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BOOK REVIEW

Scientific central banking and the tragedy of financial Keynesianism

Matthias Thiemann, *Taming the Cycles of Finance? Central Banks and the Macroprudential Shift in Financial Regulation*, Cambridge University Press, 2024.

Matthias Thiemann has written a magisterial account of the development of macroprudential regulation. At the height of the 2008 global financial crisis, central banks were tasked with saving the financial system. To ensure that this time really would be different, they set about designing new policy tools and instruments to monitor and address the systemic fragility of the financial system as a whole by strengthening its resilience, mitigating run dynamics, and deflating unsustainable credit booms. Thiemann argues that this heralded a significant break with pre-crisis thinking, aligned with Minskyian assumptions about the endogeneity of destabilising financial cycles and residing largely outside the mainstream of financial economics and regulatory science. However, these early macroprudential ambitions for taming financial cycles through countercyclical interventions were in part thwarted by political and administrative constraints. The book occupies an increasingly crowded academic field on the post-2008 politics of central banking (e.g., see Moschella, 2024; Wansleben, 2023; Wullweber, 2024). Yet Thiemann's distinctive contribution is an epistemological one, revealing how central banks' inability to ground revolutionary macroprudential ideas in sufficiently 'scientific' knowledge ultimately curtailed their scope for action.

A great strength of the book is its resistance to parsimonious explanation, whether it be national growth models, the structural power of finance, or the independence of central banks. Indeed, Thiemann rejects much of the prevailing scholarship which tends to view macroprudentialism in binary terms as either paradigm shifting or paradigm reinforcing. This he argues pays insufficient attention to the temporalities of regulatory development: that is, the complex process of transforming a loose set of ideas and discursive commitments into a practical policy framework and a range of new discretionary policy tools. The book addresses this with a laser-sharp investigation of how grandiose economic ideas are translated into actionable knowledge and technical policy devices. This required central banks to design a comprehensive new architecture for intervening in financial markets: ranging from macroprudential policy goals, definitions of systemic risks, and common indicators and metrics to policy toolkits and instruments, monitoring and assessment frameworks, and criteria for activation. In doing so, the book provides an unrivalled clarity with regard to the constraints, contradictions, and pathologies that characterise the space between the knowledge base of regulatory ideas and the regulatory actions they underpin.

The book is grounded in Peter Hall's (1989) work on how new economic ideas must address contemporary economic problems (economic viability), be aligned with long-standing administrative biases and structural capacities for implementation

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(bureaucratic viability), and appeal to the interests of the political entrepreneurs and wider coalitions of support (political viability). This is complemented by critical insights from Science and Technology Studies (STS) about how generating actionable knowledge requires epistemological work to generate credible 'risk objects' that are sufficiently understood and capable of being measured and manipulated through policy devices.

The analysis adopts a three-level approach. It begins by exploring the historical development of the macroprudential thought collective in the transnational field. This forms the basis for applied and academic economists around central banks to incubate new theories and methods about endogenous sources of systemic instability (economic viability). The second level shifts to the administrative field defined by the interaction of national and transnational technocrats. Here, the pursuit of administrative viability entails the calibration of policy devices with central bank traditions and biases – notably a concern for technocratic reputation and an aversion to politicisation – to produce workable policy frameworks and instruments. But it is at the third level of interaction between central bankers and elected officials that political viability ultimately resides. A critical distinction here is that between time-invariant (i.e., structural) tools aimed at strengthening resiliency, such as stress tests, and time variant (i.e., discretionary) countercyclical instruments, such as capital buffers. Crucially, Thiemann argues that the risk of political exposure associated with the distributional implications of the latter heightens the need for scientific credibility as a condition for action.

The framework is applied by examining the development of macroprudential regulation in three major jurisdictions: the UK, US and Eurozone. This most different systems design enables a detailed comparison of the divergent national pathways through which transnational ideas and discourse are translated through different political contexts, institutional frameworks, and governance traditions. The impressive research design triangulates findings from no fewer than four methods of data collection: (1) large-scale textual analysis (including structural and author topic modelling) to identify the evolution of themes in economic discourse on systemic risks; (2) seventy-seven expert interviews with senior financial policy-makers to understand the translation of ideas into devices and frameworks; (3) document analysis to map the motivations of technocratic policy-makers as well as institutional and political barriers to implementation; and (4) ethnographic observation at professional conferences of central bankers and academic economists.

