The long-term-effects of 'short-term' interventions:
Constructivist-evolutionary analysis of institutional transformation following the Great Recession

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Introduction

"If with a snap of our fingers you could eavesdrop on the discussions we had in Ben Bernanke’s office a decade ago...you would certainly have heard no winking from the likes of us, that a decade later the world's central banks...would be adding, in 2018, hundreds of billions more of net global QE around the world. So if you travel back in time though, from this moment to that, and you informed us where we are, our faces would have looked more ashen than they did at the time, our spirits more solemn, if you confronted us with the facts of QE today. We would have figured then, that with those facts, our monetary experiment must have failed...and the unwind of QE proved impossible. But we would be particularly shocked to hear, you reporting from 2018 to 2008...of the juxtaposition of peak QE in 2018 amid a global economic boom" (Kevin Warsh,¹ AEI Symposium, 7 July 2018).

In an effort to prevent the financial crash of September 2008 from turning into a second Great Depression, policymakers in many advanced economies activated large-scale unconventional programmes of monetary easing (Eichengreen 2014). While these unconventional interventions differed from each other in important ways, they had two things in common: they were meant to be short-term, and their sole goal was to put the pre-existing market-based growth regime back on its track. Put differently, the short-term employment of unconventional policy ideas was meant to secure conventional long-term macroeconomic goals (Haldane et al. 2016; Parliament UK 2014, 2–3).

As the above quote indicates, it seems that this plan didn’t go so well. About a decade after a re-run of the Great Depression was avoided and economic recovery was secured (Bootle 2016), central bankers are still using different forms and levels of monetary easing, and from the day they were first launched, programmes of monetary easing have been recurrently expanded well beyond the initial intention of policymakers (Haldane et al. 2016, 5–7; Warsh 2018). If we look deeper into the current processes of policymaking, things become even more puzzling. During the last couple of years, interventionist policies have become, in some advanced economies, a permanent feature within the toolbox of central banks (Haldane et al. 2016), and in some cases

¹ Kevin Warsh served as the ‘right hand’ of Ben Bernanke, the then Governor of the Federal Reserve, and in late 2008 took part in the decision to launch and operate large-scale monetary interventions.
we have even seen the emergence of interventionist policies in non-financial markets as well as different arenas of the real economy.

Two salient examples of this trend are the ‘most-different’ cases of the UK and Israel, which show similar interventionist ‘symptoms’. In both cases, monetary interventions on the side of the central bank and fiscal interventions on the side of the government keep expanding, and have already produced a new macroeconomic framework for interest rate policy (in the UK) and exchange rate policy (in Israel), as well as a new understanding of market–government relations. Accordingly, the current ideational-institutional landscape in both countries is quite different from its pre-crisis setting.

Against this background, we put forward a simple question: we ask what are the relations between the employment of short-term monetary interventions and the emergence of interventionist policies in different realms of economic and macroeconomic policymaking. Put differently, our aim is to find out what, if at all, are the causal mechanisms that connect the short-term employment of unconventional policies with long-term macroeconomic change.

The theoretical tools available in the literature are insufficient for answering this question. Most of the scholars who study the relationship between economic ideas and macroeconomic change understand the latter only as the result of a ‘wall to wall’ transformation of the ideational-institutional system, or as a transformative paradigm change (Grabel 2017). These scholars largely suggest that the main effect of the ongoing employment of interventionist policy ideas is to support the continuity of, or even to artificially resuscitate, the pre-existing macroeconomic regime (Clift 2018; Baker 2015; Blyth and Matthijs 2017). Either way, they tend to treat current policymaking as inconsequential for macroeconomic change (Carstensen and Matthijs 2017).

To bridge this gap, we combine the logic of evolutionary institutional change with insights from constructivist institutionalism, and we introduce a constructivist-evolutionary approach for institutional change. We suggest that the interaction between the highly unstable environment of the post-Global Financial Crisis (GFC) era, a highly consensual conventional macroeconomic regime, and the employment of unconventional policy ideas that were meant to put this regime back on its track, produced unintended ideational-institutional outcomes, and set in motion an evolutionary process through which temporary interventions diffused to
different policy arenas and affected the macroeconomic regime. In a broader sense, we suggest that the employment of innovative policy ideas and macroeconomic change are tightly connected via evolutionary mechanisms, and that macroeconomic change might be the emergent property of evolutionary processes.

Employing this theoretical approach, we explore policymaking in the UK and Israel from early 2009 to the present. We conclude that in both cases the irreversible and unexpected outcomes of the interaction between the unstable post-GFC economic environment, the specific ideational and institutional properties of a consensual macroeconomic regime, and policymakers’ efforts to restart its operation by using context-related unconventional measures have already changed the policy landscape and reshaped the macroeconomic framework. While the direction of this evolutionary process is not yet clear, it points to a possible bottom-up evolutionary change that deserves more scholarly attention.

**Theory**

Our research question brings to the surface two theoretical challenges. The first theoretical challenge stems from the fact that the integration of unconventional interventionist practices with the conventional policy toolbox emerged as an unintended and undesired outcome of what were meant to be short-term institutional adaptations, the sole aim of which was to facilitate a quick return to conventional policymaking. Therefore, we need a theory that can explain the ways in which unexpected and perhaps even undesired policy outcomes evolve into deliberate and desirable ideational-institutional adaptations. The second challenge we confront is how to explain the spread of unconventional policy ideas and practices across an ideational-institutional system informed by conventional macroeconomic policy, goals and ideas. For a short while, the employment of unconventional policies could have been dismissed as a ‘wartime’ response to a crisis situation which the pre-existing conventional macroeconomic regime was unable to contain. But after more than a decade, as these unconventional interventions are becoming integral parts of the policy toolbox, understanding the long-term relationship between the ‘old’ macroeconomic regime, and ‘new’ policy ideas which reflect a different economic perspective becomes vital.

Yet, when we look into the institutional literature, we find that these theoretical challenges have been widely neglected. The prevailing paradigm-centred ‘wall to wall or nothing’ understanding of macroeconomic change is based, to a large extent, on a division between the
employment of innovative policy ideas or policy change in a specific institutional sub-system, and macroeconomic change (Hall 1993). The latter, from this perspective, necessarily includes the former. But, as Grabel (2017) pointed out, the former is often perceived as trivial, unimportant and inconsequential in terms of macroeconomic change. For example, paradigm-centred studies that analyse current interventionist trends in different economic arenas tend to explain their very feasibility by the fact that they do not pose any threat to the continuity of the macroeconomic paradigm (Berry 2016; Craig 2015; Baker 2015). Paradigm-centred scholars cannot help us understand the mechanisms that connect unintended outcomes to deliberate institutional change either, since they see purposeful agents – whether they be ideational entrepreneurs or strategic narrators – as the carriers of new policies (Blyth 2007; Hay 2011; Schmidt 2011). The very possibility that macroeconomic change might emerge as the unintended outcome of unsuccessful institutional adaptations is hardly, if ever, discussed (Grabel 2017).

