening of capital requirements for private lending institutions, while deviations below that path should involve a loosening of those requirements (Haldane 2012a). Other potential macroprudential instruments include constraints on bank leverage levels and maximum levels being placed on the levels of bank asset encumbrance. Finally, advocates of macroprudential regulation have stressed the ways in which a concentrated focus on limiting financial instability in a sector-specific setting can reduce the need for more general macroeconomic restraints – limiting the potential for the financial 'tail' to wag the real economic 'dog' (Blanchard, Dell'Ariccia and Mauro 2011).

However this stress on the scope for regulatory reach in turn has implications for the need for technocratic autonomy. A macroprudential policy regime requires regulators who have the technical capacity to recognize asset price bubbles through the use of analytical and mathematical techniques that identify deviations from normalised credit to GDP ratio paths. They also have to make judgments on necessary corrective actions and have the scope and autonomy to implement those actions. The contemporary macroprudential project, is to a large extent therefore, a technocratic project, designed by technocrats for technocrats (Engelen et al, 2010), precisely because it requires some degree of expansion in the powers and discretion of a new cadre of technocratic price engineers. The words, of the Bank of England's director of financial stability, Andrew Haldane, capture the technocratic aspirations of the macroprudential project. "If there were a benign enlightened regulatory planner, able to redirect competitive forces, this could potentially avert future tragedies of the financial commons. Fortunately there is" (Haldane, 2012a, p.12). Indeed, the technocratic inception and promotion of the macroprudential approach, would seem to accord with the frameworks developed by constructivists, that stress the importance of "norm entrepreneurs" who make efficient use of information in advancing policy change (Finnemore and Sikkink 1998, Baker, 2012).

The term 'macroprudential' itself was first used by the Cooke Committee – a forerunner of the Basel Committee on Banking Supervision BCBS – on 28-29 June 1979, to refer to how problems with a particular institution could have destabilising systemic implications (Clement 2010). Informal usage of the term continued throughout the 1980s and 1990s at the Basel based Bank for International Settlements (BIS), but it was after the Asian financial crisis that the research department at the BIS began to develop a fully fledged research programme and started forwarding macroprudential proposals (Borio, Furfine and Lowe 2001; Borio and White 2004; White 2006; BIS 2006; Borio and Drehman, 2008). These efforts were also given intellectual energy and credibility by the work of a number of academic and private sector economists such as Martin Hellwig, Avinash Persaud, Charles Goodhart, Hyun Song Shin, Markus Brunnermeir and development economists such as Jose Ocampo and Stephanie Griffith-Jones (Hellwig 1995; Persaud 2000; Goodhart and Segoviano 2004; Griffith, Jones and Ocampo 2006). Moreover, the ideational shift that followed the financial crash of 2008 largely involved technocrats from the BIS, together with some of the figures above and some officials from national central banks, exercising an 'insiders coup d'etat' to depose efficient markets orthodoxies (Turner 2011; Baker 2012).

Yet, even as the macroprudential ideational shift was advanced in key ways by technocrats, it could not have proceeded without support from G20 leaders and finance ministers, or without accord with broader public sentiments – in ways that go beyond a focus on norm entrepreneurs and technocratic contexts. Indeed, the offer of a more comprehensive regulatory agenda chimed with popular sentiment and the rise of populist politics seeking punishment for the banking sector following the crash of 2008.This climate created incentives for politicians to open debates about financial regulation to include broader social externalities (Thirkell-White 2009). Given this importance of popular contexts and leader support, we stress that while macroprudential regulation is a technocratic project, any discussion of its potential must recognize the ways in which technocratic insularity maybe self-limiting as it compromises popular legitimacy. In this light, our basic position is that 'we have all been here before': Veblen and Galbraith each advanced arguments in favour of technocratic interventions that foreshadowed the macroprudential case. To aid in structuring this argument, however, we briefly detour into a theoretical discussion of constructivist analyses of norm life cycles, entrepreneurs, and their limits.

Theoretical Context: Toward a Social Psychological Constructivism

To address the economic merit and political tensions in Veblen and Galbraith's views – as these may foreshadow macroprudential dilemmas – we advance a *social psychological constructivist* perspective, one which highlights not only the popular bases of paradigmatic views, but also the ironic ways in which paradigmatic refinement can weaken those very foundations. More formally, we make two broad assumptions: that shared public attachments to ethical values prefigure the paradigmatic bases of norms and interests, and that the repression of such paradigmatic understandings can in turn undermine policy legitimacy and effectiveness. Regarding the former, we build on the recent efforts of scholars who have argued that emotional or affective contexts prefigure more refined cognitive attachments, in ways that can help to enable the rise of *specific* norm entrepreneurs (Crawford 2000; Ross 2006). For example, from this vantage, the more egalitarian everyday values of the 1940s legitimated Keynesian ideas and imbued them with a self-reinforcing momentum. Likewise, the more libertarian values of the 1970s undermined the legitimacy of Keynesian policies in ways that presaged a Classical shift. Most recently, as we suggested above, the rise of macroprudential thinking also took place in a context in which public anger at banks surged (Thirkell-White 2009). Regarding the latter, we further assume that policy intellectuals may act over time less as efficient "norm entrepreneurs" than as inefficient agents who refrain from updating their beliefs in ways that impede policy efficiency. These tendencies arise as agents engage in the unconscious 'intellectual repression' of everyday values, and so fail to modify their beliefs (Kaplan, 1957). An example of such a phenomenon can be found in the inefficiencies of Keynesian intellectuals in the 1970s, as they failed to recognize shifts in public attitudes regarding the legitimacy of fiscal restraint or wage and price controls. Similarly, one might highlight the failures of Classical economists in the 2000s, as they overlooked the declining effectiveness of rules governing competition at containing the concentration of financial power – giving rise to an inefficient, unsustainable and pathological allocation of credit in contravention of supposedly efficient markets.