The book makes three main contributions. First, it shows how central bankers' interest in endogenous financial cycles originated in the 1980s and related to mounting concerns about the increasing interconnections between banking and capital markets. But transforming these ideas into countercyclical policy devices after 2008 necessitated significant empirical research by applied economists to provide a firmer academic grounding for policy intervention. Second, the book explains how distinct political cultures, institutional arrangements, and legal frameworks shaped central bank reputational concerns over the use of discretionary tools. In short, central banks with greater insulation from external political pressures enjoyed greater freedom to enact countercyclical instruments like capital buffers. This led to important divergence over macroprudential implementation: namely, a muted response in the US, pragmatic engagement in the UK, and a more positive reaction in the Eurozone. Third, Thiemann finds that while some countercyclical measures have been used in the banking system to calm overheating housing markets, there has been little or no equivalent response to developments in the shadow banking system. Resistance to doing so comes from a powerful alliance of market regulators, lobby groups, and politicians, leaving central banks to resort to emergency liquidity backstops to mitigate periodic bouts of market turmoil, as in March 2020 and September 2022. The book concludes that while there have been real and meaningful efforts to strengthen the resilience of the financial system, actually

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existing macroprudential regulation falls short of the lofty ambitions that characterised early transnational discussion about taming financial excess.

Politics plays a curiously ambiguous role in this story. To be clear, this is not a book that sets out to (or indeed needs to) provide a deep dive into the contested national politics of post-crisis financial regulation, as many others have done (e.g., see Howarth and James, 2023; Keller, 2021; Massoc, 2020; Quaglia and Spendzharova, 2017). Instead, it carves out a distinctive scholarly niche around the functionality and instrumentality of scientific knowledge, epistemic authority, and technocratic expertise in central banks. At times, however, the precise composition of the main veto players across the three levels – politicians, securities regulators, industry lobbyists, courts – and the institutional power and political authority they wield is dizzyingly complex. Disentangling the interaction of different US administrations, deeply polarised Congressional and Federal-State politics, and the power of the Courts is a case in point. In this febrile political context, it is difficult to judge how a Federal Reserve armed with the most rigorous data on financial cycles could ever possibly overcome the hyper-politicisation, manipulation, and deliberate distortion of knowledge by multiple veto players. Similarly, the politics of the Conservative-led Coalition government in 2010 is critical to understanding the prudential empowerment of the Bank of England as (in part) an act of political symbolism designed to discredit Labour's supervisory architecture. The complex multi-level politics of the Eurozone generates its own challenges. Intriguingly, fiscal fragmentation is cited explicitly by the ECB as the rationale for creating a new supranational macroprudential competence. But to what extent was this really masking a political battle between the ECB and other EU institutions, as well as National Competent Authorities, to maximise its role and status in the embryonic Banking Union?

The place of politics in the book raises a related issue. Can we be certain that appeals to the limits of macroprudential knowledge as an obstacle to intervention principally originate from elected officials/financial interests, or do they come from regulators themselves? The latter raises the prospect that epistemology is in fact being deployed strategically by central banks as a post hoc rationalisation or justification for inaction, rather than necessarily reflecting the uncertain ontological status of financial cycles. There are two possible explanations for this. One is that central bankers intentionally appeal to strategic ignorance (McGoey, 2012) – that is, claims about what they don't know and/or is unknowable – to avoid having to make contentious decisions, deflect political attention, or shift blame. Another explanation is that imposing a high bar for 'scientific' rigour and evidence is a form of professional self-censorship, reflecting central bankers' embeddedness in self-referential transnational communities that reproduce disciplinary norms and conventions of mainstream academic economics. None of this is to contradict or challenge the central argument in the book, but it does offer the prospect of alternative (and untested) interpretations as the basis for future research.

Like the book, it is difficult to avoid ending on a downbeat note. Reflecting on the extensive central bank liquidity interventions triggered by the Covid-19 outbreak, Thiemann concludes that central banks have essentially become a victim of their own success. In other words, they have been so effective at periodically backstopping the shadow banking system that political support for tougher countercyclical intervention has ebbed away. What we are left with is what we might call a tragedy of financial Keynesianism: the state's willingness to stimulate the financial cycle in the downswing but its refusal to tame financial excess in the upswing. The lessons of postwar Keynesian demand management invite two troubling conclusions. The first is that, contrary to many critics on the left, I suspect that this particular macroeconomic regime will prove surprisingly durable. We have almost certainly not yet reached the limits of the central bank's colossal capacity to rescue the financial system, so reports of its imminent demise are greatly exaggerated. The second implication is that a condition of effective

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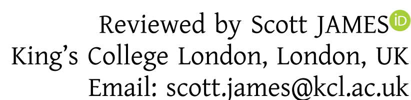
countercyclical management of the financial cycle is the further empowerment of central banks. Like Odysseus, macroprudential regulators will need to be bound to the proverbial mast so that the Siren voices of politicians, lobbyists, and voters can no longer lure them onto the rocks. But that raises more profound questions. Is a 'science' of macroprudentialism even possible? If not, then what is the basis of central bank authority for taming the financial cycle? Over to you, Matthias.



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