Theories of ideational-institutional ‘bricolage’, on the other hand, are focused on cases of intra-paradigmatic change. Their line of argument, according to which this type of change is generated by agents who creatively craft policy solutions by arranging and re-arranging policy ideas and practices that have different paradigmatic origins, might be of great interest for our research question. However, their basic assumption, according to which agents are not guided by ideas but rather use ideas strategically and instrumentally in order to secure their interests, implies that under any condition, even under conditions of severe uncertainty, actors have clear interests-led preferences that guide their policy selection. What follows is a somewhat incoherent account of the relationship between ideas and interests, and of the role played by ideas in the course of ideational-institutional change (Clift 2018; Braun 2015; Carstensen 2011; Carstensen and Matthijs 2016). Given these theoretical difficulties, bricolage theories cannot help us understand the relationship between the employment of new policy ideas and the emergence of macroeconomic change, and between unintended and undesired outcomes and purposeful ideational-institutional change.

The basic assumptions of evolutionary theories of institutional change, on the other hand, offer us a better starting point. In brief, scholars working in this field view institutional change as a continuous process of adaptation to an ever-changing political-economic environment (Steinmo 2010; Lewis and Steinmo 2012; Grabel 2017), and suggest that the adaptation of rigid

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2 For example, Blyth and Matthijs (2017, 289) suggest that the current growth regime is undermining itself endogenously. But they do not deal directly with the implications of this counterproductive evolution for macroeconomic change.
institutional structures to this dynamic environment is made possible by the imperfection of institutional rules. This imperfection both constrains and allows for variation between the behaviour, preferences and norms the institution replicates, and the decisions made by individuals interpreting these rules as they strive to adapt to change and protect their interests (Steinmo 2010). Agency, therefore, is understood as the capacity to creatively and strategically interpret constraining institutional rules, generate variation and shape the scope for policy selection.

From this perspective, institutional change is the emergent property of a complex interaction between an unstable environment, the imperfection of institutional rules, and the outcomes of previous institutional adaptations in terms of agents’ expectations (Blyth et al. 2011, 300, 306; Morgan and Olsen 2011, 443; Lewis and Steinmo 2012). Importantly, each institutional adaptation has long-term evolutionary consequences that go beyond the specific institution within which it takes place. Since institutional systems are a combination of interdependent sub-systems, any successful evolutionary adaptation of a given institution and the advantages it provides might be diffused to other institutional sub-systems, and in some cases might even feed upwards and transform the institutional system (Steinmo 2010; Lewis and Steinmo 2012).

On the one hand, this evolutionary mechanism of emergent change opens the way for a systematic explanation of the relationship between the re-interpretation of institutional rules, the employment of new policy ideas and macroeconomic change. Yet, on the other hand, this theorisation of emergent dynamics refers mostly to intended and coherent institutional outcomes and does not help us explain either the undesired outcomes of current institutional adaptations or the messy and incoherent evolutionary change we are currently witnessing. This shortcoming, we suggest, is rooted in the fact that insufficient attention has been given by evolution-oriented institutionalists to the causal role played by ideas. In order to overcome this shortcoming, we bring in the assumptions of constructivist institutionalism, and offer a constructivist-evolutionary theory of institutional change.

3 While these theories acknowledge the possibility that institutional adaptations might produce unintended and counterproductive outcomes (Steinmo 2010, 17), they do not explain or detail the mechanisms that differentiate between successful and unsuccessful – in terms of actors’ expectations – adaptations.
4 Since evolutionary theories of institutional change do not take ideas sufficiently seriously, they send us back to the theoretical problems that are embedded in the assumption that material conditions and structurally given interests are objective drivers of actors’ policy selection (Steinmo 2010; Lewis and Steinmo 2012), a problem from which ideational-institutional theories released us long ago (for example, see Blyth 2002; Hay 2001; Schmidt 2002; 2011).
The constructivist sources of evolutionary institutional change
We start from the basic constructivist assumption that agents’ understanding of their ever-changing economic environment is mediated by a set of economic ideas. These ideas ‘tell’ agents ‘what the economy is’ and how it works, and convert an otherwise too complex and incomprehensible economic reality into a manageable set of institutions, practices and rules. Specifically, economic ideas instruct agents as regards the nature of the problems they are confronting and how to solve them as they produce a specific vision of ‘economic necessity’ and ‘must do’ policies, to which there is ‘no alternative’, and they construct causal relations between the employment of specific policies and the achievement of desired macroeconomic goals. Combining constructivist and evolutionary perspectives, we suggest that in an ever-changing environment, economic ideas allow agents to translate policy outcomes into actions of policy selection and institutional adaptation.

The ‘thick’ constructivist position we adopt here has been repeatedly criticised as leading to a theoretical dead-end, where actors are ‘locked’ in the pre-existing political-economic discourse in ways that make any ideational-institutional change inexplicable (Carstensen 2011; Jones 2009; Marsh 2009, 687–690). But the ‘thick’ constructivist position is more sophisticated than this. From this perspective, while economic ideas are what allow actors to make sense of their ever-changing environment, these ideas are fluid and open to reinterpretation (Blyth 2007), and in this regard they constitute a source of variation and change.

This point needs some clarification. We do not suggest that macroeconomic ideas have no fixed meaning and can be freely hollowed out and injected with entirely new content. For example, the idea that markets are efficient cannot be ‘changed’ through reinterpretation. But, as history has taught us, actors’ beliefs about what makes markets efficient, and what types of practices, legislation, regulations or ‘marketcraft’ should be used in order to achieve this efficiency, or, no less important, how this efficiency should be measured and gauged, certainly might change (Vogel 2018; Clift 2018). In other words, the policy ideas that should be employed in order to secure macroeconomic goals are subject to interpretation. From this perspective, the source of variation and the space within which evolutionary ideational-institutional change emerges is not the fluidity of interpretations that is permitted by institutional rules; rather, it is the fluidity of interpretations that is permitted by the economic ideas, within which these institutions are embedded. Agency, understood as the capacity to reinterpret economic ideas, advance new policy ideas and reshape policy, is also an emergent force, both enabled and constrained by this
evolutionary progression. From our constructivist-evolutionary perspective, any reinterpretation, and the policy selection it involves, has long-term evolutionary consequences.

Since actors’ understanding of the economic problems they confront is guided by a reduced and simplified image of their economic ‘reality’ (Blyth 2007), the set of consensual economic ideas they hold might cause them to neglect important factors and misinterpret the economic conditions they are facing. In turn, the policy ideas they select and the evolutionary adaptations that these ideas generate might be counterproductive, and might repeatedly produce undesired outcomes. And since counterproductive outcomes are being interpreted through the lens of consensual economic ideas, actors’ responses to the gap between their ideational-based expectations, on the one hand, and recurring failures to weather actual market conditions, on the other, is constrained by the same understandings that produced these negative outcomes in the first place. But recurring failed adaptations might undermine actors’ beliefs about how best to secure the pre-existing macroeconomic goals, and, in turn, how to open up a new range of policies they view as adequate, feasible and desirable. And while this constrained change is not radical, it is still significant in some important ways.