Taken together, this stress on the interplay of popular foundations and paradigmatic repression produces a dynamic model, in which popular values legitimate more refined intellectual beliefs, until the intellectual repression of such influences gives rise to inefficiency, overconfidence, and eventual crisis. Put differently, one might argue that policy development moves at 'two speeds': Where intellectuals resist change – as Daniel Kahneman (2011) puts it – they engage in 'slow thinking', as they fail to adapt to mounting pressures. In contrast, after crises, policymakers prove more flexible in responding to shocks – acting in 'fast thinking' ways which accord with rationalist analyses of ostensible norm entrepreneurs. Indeed it was this very process of 'fast thinking' that characterized the relatively rapid and sudden rise to prominence of the macroprudential frame after 2008, with changing popular sentiment reinforcing that momentum.

Over the following sections, we trace the evolving views of Veblen and Galbraith, and demonstrate the advantages of a social psychological constructivism in stressing limits to intellectual efficiency. In methodological terms, we employ an interpretive, broadly genealogical approach, shifting from “close” discussions of the theoretical discourses of Veblen and Galbraith to more “distant” discussions of their instantiation in Progressive and Keynesian policies (Gibbons, 1987). In the process, we demonstrate two parallel tendencies, as Veblen and Galbraith each: 1) initially accorded with the essentially macroprudential Progressive and Keynesian debates of their days; but subsequently, 2) evinced increasing intellectual tendencies toward teleological, ahistorical models – seen in Veblen’s overconfidence in regulatory ‘engineers’ and Galbraith’s stress on the rise of a ‘New Class’ and managerial ‘technostructure’. In broader terms, this analysis may be seen as according with a Deweyan pragmatism, one which recognizes the dynamic nature of expectations and the inevitable limits to any technocratic framework (Widmaier 2004). Given these parallel trends, we suggest in the conclusion that the challenge for IPE theory is to better understand the limits to intellectual rationality, and that the challenge for macroprudential regulation is to recognize that technocratic refinement may exist in tension with popular legitimacy – and even, after a time, policy effectiveness.

Veblen and the Institutionalist Bases of Progressivism

In developing the foundations of Institutionalist economics, Thorstein Veblem placed a recurring stress on the social bases of consumer, industrial, and regulatory interests (Hodgson 1998). From this vantage, – and in a way that accords with the concern of contemporary advocates of macroprudential regulation with procyclicality and herding – neither wage, nor price, nor share value increases can be reduced to macroeconomic aggregates, but can themselves reflect concentrations of market power and prevailing social moods. Resulting price irregularities are therefore seen to require more formal controls. In Progressive-era U.S., this justified a focus on structural developments like the rise of the modern corporation, monopolistic competition, and the separation of ownership from control – trends which together highlighted the need for regulatory efforts. Yet, the evolution of Institutional ideas and regulatory reach would not be unidirectional: By the end of World War I, even as Veblen developed more ambitious arguments for regulation by 'engineers', a popular backlash would commence and restrict the scope for policy over the next decade to monetary efforts – in a way that served to accelerate the market boom and presaged the eventual Great Crash. In this way, while Veblen's analyses initially accorded with Progressive-era views, the increasing intellectualization of his work led his work to grow at odds with prevailing debate – a potential pitfall for any contemporary macroprudential project.

Veblen on the Social Bases of Consumption, Industry and Management

In applied terms, Veblen (1898: 392-393; 1899; 93) argued that economic analysis must address 'the entire organic complex of habits of thought that have been shaped by past practices' to acknowledge the importance of 'institutions [and]… habits of thought'. This broad view would guide his work over the first two decades of the twentieth century, from early efforts like *Theory of the Leisure Class,* which highlighted the social bases of consumption, through *Theory of Business Enterprise,* which similarly addressed the social bases of corporate interests, to his *Engineers and the Price System,* which highlighted the possibilities for technocratic government to limit social and corporate excesses.

