

Policy in the Wake of the Banking Crisis: Taking Pluralism Seriously

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Abstract

The purpose of this paper is to explore a pluralist approach to policy with respect to the financial system in the wake of the crisis (where policy encompasses both monetary policy and the regulation of the financial system). We consider first what is involved in a pluralist approach to policy more generally, and how this may be justified. This includes a pluralist stance with respect to different approaches to economic theory, pluralism in the sense of interdisciplinary enquiry, pluralism in terms of range of methods employed, and pluralism with respect to recognition of the plurality of culture and values in society. The implications are drawn for how the banking crisis is framed, how it is explained by theory and thus how policy is designed. It is argued that changing market sentiment and the breakdown of trust were important factors in the crisis which require treatment by economic theory in order for economists to guide policy. In addressing these issues, current mainstream theory focuses on a narrow definition of rational behaviour which, within competitive markets, generates a socially-optimal outcome. This approach is governed by a mathematical formalist methodology, and encourages policy to incentivise this kind of rational behaviour, with respect for example to inflation targeting and addressing moral hazard. New mainstream theory would instead recognise the socio-psychological foundation of money and banking, such that policy needs to focus on rebuilding confidence and addressing moral (including distributional) issues. The relevant analysis would require a range of methods and would address pluralities within society.

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Outline of Presentation

Introduction

- purpose is to explore a pluralist approach to policy with respect to the financial system in the wake of the crisis
- will consider pluralism in its range of meanings
- will consider both monetary policy and the regulation of the financial system within the wider policy agenda

Pluralism

- Meaning at different levels
 - different approaches to economic theory: methodological pluralism
 - interdisciplinary enquiry
 - range of methods employed
 - recognition of the plurality of culture and values in society.
- Justification
 - Epistemic: open-system reality including pluralities
 - Ethical: principles of tolerance, rights etc

Methodological Pluralism and the Banking Crisis

- Framing
 - Understandings on the part of different groups
 - Performativity
 - Power relations (between government, financial markets, non-financial firms and households)
- Theoretical explanations
 - Old mainstream:
 - narrow definition of rational behaviour within competitive markets
 - explanations for crisis:
 - market imperfections or
 - irrational behaviour
 - Pluralist approach:
 - individual behaviour under uncertainty relies on institutions and conventions, including money (and thus banks)
 - explanations for crisis:
 - changing market sentiment
 - breakdown of trust

- Methodology and policy design
 - Old mainstream:
 - Incentivise rational behaviour, with respect for example to inflation targeting and addressing moral hazard, and/or remove market imperfections
 - Very limited use of psychology
 - Mathematical method applied to establishing one best model
 - Presumes culture and behaviour are homogenised by financial incentives
 - Pluralist approach:
 - recognise the socio-psychological foundation of money and banking, such that policy needs to focus on rebuilding confidence and addressing moral (including distributional) issues.
 - Model uncertainty: role of judgement
 - Interdisciplinary
 - Range of methods of analysis
 - Recognition of plurality of culture, values

Pluralist Policy Implementation

- Policy analysis should connect with reality as experienced by different groups to be effective
- Policy decision must reflect one methodological stance (even if synthetic)
- But importance of awareness of range of stances (relating to different experience)
- Policy-making by committee
 - Pluralist judgement, not just differences in skills, data, preferences
 - Variety of opinion doesn't necessarily imply uncertainty
- Triangulation approach
 - with respect to data, investigators, theoretical perspectives and methods

Pluralist Policy in the Wake of the Crisis

- Monetary policy
 - Not separable from fiscal policy or regulation or social policy: negotiated stance
 - Importance of signalling to different groups
- Financial Regulation
 - Multi-pronged (traditional overdetermination under uncertainty)
 - Emphasis on supervision and monitoring more than CARs
 - Exploit the public sector presence in banking to improve judgement in policy-making and to encourage new socially-acceptable conventions