First, as different scholars who study ideational and discursive change have showed, policy ideas are not isolated elements but rather have relations of interdependency with each other. This means that the employment of new policy ideas in one economic arena necessarily affects policy ideas and institutions in other arenas as well, and in this regard their effects are irreversible. A good example is the parameters of the macroeconomic goal of ‘financial stability’, which have been recurrently re-articulated in response to the crises of the finance-led capitalist regime during the last 20 years, and their related policy ideas (Davies 2006). The variety of reinterpretations of how best to secure the stability of the financial system, which more often than not has produced unintended and undesired outcomes, have reshaped the policy ideas that have been used to articulate accounting practices, the qualifications of ‘creditworthiness’, the desired forms of ‘individual responsibility’, and the financial regulatory system (Soederberg 2008; Datz 2013; Finlayson 2009; de-Geode 2009; Baker 2015). As the experience of the GFC taught us, the range of interpretations that the concept of ‘financial stability’ allows for might even include, legitimise and necessitate large-scale employment of interventionist policy ideas that stand in stark opposition to the underlying logic of the pre-existing macroeconomic regime.
Given the interdependency between economic ideas and the consequential irreversible effects of evolutionary institutional change, we suggest that instead of stabilising the pre-existing growth regime, recurring counterproductive adaptations might function as a conduit for the transmission of instability across the institutional system. This type of evolutionary progression might advance the disintegration of the growth regime and lead to its breakdown, as demonstrated by the ineffective efforts to stabilise the Keynesian growth regime during the 1970s (Blyth and Matthijs 2017) and the failed adaptations of the finance-led growth regime during the last decade (Oren and Blyth 2019; de-Geode 2009; Finlayson 2009; Moran et al. 2012).

However, from a constructivist-evolutionary perspective, the interdependency between, and the irreversibility of, the ideational-institutional resources produced during the course of counterproductive evolution have a positive function. They reshape agents’ understanding of their policy landscape, disqualify the failed ‘old’ policy frameworks, and qualify new ones. They open up new opportunities and provide the ideational-institutional resources that agents can use in order to exploit these opportunities as they strive to adapt to change (Grabel 2018). Put differently, the undesired outcomes of previous adaptations constitute the building blocks of the next stages of the evolutionary progression. Horizontally, they create new interdependencies between policy ideas and their related institutional sub-systems. Vertically, these new interdependencies and the policy ideas they support might feed upwards and generate evolutionary macroeconomic change. Taken together, this type of evolutionary process translates the unintended and undesired counterproductive outcomes of previous adaptations into a desired policy change, including, as the case of both the UK and Israel currently demonstrate, macroeconomic change.

In the following we use the constructivist-evolutionary theory of institutional change to analyse policymaking in the UK and Israel during the last decade. Following policymaking processes, we elucidate the evolutionary mechanisms of ideational-institutional change with regard to both the horizontal and the vertical dimensions. With regard to the horizontal dimension, our analysis tracks the ways in which the selection of specific adjustments in one policy arena diffuses into, and reshapes, other realms of economic policy. With regard to the vertical dimension, we follow the ways in which the perceived outcomes of previous adaptations shape the evolution of macroeconomic change. Identifying similarities between the very different cases of the UK and Israel will hopefully allow us to generalise our findings and offer a
comprehensive theorisation of the relationship between short-term employment of innovative policy ideas and macroeconomic change.

**The UK**

When the GFC hit the City of London it intersected with a highly consensual ideational-institutional context. Ten years of uninterrupted economic growth had convinced the New Labour government that the finance-led growth regime they had nurtured, and the macroeconomic framework of price stability and sound public finances within which it was embedded, was the best alternative for the UK (Elliott and Treanor 2008; Treasury Select Committee (TSC) 2009b, 4, 34–35; HM Treasury 2008d, 2). As it turned out, the UK was one of the countries that was hardest hit by the GFC.\(^5\) But even as its banking system stood on the brink of collapse, this conviction did not go away. Rather, it served as the lens through which the crisis was perceived and responded to. PM Gordon Brown and Chancellor Alistair Darling saw the GFC as the result of exogenous factors which hampered an otherwise efficient system that should not be replaced but rather put back on its track. This ideational lens outlined the range of policies that were perceived as an appropriate response to the GFC (TSC 2008b, 10, Ev. 23; HM Treasury 2009, 45).

Against this background, cutting interest rates to an historically low 0.5% and the operation of quantitative easing (QE) by the independent Bank of England (BoE) were selected as the most credible and efficient way to bring inflation rates up to target, restart finance-led growth and secure economic recovery (HM Treasury 2008d, 1; Darling 2010). The need to secure ‘old’ macroeconomic goals legitimised the employment of new unconventional policy ideas. The fact that QE was perceived as easily reversible and the fact that it was meant to be short-term and limited in its scope, initially set at £200 billion, added to its credibility. As it turned out, QE failed to revive lending and mostly acted as a life-support machine for banks, which used it to shrink their balance sheets (Haldane 2010, 1, 5-6). In 2009Q4, even after QE had been expanded by another £75 billion, banks’ lending still continued to contract (BoE 2010).

In May 2010, against the background of five consecutive quarters of deep recession, which (barely) ended with a modest 0.1% expansion in 2009Q4, a 6% output contraction and a 11.2% budget deficit, a newly elected Conservative-led coalition government took office. Like New

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\(^5\) Up to March 2009, banks' equity prices fell by 80% (Haldane 2010, 1), and house prices were down by almost 15% on average (Land registry data, UK House Price Index, Gov. UK, 2017).
Labour, they also saw a causal relation between the devastating effects of the GFC and exogenous factors. But in their version, the exogenous factor was the profligate New Labour government that had deviated from the principle of ‘sound public finances’, spent its way out of political problems on the back of a ’debt-fuelled economy' and left the UK "uniquely exposed" to the pressures of the GFC (The Conservative Party 2009, 14). The metamorphosis of the banking crisis into a sovereign debt crisis (Blyth 2013) allowed the new PM David Cameron and his Chancellor, George Osborne, at once to discredit New Labour's macroeconomic policy while protecting the credibility of the macroeconomic ideas they shared with their predecessors, and to represent their plan to cut £81 billion of government spending over the next five years as the only way to turn the 11.2% deficit into a budget surplus and to pull the economy out of this "debt crisis" (Osborne and Sachs 2010).

Before winning the election, David Cameron had stated that QE should be ended "soon", and Osborne argued that "[p]rinting money is the last resort of desperate governments when all policies have failed" (BBC News 2009). In their eyes, the employment of QE symbolised the failure of New Labour’s economic policy. But after they took office, they found themselves recurrently authorising new rounds of QE and initiating varied interventions in different markets. In the following section we explain why they acted in the way they did.

From austerity to state-backed privatised Keynesianism

From the conventional economic perspective of Cameron and Osborne, the expansionary mechanisms of austerity were expected to facilitate a robust real sector growth, "balanced across regions and industries" (HM Treasury 2010b, 1). Indeed, by June 2011 the deficit was down to 7.9%. But, as Blyth (2013) has suggested, the combination of fiscal consolidation, on the one hand, and deleveraging banks, businesses and households, on the other, made things worse.