Theory of the Leisure Class remains Veblen's most-well-known effort. In part this was an analysis of the social bases of consumer excesses, with Veblen attacking assumptions regarding consumer sovereignty which stood at the heart of Classical frameworks. Veblen (1909:629) urged a greater recognition of the 'wants and desires [that shape an] individual's conduct [and] are functions of an institutional variable that is of a highly complex and wholly unstable character'. Veblen condemned elites engaged in 'conspicuous consumption' – or wasteful consumption and a deliberately idle lifestyle not out of any desire for utility, but rather to advance their social standing. This broad emphasis on the social construction of wants would foreshadow later criticisms of abuses of market power in the construction of private rather needs and monopolistic pricing.

In his later *Theory of Business Enterprise,* Veblen moved to apply this socialized analysis to an earlier point in the production chain, addressing the sources of corporate interests. In this regard, Veblen accorded with the Progressive dispositions of the day in stressing the importance of large organizations possessing market power. Highlighting the monopoly power enjoyed by industrialists and financiers, Veblen (1904: 2) argued that 'the business man… has become a controlling force in industry [and]…controls the exigencies of life under which the community lives'. Focusing on the implications for monopolistic prices, Veblen (1904:16) elaborated that the 'principle which guides producers and merchants… in fixing the[ir] prices… is… known in the language of the railroads as "charging what the traffic will bear".' However, Veblen went beyond noting increases in deadweight losses imposed upon society, to highlight an intellectual division of labor in which owners and 'captains of industry' found it increasingly difficult to comprehend the complexities of monopoly pricing. In such contexts, power in firms would shift from the owners of large firms to the 'engineers' who actually administered prices to maximize revenues – setting the stage for a potential emergence of tensions because the owners and managers of the modern corporation, with potential implications for regulatory efforts.

In *Engineers and the Price System,* Veblen again extended these themes to highlight potential social bases of regulatory interests – and the potential for a technocratic rebellion. In the process, he began by offering an expanded theory of industrial '*sabotage',* stressing the wasteful tendencies of corporate owners and managers. Traditionally, Veblen (1921: 5-7) argued, the notion of sabotage had been applied to laborers who 'resorted to such measures to secure improved conditions of work, or increased wages'. Yet, while often associated in a pejorative sense with strikes, Veblen argued that the term could be used to 'describe any manoeuvre of slowing-down, inefficiency, bungling, obstruction'. In this light, he highlighted tendencies to *monopolistic* sabotage, which entailed the 'delay and obstruction of industry' to 'maintain prices at a reasonably profitable level'. Given the rise of large corporations, Veblen (1921: 25; 34) argued that 'enterprise may fairly be said to have shifted from the footing of free-swung competitive production to that of a "conscientious withholding of efficiency".' Instead, the conscientious withholding of efficiency had come to require a degree of skill which exceeded entrepreneurs and businessmen, requiring 'systematic control under the direction of… "production engineers".'

Perhaps influenced by Wilsonian World War I-era idealism, Veblen then advanced a more explicit, if not teleological theory of how conflict between absentee owners or businessmen and engineers might be resolved. It would, he argued, reflect the emergence of a new kind of sabotage not by business, labor or the state, but by the technical elite itself, as it recognized the costs of absentee ownership for output and efficiency. In this context, Veblen (1921: 102-103) argued that the engineers would ‘draw together… and decide to disallow absentee ownership” through their own “ conscientious withdrawal of efficiency’ and so set off a ‘general strike, to include so much of the country's staff of technicians as will suffice to incapacitate the industrial system’. Having taken control of the industrial machine, they would then ostensibly run it more effectively.

While this faith in expert management reflected the basic ethos underlying the Progressive movement, Veblen’s early-1920s analyses in *Engineers and the Price System* stood at odds with the direction of prevailing sentiments, as Wilsonian idealism and efforts at reform had foundered in the postwar context. Indeed, the atmosphere of the Palmer raids and postwar red scare spoke to the reemergence of Hofstadter-styled anti-intellectualism – and the reformist impulses of the past two decades would dissipate in the context of a more limited focus on monetary policy.

Veblen, Progressivism and the Limits to Reform

To make sense of these latent limitations of regulation requires situating Veblen’s analyses in a sense of the rise and demise of Progressive-era politics. In a broad sense the Long Depression of the 1870s to the 1890s gave rise to the Populist monetary politics of the 1890s, which culminated in the 1896 defeat of the ‘free silver’ campaign of

Democratic candidate William Jennings Bryan. However, the reduction in concerns for deflation did not amount to a cessation of concern for financial instability, and so the agrarian stress on monetary politics yielded, with the rise of Theodore Roosevelt to the Presidency, to a Progressive movement focused on reform and regulation. Over the Roosevelt administration, efforts to limit corporate abuses of market power gave rise to new efforts at centralized wage bargaining and price control, to limit Veblen styled corporate and labor sabotage. To be sure, Roosevelt's aggressive approach to regulation – later termed the "New Nationalism" – was not the only variety of Progressivism. By 1912, in the three-way campaign that pitted Roosevelt, William Howard Taft and Woodrow Wilson against one another, Roosevelt's New Nationalism would be pitted against a Wilsonian 'New Freedom' which stressed the need for antitrust and liberalization.

