Johnson
Cornell
SC Johnson College of Business

Book Review

Administrative Science Quarterly
1–2

DOI: 10.1177/00018392221105200
journals.sagepub.com/home/asq
SAGE

Mitchel Y. Abolafia. Stewards of the Market: How the Federal Reserve Made Sense of the Financial Crisis. Cambridge, MA: Harvard University Press, 2020. 224 pp. $41.00, hardcover.

The 2008 financial crisis devastated the U.S. economy, wiping out $10 trillion of wealth and prompting an overhaul of the financial regulatory system. At the center of it all was the Federal Reserve, an institution whose responsibility is to maintain economic stability. Looking back at the actions the Fed took (or did not take) during this period, stakeholders continue to debate important questions: did the Fed not see the crisis coming? If they did, why did they not take more aggressive actions to avoid it? In *Stewards of the Market*, Mitchel Abolafia takes us into the room with Fed officials, offering a firsthand account of the conversations that led to their most important decisions. Through his analysis, we come to not only understand but appreciate the challenges the Fed faced as well as the limits of their control during the crisis.

Drawing on the verbatim transcripts of the Federal Open Market Committee's closed-door meetings from August 2007 to December 2008, Abolafia peels back the technocratic veneer and exposes to the reader how deeply social the Fed decision-making body truly is. Adopting a sensemaking perspective, he walks us through how Fed officials in these meetings 1) debated the meaning of cues about the economy, 2) cobbled together a shared narrative to make sense of the crisis, and 3) worked to map that narrative onto policy actions that seemed appropriate. As we are led through these discussions, we see how the Fed grappled not only with making sense of the crisis but also with taking timely action. These challenges were created, as Abolafia reveals, because Fed officials faced constraints natural to any decision-making process. I found his discussion of three constraints particularly compelling.

First, early cues that foreshadowed the crisis were ambiguous, making it difficult to construct a new narrative to make sense of the situation. Abolafia points to the re-pricing of risk as a good example. Re-pricing refers to investors demanding higher premiums for investments previously believed to be safer. While officials recognized that this could indicate that something was wrong with subprime mortgages, they correctly pointed out that it could also reflect a well-functioning, efficient market. If such re-pricing was happening, then the market must have been overpriced and, as Chairman Bernanke pointed out, such adjustments were "obviously a healthy development" (p.13). Another example was the sudden loss of confidence in credit agencies. This cue clearly raised questions about the market's stability, but officials had to square this with other cues indicating that the economy was still operating strongly. These examples thus show that the Fed saw the early warning signs of the crisis, but the lack of coherence and alternative interpretations of these cues constrained the Fed's ability to develop a timely narrative that captured what was truly going on.

Second, once Fed officials had developed a shared narrative that depicted the seriousness of the crisis, they found they could not take the actions they believed were necessary. In particular, the Fed's narrative portrayed a contagion spreading across the economy, which led them to believe that aggressively lowering the federal funds rate was their best chance at slowing this spread. However, Abolafia shows that officials expressed concern about how such aggressive actions would also send another signal to the market. Charles Plosser, President of the Philadelphia Federal Reserve Bank, argued that these actions had ''the potential to confuse people—that [they would be] taken as a desire to bail out bad actors—and that could feed into the moral hazard'' (p. 35), thus making things worse than they already were. The Fed found themselves yet again constrained, this time by an epistemic problem of knowing how the market would react, leading them to err on the side of caution and lower interest rates more slowly than they believed was best.

Finally, once market participants had accepted the calamity of the situation and were willing to let the Fed do whatever it takes to avoid a total system collapse, the Fed faced its ultimate constraint—political pressure. To showcase this point, Abolafia asks us to revisit why the Fed saved Bear Stearns in early 2008 but let Lehman fail later that year. After casting doubt on the two most prominent explanations—1) that the market had already taken precautionary measures to anticipate Lehman's collapse and 2) that the Fed did not have the legal authority to step in—Abolafia offers a compelling alternative. He shows us how the political discourse over the summer of 2008, which focused on individual responsibility and defined the Fed's actions as a government bailout, painted the Fed into a corner. In theory, the Fed had the power to defy these pressures, as the institution is not beholden to politicians. But if they chose to save Lehman, they would risk their own legitimacy as an institution. That risk was simply too large, and so the Fed was constrained yet again in taking the actions they deemed most appropriate.

Overall, Abolafia convincingly demonstrates that the Fed, as a deeply social decision-making body, has its limits. What I like most about this portrayal is that it helps readers grasp just how understandable the Fed's actions were over the course of the financial crisis. Had one been in the room during these discussions, the policy actions would have made sense. In this regard, Abolafia's treatment of the Fed is deeply respectful, free of the retrospective smugness that can come from hindsight. For these reasons, this book offers a refreshing take on the financial crisis, complementing existing arguments about how the macroeconomic training of central bankers was the primary reason the Fed failed to take appropriate action during this period. I highly recommend this book to readers interested in the sociology of finance and the role of the Fed in the U.S. economy. I also recommend it to those seeking better understanding of how institutions operate, as this book reveals the limits of our civic institutions, not only in their interpretive capacity as social bodies but also in the face of political pressure.

Derek Harmon
Stephen M. Ross School of Business
University of Michigan
Ann Arbor, MI 48109
djharmon@umich.edu