By the end of 2011, Osborne’s austerity programme had saddled the UK with growing unemployment,6 stagnant real wages, and £5.1 billion lower than expected tax revenues, which further depressed economic growth (Office for Budget Responsibility (OBR) 2012a, 38, 66–80, 83). In 2011Q4, following a 0.3% contraction, the economy entered a double-dip recession (OBR 2012b, 2013b). Yet Osborne (2012) insisted that slowing down the pace of austerity and increasing government borrowing would represent "a complete loss of Britain’s fiscal credibility". Instead, in order to ease the effects of fiscal consolidation, Osborne authorised two

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6 The unemployment rate reached 8.1%; youth unemployment stood at 21.2%.
new rounds of £50 billion QE. However, during the first half of 2012 banks continued to deleverage and lending to households and companies continued to contract. At the same time, deleveraging non-financial companies cut borrowing levels and "contain[ed] their finance requirements until more certain conditions…emerge[d]" (British Bankers’ Association (BBA), 2013).

The failure of both fiscal consolidation and new rounds of QE to facilitate real sector growth increased the UK’s dependency on financial sector growth. Under these conditions, and constrained by their conventional economic thinking, in July 2012 the Treasury and the BoE co-initiated a new £70 billion Funding for Lending Scheme (FLS). The new Scheme allowed banks and building societies to borrow from the BoE at a lower rate, in the hope that they would use this funding to make mortgages cheaper for “families aspiring to own their own homes”, help businesses to expand and “support the flow of credit to where it is needed in the real economy” (Osborne 2012). Put differently, since market mechanisms had failed to bring the much expected recovery, monetary intervention stepped in to replace them. And while the independent BoE operated the intervention, it was the government which pushed the interventionist trend further (Osborne 2014; Carney 2014), advancing a state-managed variation of ‘privatised Keynesianism’.

As was the case with other types of QE, the FLS was meant to be short-term – initially planned to be terminated by the beginning of 2015 – and limited in scope. But the way actors perceived its counterproductive outcomes led to its expansion. First, the UK’s major lenders did borrow from the FLS, but instead of lending the money they mostly used their borrowing, once again, to shrink their balance sheets.  

Second, by providing banks with cheap funding, the FLS ‘released’ them from the need to attract savers and allowed them to pay lower interest rates on savings. Against the background of historically low interest rates, the FLS sent savers to search for yield in other markets, and eventually increased both asset and house prices. Third, it turned out to be the wrong medicine for companies, which continued to deleverage, with levels of repayments still higher than borrowing. Fourth, after the financial crash of September 2008 mortgage lenders toughened their lending requirements, demanding first-time buyers to provide a 25% down payment, shutting many of them out of the market. The cheap funding they received from the FLS didn’t change this picture, and mortgage lending continued to

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7 The FLS helped RBS and Lloyds to reduce their stock of lending by £2.3 billion and £5.6 billion, respectively (BoE 2013).
contract.\textsuperscript{8} Yet, while the BoE's interest rate was still being kept at 0.5%, and when the volume of QE had reached £375 billion, the Treasury extended the FLS, first until 2015 and then up to 2016, and expanded its scope.

On one hand, while the outcomes of recurring rounds of monetary intervention had failed to adhere to actors’ expectations, the legitimacy of innovative policy ideas and the range of policies which had been perceived as a feasible and desirable policy response were still constrained by dominant macroeconomic ideas. But, as we show below, along with this constrained evolutionary progression, a more substantial change had emerged.

The backing of both the bipartisan TSC (2013c, 96) and the BoE's Governor, Mervyn King (King, 2013), who "welcomed" the extension of the FLS, signalled the build-up of a strong consensus around the long-term employment of ever-growing monetary interventions. In spite of the counterproductive outcomes discussed above, actors' understanding of their unstable economic environment, and specifically the credibility and the reversibility ascribed by their conventional thinking to monetary interventions, turned unconventional policies into a legitimate integral part of the UK’s policy landscape. This translation of unintended outcomes into deliberate and consensual policy laid the foundation for a gradual evolutionary macroeconomic change.

A new remit for the Monetary Policy Committee (MPC) set by Osborne in the 2013 Budget reflected this new consensus. The remit basically separated the MPC's interest rate policy from the rate of inflation, and re-articulated the meaning of a 'credible' macroeconomic policy. It restated "the primacy of price stability" and re-emphasised that "the inflation target [of] 2 percent […] applies to all times". But it also stated that keeping to this target under conditions of "shocks and disturbances" may cause undesirable effects, and it mandated the MPC to make a trade-off – under "exceptional circumstances" – between the short-term objective of economic growth and the long-term objective of price stability, and to develop and employ new "unconventional monetary instruments" whenever it found this necessary. As the MPC admitted, it had "already [been] follow[ing] a flexible inflation target" (TSC 2013b, 48) since December 2009, as part of its effort to support the still sluggish economic recovery.\textsuperscript{9} Osborne

\textsuperscript{8} Lending to UK businesses and households continued to contract throughout 2014, falling by £3.9bn in 2014Q2 alone (BoE 2014, 5).

\textsuperscript{9} During 2011, while inflation reached 4.5%, the Monetary Policy Committee (MPC) executed recurrent rounds of QE and kept BoE rates at 0.5% (TSC 2013b, 97-98).
mainly translated this 'temporary' practice into a permanent ideational-institutional change. Central actors – including Mervyn King (2012, 12), the new BoE Governor Mark Carney (TSC 2013a, Ev. 8, Ev.12) and the chairman of the Financial Services Authority, Lord Adair Turner (2013, 15) – converged on the idea that "flexible inflation targeting" should be a permanent foundation of monetary policy.

In a deeper sense, the remit reinterpreted the parameters of central bank credibility. It opened new space for agency, allowing the MPC to determine what type of variables it should consider when setting interest rates, and outlined a new range of policy ideas that the MPC could use. The counterproductive outcomes of previous monetary interventions, and the intricate web of interdependencies they produced, played a productive role. While disqualifying the pre-crisis framework of monetary policy, they reshaped the macroeconomic goals of the UK’s growth regime and turned the temporary employment of unconventional interventions by the MPC into a long-term macroeconomic change. The evolutionary progression that followed demonstrates this trend.

In August 2013, Mark Carney (TSC 2013a, Ev. 31, Ev. 34–35) added the policy of "forward guidance" to the framework of "flexible inflation targeting", announcing that the MPC would "no longer link the future direction of interest rates to a single indicator", but rather would consider a broader set of factors, including the rate of unemployment and real wage growth (Financial Times 2014). The gap between pre- and post-crisis understanding of central bank 'credibility' and the perception of the macroeconomic goals it should secure grew still further.

The BoE’s response to the potential negative effects of the Brexit vote is, perhaps, the most salient example of the emergent, evolutionary macroeconomic change outlined above. In August 2016, against an historically low unemployment rate and an inflation rate of 0.6%, the MPC cut interest rates to 0.25%,\(^{10}\) launched a new £60 billion round of QE, extended the FLS until January 2018, and in order to support "additional lending to the real economy", launched a new £100 billion Term Funding Scheme which provides funding at a decreased rate to participant banks as long as they pass the discount on to households and businesses (BoE 2016). As the next section shows, the same emergent dynamic has pushed the evolution of government intervention in other markets along a similar path.