Nevertheless, regulatory efforts increased in importance over the Wilson administration. Having secured passage of the Federal Reserve Act of 1913 – which made monetary policy possible in establishing a central banking system – and the Revenue Act of 1913 – which made fiscal policy possible in a progressive income tax – war would push Wilson even further towards a Rooseveltian stance. Even prior to U.S. entry, Wilson would establish public-private hybrid agencies in the War Industries Board, Price Fixing Committee, and Food and Fuel Administrations (Rockoff 1984: 43). These were designed with an eye to limiting the effects of wartime mobilization on prices. Working with a combination of direct legal sanction, fiscal restraint and moral suasion, they served to keep inflation in check, and reinforced Veblen's insights regarding the interplay of monopoly power and price control – as Frank Taussig (1919: 217), the Price-

Fixing Committee's chief economist noted in citing the stabilization of nickel prices – where the American Nickel Company stood as 'a single producer, in possession of a complete monopoly'.

Yet, the move toward increasing regulation would be slowed as what had been acceptable during the conflict would be viewed more skeptically in the context of postwar conversion. The end of the war spurred a backlash against crusading idealism across a variety of contexts, and so Veblen's support for governance by technocratic engineers would be undermined by the postwar emergence of a populist anti-intellectualism. As Arthur Schlesinger, Jr. (1957: 43-44) described this broader backlash, 'war had destroyed progressivism' and intellectuals now found themselves 'persecuted by the state' and if 'but a few had actual indictments hanging over them, all felt a sentence suspended over their enthusiasms, their beliefs, their innermost thoughts'. Over the next decade, regulatory instruments would be dismantled and Treasury Secretary Andrew Mellon's fiscal policy would be frozen in an expansionary stance, shrinking the scope for economic policy to monetary fine tuning. The abrupt nature of this retreat can be seen most clearly in the scuttling of the Commerce Department's Industrial Board, which was briefly set up in early 1919 to enable industry coordination in limiting the deflationary consequences of demobilization. Had industrial actors and Veblen-styled engineers been permitted to collude, this might have reduced the need for the Federal Reserve's postwar monetary tightening. However, the Commerce Board would almost immediately be dismantled, as the early postwar crusading spirit had yielded by May 1919 an aversion to regulation and revived faith in a New Freedom-styled stress on antitrust efforts and competition.

Over the 1920s, opposition to regulation – in a context of intellectual retreat and populist appeals to what Herbert Hoover termed a 'rugged individualism' – left monetary policy the sole means to economic stability. Where regulatory initiatives were attempted, they were often quickly rebuffed. For example, to reconcile tensions between real economic growth and asset price stability, the Federal Reserve in February 1929 briefly sought a limited regulation as it applied moral suasion in a statement asserting that 'a member bank is not within its reasonable claims for rediscount facilities… when it borrows… for the purpose of making speculative loans' (Galbraith 1954:33). While in the immediate context, this statement was followed by halt in the boom, by late March the National City Bank would issue $200 million in call market credit, preempting any regulatory revival. The effectiveness of direct pressure remains subject to debate, with monetarists like Friedman and Schwartz (1963) casting it as irrelevant, while Galbraith (1954) and Bernanke (2012a) suggesting that such efforts provide a useful first line of defense.

In this sense, Veblen's rising enthusiasm for regulatory initiatives from *Theory of the Leisure Class* to *Engineers and the Price System* ran counter to the direction of public sentiment. However, Veblen was not entirely unaware of these dynamics, noting a Hofstadter-styled anti-intellectual dynamic. Veblen (1921: 93) observed that the public often exhibited a 'sentimental deference… to the sagacity of its business men' and warned that 'popular sentiment in this country will not tolerate the assumption of responsibility by the technicians, who are in popular apprehension conceived to be a somewhat fantastic brotherhood of over-specialized cranks, not to be trusted out of sight except under the restraining hand of safe and sane business men'. Veblen so recognized –

in the abstract, and in a somewhat-condescending manner – that without widespread public legitimacy, technocratic regulators who owe their authority to their expertise, but have not bothered to build and nurture constituencies of support amongst the wider public, could find themselves in vulnerable and precarious positions. Such dynamics would in turn be evident in the evolution of Veblen's successors like Galbraith, who would build on Institutionalism to provide a regulatory basis for a Keynesian policy mix of regulation and macroeconomic fine tuning. Yet, even as this approach would produce prolonged postwar success in sustaining growth and limiting inflation, it would eventually confront diminishing popular support. Over time, as public skepticism in calls for wage and price restraint fed back on their effectiveness, no amount of technocratic sophistication could legitimate restraint.

Galbraith and the Institutionalist Context of the Keynesian Order

Over the decades following the Great Depression, John Kenneth Galbraith would integrate insights from American Institutionalism with the more macroeconomic insights of John Maynard Keynes in a way that laid the foundations for a postwar regulatory-macroeconomic 'policy mix'. This policy mix anticipated later aspects of macroprudentialism in its use of wage and price guidelines to address the institutional bases of the wage-price (in lieu of the asset-price) spiral, in a way that would increase the scope for monetary or fiscal expansion. Over the postwar decades, Galbraith (1958; 1967; 1973) would advance such arguments not so much as an academic economist but as a policy adviser to Presidents Roosevelt, Kennedy and Johnson and as a public intellectual in works like *The Affluent Society, The New Industrial State,* and *Economics and the*

Public Purpose. Yet, like Veblen, Galbraith did at times err in the direction of theoretical over-exuberance – as he overlooked the ways in which his elite 'technostructure' might fail to adapt to shifting public expectations – and by the end of the 1970s, found himself at odds with popular support for deregulatory initiatives.

Galbraith and the Institutional-Keynesian Consensus

To make sense of this evolution, it is necessary to highlight the theoretical, if not epistemological, accord between Institutionalist and Keynesian ideas. Paralleling Veblen, Keynes (1936; 1937, 113-114) stressed the intersubjective influences on state and market agents. Rejecting the view of markets as efficient in the use of information, similar to the contemporary macroprudential case, he argued that the Classical theory 'assumes that we have a knowledge of the future of a kind quite different from that which we actually possess' and leads economists to downplay the weight of *uncertainty* in shaping agents' choices. Rather than viewing uncertainty as a form of subjective doubt or as merely distinguishing 'what is known for certain from what is only probable,' Keynes argued that uncertainty pertained to matters about which 'there is no scientific basis on which to form any calculable probability whatever. We simply do not know.' To limit its effects, he accordingly stressed the importance of prevailing intersubjective *conventions.* Economic agents would follow social trends, looking to collectively formed understandings for guidance. They would 'endeavor to conform with the behaviour of the majority or the average', leading to 'what we may strictly term a conventional judgment'. Such conventions might themselves influence 'real' fundamentals, as self-fulfilling depression spurred downwards economic spirals and self-reinforcing wage-price spirals could give rise to accelerating inflation. These observations are mirrored by references to herding in contemporary macroprudential thinking, as a consequence of myopic and less than rational agents, further amplifying the procyclicality of credit and financial markets (Turner 2011; Tucker 2011). In the early wartime context, Keynes (1941:423-425) stressed the need to stabilize inflationary expectations, arguing that 'some measure of rationing and price control' would be needed to prevent 'wages and prices chasing one another upwards'.

Yet, to the extent that Keynes never developed an argument for efforts to stabilize the conventional bases of inflationary expectations at any great length, this strand of argument would be taken up by Galbraith – as an economist and policymaker, playing a key policy role as head of the Price Division at the Office of Price Administration (OPA). Galbraith (1941: 83-84) explicitly stressed the macroeconomic purpose of wage-price regulation in the wider policy mix, warning that if fiscal or monetary policy were used to limit inflation, they would impede the growth necessary to fuel the exigencies of wartime mobilization. Wage-price guidelines would be needed not simply for price stabilization, but to reconcile stabilization with full employment:

> That inflation can be checked by a sufficient over-all reduction of expenditures is not in doubt; but this measure has the crudity in application of any general or blanket measure. *Further, if it is applied too soon it will check inflation by checking the whole expansion process* (emphasis added).

To be sure, his thinking would also evolve over the course of the conflict. Initially, Galbraith favored a sector-by-sector approach to price control – hewing in effect to a more technocratic than a democratic approach. However, by early 1942, the OPA would find the complexity of enforcement to be overwhelming. Recognizing the need for a comprehensive approach, Galbraith and the Roosevelt administration accordingly shifted to a systemic guideline in its ‘General Maximum Price Regulation’ of 1942. This placed an over-all ceiling on all U.S. prices, providing a universal convention that policymakers could then modify in sector-specific settings as necessary. In the aftermath of the conflict, Galbraith would go further than Keynes in stressing the importance of both market structure and everyday sentiment to price control. Regarding the former, Galbraith (1952: 17) argued in his academic monograph *Theory of Price Control* that ‘it is relatively easy to fix prices that are already fixed’. Regarding the latter, Galbraith (1946: 481) argued that ‘a community that has come to regard war as a tragedy stigmatizes illegal profiteering’. In this way, price control was recognized to be an explicitly political activity, requiring the coordination of expectations.

Moving out of the wartime context, Galbraith returned to academia, where he paralleled Veblen’s stance as a public intellectual and most prominently synthesized Institutionalist and Keynesian insights in his 1958 effort, *The Affluent Society.* Issued in the context of the *sputnik* launch and concerns for the health of American society, the *Affluent Society* merged Veblen-styled social criticism and concerns for monopoly power in the context of a Keynes concern for macroeconomic policy. Echoing Keynes’ view of conventions, Galbraith (1958-6-7) coined the notion of the ‘conventional wisdom’, or ideas that enjoyed success not on their merits, but on the basis of familiarity and acceptability. In the economic context, Galbraith went on to critique the prevailing conventional wisdom for casting the economy as dominated by a large number of small firms lacking control over prices or tastes. Countering this view, Galbraith (1958:85-86) first highlighted the dominance of those large firms which acted to reduce uncertainty and competition. Likewise, taking issue with the notion of consumer sovereignty, Galbraith stressed the weight of a ‘dependence effect’, through which large firms making use of advertising to spur tendencies to emulation could effectively create new private wants. Highlighting the paradoxical consequences, Galbraith (1958:158) argued that higher levels of production would simply lead to a ‘higher level of want creation [in turn,] necessitating a higher level of want satisfaction’. Perhaps more importantly, he highlighted the adverse implications for the extent of ‘social balance’, as excessive concern for private wants risked a corresponding neglect of the public good.