\(^{10}\) In November 2017, the MPC increased the interest rate again to 0.5% and in August 2018 set it on 0.75%.
**Intervention in mortgage and housing markets**

As we have seen in the previous section, monetary easing contributed to house price inflation and failed to boost mortgage lending. During 2012, mortgage lending and equity withdrawals – which during the 2000s constituted the main engine of finance-led growth and fuelled the mechanisms of what Colin Crouch (2008) defined as 'privatised Keynesianism' (Crouch 2008) – were significantly below their pre-crisis trend (BBA 2013). In addition, as part of his fiscal consolidation plan, Osborne slashed £10 billion allocated for 'affordable homes programmes' by the previous New Labour government for the three years between 2008 and 2011 to only £4.5 billion for the whole period of 2010–2015. By so doing, he further intensified housing market pressures and increased the unaffordability of homes (HM Treasury 2010).

Responding to these conditions, the Treasury diagnosed the "deposits demanded for a mortgage 'these days'" as the source of a "market failure", and cast the government as an indispensable "active agent", the job of whom is to "make the aspiration of home ownership a reality for as many households as possible", as long as it does not break the fiscal rules (HM Treasury 2013, 19). This new articulation of government–market relations opened the way for the employment of new policy ideas, which further advanced two parallel processes that were already en-route: the disintegration of UK’s growth regime, driven by the expansion of the interventionist trends on the one hand and the conventional devotion to austerity and pre-existing macroeconomic goals on the other, and the progression of evolutionary macroeconomic change.

In an effort to contain the diagnosed 'market failure', Budget 2013 launched a £3.7 billion scheme titled the "Help to Buy" (HBS). HBS was meant to be a short-term mortgage market intervention that would provide first-time buyers with an equity loan covering 20% of the value of a newly built home – most of the down payment required by mortgage lenders (HM Treasury 2013, 9–12, 19). To further boost mortgage lending, the government operated a Mortgage Guarantee Scheme that used £12 billion of government guarantees to underwrite £130 billion of high loan to value mortgages – higher than what most lenders would have otherwise approved – for all categories of property buyers (TSC 2013, 66–71).

The policy ideas which underpin these interventions reflect the peculiar post-GFC evolution of the UK’s growth regime. The failure to boost real sector growth pushed the government back, once again, to nurturing finance-led growth, the only available growth engine they had at their

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11 In other words, through the operation of this program the government is underwriting 10% of the £1.2tr mortgage market (TCS 2013, Budget, 77-78).
disposal. But since different types of monetary interventions failed to achieve their target, and banks were still reluctant to return to pre-crisis lending levels, the government, guided by conventional economic thinking and pre-existing fiscal constraints, selected a specific type of new intervention. The policy of HBS had been selected because "the taxpayer [is] making an investment and getting a return", and therefore this intervention did not disrupt fiscal consolidation. Moreover, it was the credibility of the government’s fiscal consolidation that gave the grounds for this type of intervention (Osborne, 2013). In this way, the state-backed variation of privatised Keynesianism, already operating through the FLS, was diffused into the mortgage market. It was still consumers who were taking on debt, but the government – drawing legitimisation from conventional pre-existing macroeconomic goals – was backing, underwriting, and facilitating their risky borrowing.12

In its Budget Report, the TSC (2013, 77–78) warned that what the Treasury diagnosed as a 'market failure' might reflect structural factors, pointing to the scarce supply of housing stock, with about 300,000 new homes being built a year, characterising the UK’s housing market. The Committee argued that without dealing with this problem the intervention might further increase house prices and, in turn, become a "permanent feature of the UK housing market". But Osborne – expecting that boosting demand would necessarily incentivise the construction industry to build more and solve the supply problems – largely dismissed this warning (HM Treasury 2013, 19). Other factors, such as increasing speculation and growing numbers of investors attracted to the UK’s housing market in a low interest rate environment, were not even discussed (Pettifor 2018).

The scheme increased the number of first-time buyers entering the market, but in contrast to Osborne’s predictions, growing demand failed to incentivise the contracting construction sector and further drove up house prices.13 Up to the end of 2013, the volume of property transactions grew by 22.6%. During the same period, house prices in England and Wales had increased on average by 10% and in London by more than 20% (OBR 2013b). As the OBR suggested (quoted in TSC 2014, 18), the government, by ignoring the housing market’s structural problems, might have helped to inflate a new housing bubble and increased the unaffordability of homes. Yet Budget 2014 extended HBS up to March 2020, and expanded its scope (Public Accounts Committee 2014). The interdependency between monetary easing and mortgage market intervention called into question the reversibility of both. As we show below,

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12 Help to Buy did not set threshold conditions for borrowers' creditworthiness (TSC 2014).
13 During 2012 and up to October 2012, house price inflation remained flat, before starting to rise again.
this interdependency, and the irreversibility of the counterproductive effects that these interventions produced, generated a new articulation of government–market relations which both coincided with pre-existing macro-economic goals and opened up a new range of policy ideas that reshaped these goals.

As mentioned above, different factors, which the government largely neglected, pushed house prices up. In turn, HBS mostly benefitted those who were anyway capable of buying their own home (Public Accounts Committee, 2019). During the 2015 general election campaign, the unaffordability of homes became a central concern of younger generations and a source of intensifying criticism directed towards the harsh austerity measures enacted by the government (Fee 2015, 103).

Against this background, the newly elected Conservative government, with Osborne re-appointed as Chancellor, diagnosed the problem of unaffordability as a "home ownership crisis” caused by the under-supply of newly built homes. This diagnosis coincided with conventional economic thinking (UK Parliament 2018) and, as such, enjoyed wide political support. Diagnosing housing market conditions as a 'home ownership crisis' allowed Osborne to construct and justify his intervention as both unavoidable and temporary. It also helped him ignore the hardship within the rental sector and avoid putting his fiscal goals at risk (Somerville 2016, 166). But at the same time, instead of waiting for the market to do its thing or viewing the government as just an 'incentivising agent', Osborne developed a clear, centralised housing strategy for the mid-term, underpinned by government direct intervention. While following the overarching macroeconomic goal of fiscal consolidation, he further advanced the evolution of macroeconomic change.

The Treasury’s response to the crisis was twofold. First, in order to keep up the pace of the planned austerity, new spending on affordable and social housing programmes for 2015–2018 was limited to just £2.87 billion. Second, building on OBR predictions for a budget surplus in financial year 2018–2019, the Treasury allocated £6.9 billion new investment for the years 2018–2021, of which £4 billion was targeted at subsidising a new part-ownership HBS scheme for low- to medium-earning families, and £2.3 billion was allocated for subsidising the building of affordable homes (HM Treasury 2015).