Having characterized and criticized the prevailing conventional wisdom, Galbraith moved to advance a series of more specific policy critiques and sociological propositions. First, Galbraith (1958: 195) stressed the influence of the conventional wisdom on economists’ beliefs, highlighting the success of ‘Social Darwinists and the utilitarian philosophers’ in identifying ‘vitality and liberty with the free market’, ensuring that regulation and control ‘will be regarded as an even more far-reaching menace’. This, he argued, led to a preoccupation of macroeconomic policy instruments in stabilizing inflation, despite the costs of fiscal or monetary restraint for growth. Just as he had argued in 1941, Galbraith stressed the danger of reliance on macroeconomic restraint where firms possessing market power might sustain high prices in the face of weakening demand – necessitating a redoubling of restraint. Instead, Galbraith (1958: 194) advocated a policy mix that would ‘combine fiscal policy with control over prices and wages’. From this vantage, wage and price guidelines might serve as the optimal means to forestalling wage-price spirals. Even given tight labor markets, if labor could recognize shared interests in private restraint, it might refrain from the full use of its market power, easing pressures on firms to raise prices. It is worth at this point stressing the Galbraithian accord with macroprudential thinking: Efforts to adjust wage and price guidelines resonate with macroprudentialists who advocate tightening capital requirement when asset price growth is seen to be excessive, or a loosening of cushions when credit conditions deteriorate. If wage-price pressures and modern financial markets left to their own devices gravitate towards excesses and procyclicality, which Galbraith and macroprudentialists each view as possible, then price controllers could mitigate this by catalysing and injecting countercyclicality into the system.

In such analyses, much of the *Affluent Society* contained an essentially pragmatic approach to economic policymaking – one which recognized the variable nature of everyday expectations and the need for policymakers to maintain a degree of connection with the wider public (Widmaier 2004). However, in some tension with his open-ended pragmatism, Galbraith then moved to advance a more teleological argument positing the expansion of a sense of the public interest. He suggested –in a manner that echoed Veblen's stress on the role of engineers – that affluence would over time make possible the rise of a 'New Class' of educated professionals. Galbraith (1958: 258) argued that social attitudes had changed in the U.S to the point that 'the leisure class, at least as an easily identifiable phenomenon, has disappeared. To be idle is no longer considered rewarding or even entirely respectable'. More broadly, Galbraith argued that the pursuit of educational opportunity in the New Class might facilitate a broadened appreciation of the scope for the public interest – much as Veblen's engineers had been seen as harbingers of a more enlightened price system, albeit on a much broader scale, also chiming with Haldane's current calls for benign, enlightened, regulatory planners.

In his 1967 effort *The New Industrial State,* and into his more policy focused 1973 effort on *Economics and the Public Purpose,* Galbraith built on his analysis in *The Affluent Society,* arguing that the imperatives of planning had given rise to a 'technostructure' made up of the managerial elite, and supported by the state, an 'educational and scientific estate' spanning civil society and the leading research universities. This posed an increasing challenge for advocates of the free market conventional wisdom and foreshadowed an increasing reliance on planning in lieu of the market. By the late 1970s, Galbraith (1977:189-190) would assemble 'an integrated view of… the structure of modern economic society' in which he cast the economy as 'a double or bimodal system' marked by a division between the 'market system' and the 'planning system' which had given rise to new instabilities.

Viewing the planning system and the market system in tandem, Galbraith (1977: 191) stressed the planning system's 'concentration of market and political power' and its dilution of entrepreneurial and individual power. Regarding its concentration of power, he argued that the large corporation possessed extensive influence over its prices and over its costs, could finance itself from earnings, shape consumer tastes, and benefit from an early form of 'too big to fail' relationship with the state. As Galbraith put it, 'the government is the safety net into which the firm falls in the event of failure. Above a certain size… a corporation cannot be allowed to go out of business'. Regarding its tendency to diffusion, Galbraith (1977: 192-193) echoed Veblen as he argued that the complexity of corporate activities compelled delegation and the emergence of 'shared responsibility of specialists-engineers, scientists, production men, marketing men, lawyers, accountants, tax specialists [making up] the technostructure'. Galbraith then juxtaposed the rising power of the planning sector against the weakness of the market sector, where firms had no control over costs or consumers.

Given this asymmetry, Galbraith (1977: 194-195) argued it explained stagflation, as it would produce a 'persistent tendency for severe unemployment… to be combined with severe inflation'. This was so because the planning sector held 'the power to maintain its prices' and even if labor pressed for higher wages, large firms could in tandem pass these costs on to consumers. Galbraith (1977: 196-197) accordingly concluded that 'there remains only one alternative: to restrain incomes and prices not by unemployment but by direct intervention, by an incomes and price policy'. In its absence, inflation could not be arrested 'by fiscal and monetary policy alone unless there is willingness to accept a very large amount of unemployment'. With the breakdown of the postwar support for regulation in the 1970s, Galbraith's analysis on this last point would prove more right than he could have appreciated, as the Federal Reserve's late-1979 imposition of unprecedented monetary restraint would in the early 1980s use the imposition of unprecedented unemployment to wipe out the inflationary expectations. In this way, the policy utility of Galbraithian arguments for regulation had been undermined by a shift in public sentiments – a development better understood by briefly and more explicitly engaging the wider context of postwar economic debate.

Galbraith, Institutional Keynesianism and the Limits to Reform

While Galbraith began the Keynesian era articulating a broad vision for a regulatory-macroeconomic policy mix, this vision would be undermined over time as it proved at odds with populist sentiment. As noted above, societal experiences with the OPA during World War II had done much to demonstrate the merit of wage and price controls. More importantly, they had demonstrated the potential for regulatory contributions to the policy mix, as controls could hold down inflationary pressures in ways that might increase the scope for greater growth. To be sure, the wartime experience had also been seen by some a unique one. Even as it demonstrated the scope for emergency controls, many viewed such efforts as 'drastic measures' and abridgements of economic liberties that should be removed with the return to a peacetime footing (Rockoff 1984). In this light, the early peacetime period is significant in that it was marked by a return to support for regulation in the ostensibly 'liberal market economy' of the U.S.

Ironically, over the postwar era, it would not be Republican economists but Democratic policy makers would undermine this scope for regulation: Over the 1960s, the Phillips Curve framework reshaped the terms of debate, with Kennedy advocates of a 'Neoclassical Synthesis' of Classical and Keynesian views stressing the scope for fiscal fine tuning of an inflation-unemployment trade-off (Samuelson and Solow 1960). Through the Kennedy-Johnson administrations, Galbraith would fight a rearguard defense against such views, with diminishing effectiveness. Indeed, the Nixon administration would eventually go further than the Kennedy economists in employing not simply voluntary guidelines, but mandatory controls. However, speaking to the importance of legitimacy, the Nixon economists did so in an erratic way, moving through four "Phases" of controls over the 1971-1974 period, engaging in a back-and-forth that exhausted public patience. In this context, public support for incomes policies of any sort would decline over the decade, with government spending and monetary irresponsibility increasingly constructed as having caused stagflation (Friedman 1968).

Interestingly, in making sense of the diminishing successes of Neoclassical *fiscal* Keynesianism, Galbraith recognized the limits to technocratic governance. In particular, he stressed the importance of 'the fatal inelasticity of the Keynesian system'. From this perspective, taxes could be much more easily lowered than they could be raised. Looking back, Galbraith (1975: 276) argued that over the 1960s, 'expenditures ceased to be subject to reduction', elaborating:

> If expenditures can be increased but cannot be reduced and taxes can be reduced but cannot be increased, fiscal policy becomes, obviously, a one-way street. It will work wonderfully against deflation and depression but not very well against inflation. The Keynesian system had always been more inflexible than its proponents imagined.

Yet, even as he stressed the limits to political support for fiscal policy, Galbraith underestimated the similar opposition to *incomes* policies – which by the late 1970s would be opposed not only by capital, but also labor, as the AFL-CIO opposed a final Carter administration attempt to employ 'Tax based incomes policies' in 1978 (Lerner 1977; 1978). Signaling the popular extent of this broader shift, Ronald Reagan (1981) would argue that 'government is not the solution to our problem; government is the problem' and offered an anti-government populism in denouncing 'government by an elite group'.

Over the ensuing decades, the policy consensus would hold that regulation and control could only distort the workings of the price system. By the early twenty-first century, even prudential regulations had eroded, laying the foundation for the subprime boom that preceded the Global Financial Crisis – and revival of macroprudential themes described above. In these contemporary debates, macroprudential policymakers can be seen as building on a century of *de facto* macroprudential debate – extending the insights of Veblen and Galbraith regarding regulatory efforts to contain the institutional bases of monetary and/or financial instability. However, a key challenge – in attaining and sustaining the legitimacy of the macroprudential project – will also pertain to their ability to avoid the pitfalls encountered by Veblen and Galbraith, so that a focus on technocratic possibilities does not blind them to the importance of legitimacy.