However, these future plans were far from being sufficient. The unaffordability of homes, and the political pressures it generated, continued to cause aggravation. In June 2017, after the

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14 Between 2003 and 2013 home ownership in England declined from 71% to 63% of total households (Fee 2015, 1–3, 11).
Brexit vote, under the leadership of PM May, the government committed itself to a massive increase of the supply of affordable homes, including in the rental sector, and explicitly stated that "government is not allowed to ignore the needs of so many of its citizens" (The Conservative Party 2017, 70–71). Building on Osborne’s previous interventions, the new Chancellor, Philp Hammond, "dramatically extended" the Affordable Homes Programme for the years 2018–2023, and expanded its scope. £7 billion of new funding and another £8 billion of loans and guarantees were allocated to incentivise the building of "more than 200,000 homes" in order to help the weakest parts of the housing market. This £15 billion was part of a larger-scale five-year package of £44 billion comprised of loans, guarantees and fiscal spending, which aimed to bring about "the biggest annual increase in housing supply since 1970" and to provide solutions for the rental sector as well (Hammond 2017, 22).

On the one hand, Hammond’s housing policies were still subjected to conventional fiscal rules. From his point of view, government intervention in the housing market was based on, and could only be legitimised by, a successful budget deficit reduction (Hammond 2017). But, on the other hand, the nature and scope of the intervention, as well as the policy ideas which had been employed in it, and its features, were the emergent property of the prolonged evolutionary progression that our analysis has brought to the surface.

The political unrest that is currently growing across the UK has generated a critical discussion that emphasises the relationship between the tendency of monetary intervention to foster the upwards redistribution produced by the finance-led growth regime and the Brexit vote (Cumbo 2018; Blyth and Matthijs 2017). Roughly speaking, the political upheaval has been explained by different observers as either a bottom-up reaction to (Rodrik 2017), or as a top-down exploitation of, the social misery generated by the crisis of finance-led capitalism and its resolution (Blyth and Matthijs 2017, 218–219; Hopkin 2017). Either way, the general view is that this radically changed political environment might be a potential driver of a fundamental macroeconomic change (Hopkin 2017, 476). The basic assumption underlying this projection is that, so far, no macroeconomic change has yet taken place.

Our analysis has told a different story. The debate over public spending is indeed still bounded by conventional economic thinking, but both monetary and fiscal interventions that were meant to be short-term produced long-term effects which are not easily reversible and can no longer be dismissed as a short-term response to exceptional circumstances. Their counterproductive outcomes deepened the disintegration of the pre-existing growth regime, reshaped monetary
and fiscal goals and generated evolutionary macroeconomic change. Taken together, the effort to restart market- and finance-led growth, guided by conventional macroeconomic ideas, might have laid the foundations for the evolutionary emergence of a new, more interventionist growth pattern for the UK.

**Israel**

In May and June 2019, a decade after the GFC, the Bank of Israel (BoI) purchased foreign currency to mitigate the appreciation of the Israeli Shekel and thereby support exports (Ben Simon 2019). This meant that the Bank’s unconventional monetary intervention would continue under a third governor. The continuation of this unconventional policy is particularly striking in the Israeli case, as it responds not to a weakness of the Israeli economy, but rather to its relative flourishing during the last decade. In parallel, unconventional market intervention has also been taking place in the Israeli housing market, where the government has been operating massive tax subsidies to assist families to become homeowners.

Current housing and foreign exchange (FX) policies reflect substantial deviation from the pre-2008 liberalisation trend in both markets. Intervention in FX and housing markets was a central tenet of the Israeli developmental state (Maman and Rosenhek 2012), but since the mid-1980s both markets have been continuously ‘liberated’ from government meddling. In this respect, the renewed forms of intervention in Israel are no less puzzling than those taking place in the UK. The constructivist-evolutionary framework reveals the mechanism behind them. It reveals how short-term FX intervention, which were supposed to respond to and fix temporary market disruptions, became part and parcel of the BoI’s toolbox and policies, and how this new logic of ‘market intervention for the sake of market preservation’ has travelled also to the housing market.

**Unconventional monetary intervention: short term and continuous**

One of the central components of Israel’s road towards economic liberalisation included ending its long tradition of intervention in the FX market. The process towards achieving that goal occurred gradually but steadily: a fixed exchange rate regime was replaced in 1989 by a floating exchange rate with relatively narrow bands; these bands gradually broadened throughout the 1990s, until becoming obsolete in 1997 and formally removed in June 2005, shortly after Stanley Fischer was nominated as governor. Indeed, when promoting the removal of the band
in 2002, the BoI emphasised that it would completely allow the bank to avoid intervening in the FX market (Klein 2002).

This is the background for the BoI’s renewed FX intervention against the appreciation of the Israeli Shekel, which began in March 2008 and continues – alternately – to the present day. Crucially, renewed FX interventions were not supposed to become a permanent phenomenon, especially not in 2008; rather, they were initiated to achieve an immediate goal (countering a specific moment of over-valuation of the Shekel in the FX market) and an additional short-term goal (increasing the Bank’s FX reserves). Accordingly, when explaining the Bank’s FX operations in April 2008 at the Israeli parliament (Knesset Finance Committee (KFC) 2008), Fischer emphasised their short-term prospects, and defined the counter-speculative action as a “unique step… which was, and would remain, so we hope, a rare event” (Ibid). Along the same lines, increasing the Bank’s FX reserves was supposed to be moderately carried out and to have a clear expiration date: “we are there every day, [buying] 25 Million [US$], doing that two years, reaching the [desired reserves] level, and getting out” (Ibid). Adhering to prevailing dominant ideas of the efficient market, Fischer emphasised that “the Israeli FX market has been extremely efficient in the last ten years […] we don’t want to enter to such an efficient market [causing] people to ask what is the Governor’s mood today” (Ibid). Indeed, intervention against the Shekel’s appreciation was justified because the market was not operating as efficiently and smoothly as it was supposed to according to the same dominant ideas, but such deviation was perceived as short term and self-correcting: “in the last months [the market] was less stable […] and we saw the need in a two-day intervention, but now it begins to stabilize.”

Nevertheless, markets did not stabilise as they were supposed to according to the dominant conventional perception, and the Bank’s interventions have evolved accordingly. Already in late 2008 the BoI updated its goal for FX reserves – from $35–40bn to $40–44bn in November that year (Atad 2012); this goal would be continuously updated. In practice, reserves would reach $70bn in late 2010 (BoI 2010a) and $115bn in mid-2018. Concurrently, the Bank enhanced substantially its attempts to counter the appreciation of the Shekel by quadrupling its FX purchases to $100 million a day. This occurred after the collapse of Lehman Brothers, when it was already clear the global economy was in turmoil. Reflecting the fact that global markets were not as stable as they were expected to be, but also that this represents a temporary phenomenon, the Bank announced that it “considers the possibility of further purchasing foreign currency, for some time” (BoI 2008) even after the new reserves goal was achieved.
In August 2009, the Bank adjusted its FX policy again, announcing that it would halt its regular foreign currency purchases, and that

[From now on, the Bank of Israel will act in the foreign exchange market in the event of unusual movements in the exchange rate which are inconsistent with underlying economic conditions, or when conditions in the foreign exchange market are disorderly (BoI 2009a; 2009b).

This reflects the evolution of the Bank’s ideational framework for analysing the FX market, which continued to defeat the Bank’s prevailing conceptions by not operating as effectively and smoothly as it was supposed to: FX prices did not necessarily embody market trends but rather could well be “inconsistent with underlying economic conditions” (BoI 2009b). Furthermore, the Bank announced that no time limits are set for this policy (BoI 2009b). However, at the same time, the Bank still adhered to pre-crisis dominant ideas and accordingly declared that “it has no intention to operate against global trends in exchange rates.” Therefore, policies like re-instating an exchange rate band, not to mention ‘harsher’ means of controlling the exchange rate, were off the table. Accordingly, the Bank also suggested that the business sector would continue to consider “the uncertainty in the exchange rate changes and would protect themselves against expected and unexpected developments […]” (BoI 2009b). The Bank continued by saying that

We see the current period of FX intervention as exceptional, and as a direct result of the global crisis […]. We expect the market to go back to its 1998-2008 conditions, when the BoI did not intervene at all in the FX market, or that the need in such intervention would occur in rare events and very exceptional circumstances (BoI 2009c).

Then again, we should emphasise that ideational evolution did occur, while it was constrained by dominant beliefs in market efficiency. For one thing, the Bank started referring in its announcements to the fact that FX interventions are not a unique phenomenon anymore and that “many countries intervene in the recent period in FX markets by purchasing foreign currency” (BoI 2010b; Basok 2010). In addition, and in contrast to its past rejections of any FX intervention, BoI officials began to distinguish between counter-apperception and counter-devaluation efforts: while the latter are unsustainable since they require foreign currency that the Bank does not control, the former are viable since they require local currency of which the Bank has unlimited amounts (Fischer 2011). Later on, Karnit Flug, Fischer’s successor, would suggest that
In contrast to the past perception, according to which stable exchange rate policy regime are either a fixed exchange rate or a fluctuating exchange rate, after the crisis there is a growing recognition in the possible optimality of a “managed float” exchange rate regime (Flug 2014).

This seems to reflect the evolution of the ideational framework for FX policy from the pre-2008 ideal of non-intervention towards a new perception legitimising routine FX intervention within a liberalised market context. Flug further explained that in the event of there being strong depreciation on the Shekel, the Bank would be able to moderate this by using the vast amounts of foreign currency reserves it had accumulated; in other words, she suggested that within a ‘managed float’ exchange rate regime the BoI would also be willing to undertake exchange rate interventions in a direction that Fischer defined as unsustainable in 2011.

In a public discussion on the Bank’s policies, which took place in late 2015 (Interdisciplinary Center 2015), the former Deputy-Governor and the former General Director of the Finance Ministry both expressed their concerns regarding FX interventions, which “smeared” the exchange rate and became “addictive.” In response, the two members of the BoI’s monetary committee justified the necessity of FX interventions by fundamentally questioning the ‘pureness’ of the FX market in the first place and rationalising the ‘addiction’. Alex Cukierman, an international scholar of monetary policy and central bank independence, pointed at the disconnect between the exchange rate and real economic conditions:

In the last two decades, exchange rates are determined more by capital movement than by the current account. We know that capital market actors make many mistakes. Therefore there is a place for intervention, to protect the real economy (Interdisciplinary Center 2015).

Nathan Sussman, the head of the BoI research department, suggested that the Bank sees its duty to intervene regardless of whether the FX market is in equilibrium:

We are sometimes being asked why do we intervene in the FX market which is supposed to be in equilibrium; but if we do nothing and say that everything would go into place in equilibrium, we will get a recession. Therefore what we can do is to intervene and somewhat moderate that trend (Interdisciplinary Center 2015).

While this reflects a real change in the ideational framework guiding monetary policymakers in Israel, it has also been a gradual change which had an evolutionary pattern. Accordingly, Cukierman did not suggest the reversal of capital and financial market liberalisation, even
though it is clear that economic liberalization in these areas seems to stand behind this diagnosis. Likewise, neither Sussman nor Flug have questioned the fundamental idea that the exchange rate should be primarily determined by the market; Israeli policymakers did not ‘throw away’ their past beliefs. But throughout the evolving employment of unconventional interventions, they reshaped the pre-existing macroeconomic framework. At the time of writing, the ideational framework of Israel’s monetary policy continues to evolve: recently it was reported that Amir Yaron, the Governor who replaced Flug in 2019, has considered stopping sterilising the BoI foreign currency purchases (Barkat 2019). In other words, another conventional perception in 2008, according to which any FX intervention must not drive up inflationary pressures, is also being undermined. Taken together, the interaction between Israel’s economic environment, the economic ideas held by its dominant actors and the unexpected and undesired outcomes of previous rounds of FX interventions, together laid the foundations for the emergence of evolutionary macroeconomic change.

Unconventional housing market intervention

Like the FX market, the housing market has gone through gradual but fundamental liberalisation. During the developmental state period, the Israeli government was heavily involved in the housing market through subsidising investment in construction and construction materials and offering very significant subsidies to – mostly middle-class – buyers. These interventions had very clear national colours: they were mostly offered to Jews and were meant to serve partisan and Zionist goals (Rosenhek 1999). But in 2007–2008 these forms of intervention were already absent: Israeli governments discontinued subsidising construction during the 1990s and concurrently minimised their subsidies to home buyers. At least within the 1967 borders, housing policy was mostly disconnected from past national goals and housing prices were determined by market forces. Government intervention took the form of residual welfare policy, limited to assisting poor households that could not afford housing at market prices.

While Israel’s housing market did not suffer any direct ‘hit’ by the GFC (like Spain and Ireland have, for example), it was nonetheless indirectly affected by the BoI’s response to the Great Recession. As it turned out, the evolving expansion of unconventional monetary interventions generated unintended and counterproductive outcomes that are not easily reversible. Unprecedentedly low interest rates have amplified the demand of both households (whose
mortgage costs were slashed) and investors (whose alternative investment channels became either unprofitable or too risky). This produced a cycle in which rising housing prices and low interest further pushed the demand of both groups; the housing prices index accordingly rose by 88% between mid-2007 and late 2016. Consequently, many middle-class households, mostly young couples who were unable to take a mortgage given the price hikes, were “ousted” from the housing market (and at the same time increased their housing expenditures, whether as debtors or as renters), making housing policy a central concern and political issue (Milrad 2017). Similar to the case of the UK, these undesired policy effects, and the way they had been interpreted by Israeli policymakers, created new interdependencies between monetary and housing market interventions that had far-reaching evolutionary consequences. The mixed policy responses to what became commonly known as ‘the housing market crisis’ reflected this process.

On the one hand, various attempts were made to further the deregulation of the housing market by creating new and faster channels of planning and permit giving, which were supposed to enhance housing supply. Likewise, the government, which owns most of the land in Israel, was ‘releasing’ more land for housing purposes. But on the other hand, Israeli governments implemented various policies that essentially reflected a reversal of past liberalisation efforts, most notably in terms of setting housing prices in certain regions and projects at rates substantially lower (by 20–25%) than market prices. The exact form of these interventions has changed over time, but was essentially based on committing private contractors to sell apartments at a pre-determined price in return for purchasing the land from the government at a discount. Additional forms of government actual and suggested intervention in the housing market included the implementation of a massive long-term rental project and removing VAT payments on new apartments.