Conclusions: Theoretical, Historical and Practical Implications

This analysis has implications for theoretical, historical and policy debates. First, in theoretical terms, it highlights the importance of popular legitimacy to paradigmatic beliefs, in ways that counter elite-centered constructivist analyses which posit the existence of self-sustaining 'norm life cycles' (Finnemore and Sikkink 1998). More specifically, it highlights the ways in which different types of legitimacy – based in popular consent, institutional openness, and policy outputs – are interdependent, and so the legitimacy of any technocratic policy norms is contingent on evolving values and institutional arrangements (Schmidt 2012). Secondly, in historical terms, this analysis highlights the popular sources of shifts in macroprudential legitimacy over the past century, as the ideas espoused by Veblen and Galbraith were at first grounded in shared values, but later obscured by technocratic consensus which impeded efficiency in the use of information and so provided an endogenous contribution to eventual crises. Finally, with respect to contemporary debates, this analysis highlights not only the ways in which the Global Financial Crisis provided a populist foundation for macroprudential legitimacy, but also the potential for ongoing debates over the Global Financial Crisis to shift in ways which pose a challenge to macroprudential advocates, lest they retreat to far into technocratic abstraction.

Consider first these theoretical implications of this social psychological constructivism, as it has highlighted the ways in which shared values and opportunities for deliberation may feed back on utilitarian performance itself. In making sense of such possibilities, one might disaggregate notions of legitimacy in a manner akin to that of Schmidt (2012: 7), who distinguishes notions of 'input legitimacy', which pertains to popular values, 'throughput legitimacy', which pertains to the accountability and inclusiveness of governing processes, and 'output legitimacy', which reflects the more utilitarian performance of any policy regime. To the extent that asset-price trends are not mere functions of set ratios between growth, macroeconomic variables or any econometric relations, but are instead functions of evolving expectations, the failure to engage popular conventions may deprive elites of an understanding of popular views, and impede their 'throughput' ability to modify regulatory measures. These failures may eventually compromise the utilitarian effectiveness of their paradigmatic assumptions themselves, presaging policy error and crisis. This analysis is paralleled by that offered more broadly by Leonard Seabrooke (2007: 258), who posits that a 'legitimacy gap' occurs when the claims made by an institution or organization with a specific policy function are rejected in the expressive practices of those being governed, resulting in a gap between claims and acts. As we have seen technocratic forms of governance are vulnerable to legitimacy gaps, because insulated technocrats become convinced of the correctness of their own prescriptions (and so grow over confident) and can become divorced from popular sentiments, which can simultaneously undermine the effectiveness of their technical policy prescriptions. Avoiding such pitfalls, requires constant vigilance on the behalf of technocratic regulators in relation to how their policies map onto wider public moods and concerns.

Secondly, in historical terms, we have outlined how these dynamics contributed to Progressive- and Keynesian-era policy shifts. Initially, economists like Veblen and Galbraith initially offered key insights into regulatory policy possibilities – in ways that corresponded to the broader ethos of the Progressive and 'embedded liberal' eras. However, to the extent that each failed to recognize shifts in popular sentiment, they each would over their careers insist on the increasingly technocratic application of regulatory frameworks, underrating the importance of popular engagement and legitimacy. For example, Veblen saw an increasing scope for the activities of financial engineers in the 1920s, while Galbraith failed to anticipate the diminished support for incomes policies – even on the part of labor – by the late 1970s. Taken together, each failed to recognize the tensions between technocratic refinement and policy legitimacy. To be certain, restraining the market power of finance in the 1920s and labor in the 1970s might have been beyond the reach of regulatory solutions. Yet, any regulatory efforts would have likely been more successful in each period had they admitted public 'input' and institutional 'throughput', rather than relying primarily on macroeconomic criteria in governing controls.

Finally, such insights have relevance to ongoing policy debates, as we have suggested that Veblen's and Galbraith's Institutionalisms can be seen as antecedents to contemporary macroprudentialists. Indeed, as noted above, a post-Global Financial Crisis enthusiasm for regulation provided key popular foundations for macroprudentialism (Thirkell-White 2009). Yet, our analysis suggests that advocates of stronger macroprudential positions will not themselves ultimately triumph unless they are able to balance claims for technocratic expertise with an engagement with popular sentiment. Interestingly, there are early signs that some key advocates of macroprudential regulation appreciate this dynamic. For example, Andrew Haldane (2012b: 10) has not only argued that we may be in the early stages of a reformation of finance, but also credited the Occupy Movement with having 'helped stir' these changed in making arguments that 'have helped win the debate'. Moreover, Haldane has also recognized that technocratic policy makers will need their 'continuing support in delivering radical change'. In this light, we conclude that intellectual and technocratic arguments are always endogenous to broader popular values, and so – where economic policymakers lose sight of such constraints – a Seabrooke-styled (2006; 2007) technocratic 'legitimacy gap' can undermine popular support and policy effectiveness.

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[1] As a specific term of art, "macroprudential regulation" in contemporary debate refers to regulatory efforts designed to prevent private investment choices from threatening systemic instability. While the precise term "macroprudential" was not used in the Progressive or Post-World War II eras, the underlying belief that private wage, price *or* investment choices could cause system-wide disruptions legitimated regulatory efforts in each era. In this sense, macroprudential concerns – for imprudent choices that threaten macroeconomic destabilization – havean enduring pedigree, which we trace in this paper.

[2] To be sure, the scope for macroprudential regulation remains contested, as U.S. policymakers like Ben Bernanke (2010) take a more minimalist view that aligns macroprudential regulation with notions of micro-level supervision and monitoring.