As in the case of FX market interventions, these new policies have reflected, and resulted from, an ideational evolution triggered by the gap between policymakers’ general perception of the market as the best and most efficient allocation mechanism and their view of contingent market conditions as deviating from that ideal. On the one hand, policymakers – in this case elected politicians rather than non-elected experts – have expressed their continued belief that the fundamental solution to the crisis has to come through an increase in the supply of apartments. The underlying assumption was that prices have hiked because exogenous factors (government inefficiencies and policies) have put hurdles in the way of the market and were the essential reason why the supply of housing did not increase as it was supposed to in response to rising
prices. On the other hand, the same policymakers have based their policies on the assumption that, even if they were to manage to encourage greater housing supply, the market would not react in a timely manner to the rise in demand, and therefore the government has to enact immediate direct interventions. Put differently, interpreting the undesired effects of monetary interventions through the lens of their conventional economic thinking, policymakers advanced the diffusion of interventionist policy ideas into the housing market.

This is demonstrated by the words of the two different finance ministers who served in office in the period 2013–2019, Yair Lapid and Moshe Kachlon, with regard to their housing policies. While affiliated with two different parties, both were elected on the promise that they would tackle the housing crisis, and indeed housing policies were at the top of their agendas. In a speech he gave in 2013, Lapid firstly referred to the current dysfunction of the market: “We have an emergency in housing that threatens a whole generation of young people who are afraid they will never have an apartment.” The response he advocated rested, on the one hand, on “removing bureaucratic barriers […] in order to increase the rate of construction starts in Israel.” But at the same time, he announced that the government would also take more immediate and direct intervention steps in the form of a “’National Housing Project’ for the construction of 150,000 long-term rental units” (Ministry of Finance (Israel) 2013). Throughout this project, he explained at another opportunity, “[the government] will bring tens of thousands of apartments for rent to demand areas, lowering housing prices that threaten to crush an entire generation of young Israelis” (Ministry of Finance (Israel) 2014). Clearly, such an intervention on the part of the government suggests that the market does not operate effectively in answering demand in the so-called ‘demand areas’.

Kachlon, who replaced Lapid in 2015, followed in his policies a very similar logic, according to which government policies should combine “structural solutions alongside short-term emergency measures” (Nissan 2015). Later on, he explained in more detail that “creating a stock of available land for construction and increasing supply are the fundamental steps for resolving the housing crisis” (Ministry of Finance (Israel) 2015). However, at the same time, since the effect of such measures would necessarily be limited in the short term, he implemented his flagship short-term policy of subsidising housing prices (Mekhir LaMishtaken, ‘Price for the Resident’). As further explained, “we are flooding the market with land [the longer-term policy], along with a Price for the Resident [the immediate intervention], which answers young couples who have never owned an apartment” (Gazit 2016). Justifying further the government’s market interventions, Kachlon contended that “a roof is a basic right
and it is our duty to provide it”, essentially expanding the residual logic of pre-crisis housing support, which was restricted to poor households, to all Israeli households (and to the middle class in particular). Yet this expansion did not represent a shift towards a new type of social housing policy. Rather, it was meant to contain the ‘housing market crisis’ by temporarily subsidising housing in the context of a temporarily low market supply.

The actual results of these policies in terms of changes in housing prices were either continued price hikes (until 2016) or a slowdown in price increases (since 2016). Either way, such results did not satisfy policymakers’ expectations. The interpretation of these undesired outcomes, constrained by the effects of previous monetary interventions on the one hand and prevailing economic ideas on the other, produced new variations of government intervention. Accordingly, the exact forms of intervention changed, and existing forms of intervention were expanded and recalibrated so that they would produce more effective results. Like in the case of FX interventions, these extensions and recalibrations reflected the combination of policymakers’ clinging to past perceptions of market efficiency and their perception of actual present conditions as reflecting a market dysfunction that requires government correction. One of the early explanations for market dysfunction, as already mentioned, was government regulation. But later, after deregulatory steps were already implemented, certain market actors – most notably the contractors and the banks – were identified as the cause behind continued high prices:

There are large interest groups here that do not want prices to fall, and that includes the banks. Does it make sense to you that a bank whose job is to give a mortgage doesn't do it when the person needs only a hundred thousand equity and the apartment costs 600,000? (Bizportal 2016)

As in the case of the FX market, where policymakers have acknowledged financial markets as a factor biasing the exchange rate, these comments point towards factors which are inherent to the housing market and still bias its results. As such, it reflects how ideational evolution in the housing market, despite its inherent limits and constrains, has also produced some more substantive ideational changes. More generally, this case demonstrates the emergent dynamic of evolutionary change, where the unintended and counterproductive outcomes of previous adaptations, and the interdependencies they produce between different policy arenas and institutional sub-systems, reshape actors’ understanding of their economic environment and
generate ideational-institutional change. And while this type of change is not radical in itself, it might have far-reaching macroeconomic outcomes.

Conclusions

This paper has introduced a constructivist-evolutionary approach to institutional change that offers a new way of thinking about post-GFC economic policymaking in advanced economies, and more specifically about the evolving relationship between conventional macroeconomic goals and the expanding employment of unconventional policy ideas. Exploring the 'most-different' cases of the UK and Israel, we have shown that, in both countries, the employment of unconventional policy ideas that were meant to support the continuity of the pre-existing macroeconomic regime generated evolutionary macroeconomic change.

In both cases, the interaction between an unstable economic environment, the conventional ideas through which actors made sense of the unfavourable economic conditions they confronted, and the unconventional policy ideas they employed in order to contain these conditions generated – in terms of actors’ intentions and expectations – a counterproductive evolutionary process with far-reaching consequences. Instead of stabilising the economy, these interventions produced unintended and undesired outcomes that preserved the sources of instability they strove to contain.

In the UK, the failure of austerity on the one hand and monetary easing on the other to spur real- and financial-sector growth drove both the expansion of monetary and fiscal interventions and their diffusion to different financial and non-financial markets. On the side of monetary easing, this process led to the emergence and the institutionalisation of an innovative framework for monetary policy. On the side of housing and mortgage market interventions, this process generated a new interpretation of government–market relations and opened the way for the emergence of what we termed 'state-backed privatized Keynesianism', where the government stepped in to support, and to some extent replace, the market. In Israel, the new approach to monetary and exchange rate intervention was driven by the interaction between ideas of efficient FX markets and their actual behaviour, which threatened Israel’s growth engine – its export sector. FX market interventions, which began as a short-term instrument to be utilised in exceptional circumstances, were legitimised as persistent policy tools and were de-facto institutionalised. House price inflation, which emerged as an unintended outcome of the unconventional interest rate policy, led to the diffusion of interventionist policies into the
Israeli housing market as well. Put differently, in both cases the progression of counterproductive evolution produced an intricate web of interdependencies between policy ideas, practices and institutions that reshaped pre-existing macroeconomic goals and generated evolutionary macroeconomic change.

Based on this analysis, we showed that macroeconomic change is not necessarily the outcome of a sweeping ideational-institutional transformation but could also emerge as the unintended result of counterproductive evolutionary processes. As is always the case with an evolutionary dynamic, the future direction of this process is difficult to predict. But based on our analysis we may conclude that in both cases the current ideational-institutional context is already very different from its pre-crisis setting, and that the expansion of both central bank and government intervention might have laid the foundations for a more substantial macroeconomic change.

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