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EDITORIAL

Challenges for economic policy

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Before the financial crisis hit the world economy in the aftermath of the Lehman bankruptcy in the summer of 2008, the prevailing economic policy doctrine had been mainly one of market efficiency by deregulation. In fact, the refusal of the American Government to rescue Lehman can be interpreted as a last ditch attempt to enforce market discipline—with disastrous results. However, it would fall too short to blame neoliberalism alone for the crisis. After all, many mistakes had been made before through public intervention, including the artificial creation of a homeowner society in US and the flooding of markets with idle money, not only by the FED, but also by the ECB. It is also telling that, in Germany, the federal state banks were much more involved in the accumulation of toxic assets than the private banks. Thus, policy failure has played a substantial role in generating the recent financial crisis. However, it has also given a wake-up call to economists around the globe to reconsider the relevance of their theories to reality. After all, economics is not only a theoretical, but also an applied science. Accordingly, it takes more than academic brainstorming and empirical bean counting for an economist to be able to give sound policy advice. Not least, some knowledge of both economic history and the history of economics could be particularly helpful, because the recent crisis was not exactly the first ever. Financial crises such as the Dutch tulip mania or John Law's paper money disaster emerged before economic liberalism was even thought of. In fact, the emergence of new forms of financing such as credit, stocks or SPV's seem to periodically overcharge both market players and regulating institutions alike. Consequently, there are reasons enough to confront our theories not only with empirical evidence from today, but also with historical experience and the explanations which provided by economists of the past, including those that may have been undeservedly forgotten.

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For this special issue of International Economics and Economic Policy, we have selected four papers which were presented at the 12th Annual Conference of the International Network of Economic Research (INFER) in Münster, Germany. They are all written in the context of the special topic of the conference "Institutional Economics and Economic Policy: addressing the practical and theoretical challenges of applied economics". The authors deal with various aspects of this subject: improved methods for empirical research as a basis for policy recommendations, the effectiveness of macroeconomic policies, and more tangible problems of economic policy, such as house ownership and family issues. Notwithstanding the divergence between these topics and methods, all papers have in common that they are not art for art's sake, but aim to contribute to a better economic policy design.

This issue starts with a technical paper by Makram El-Shagi. His motivation is that the recent crisis has demonstrated the importance of nonlinearities, when an economy is far from equilibrium. In order to give sound policy advice, developing a technique for estimating these nonlinearities will surely constitute one of the fundamental challenges for applied economic research in the coming years. However, one of the most popular types of model used for such phenomena—the Threshold Vector Error Correction Model (TVECM)—has so far been computationally unfeasible for larger models with more than two variables. El-Shagi develops an evolutionary algorithm for estimating TVECM with more than two cointegrated variables and an unknown cointegration vector, which saves around 90% of the computation time, compared to the traditional grid search approach.

The second contribution deals with problems arising from the asymmetrical design of the current monetary regime. Martin Menner and Cordelius Ilgmann review the history of negative nominal interest rates and provide a brief survey of the proposals that received popular attention during the recent financial crisis. They show that 'taxing money' proposals have a long intellectual tradition and that, rather than being the conjecture of the alleged "monetary crank" Silvio Gesell, they constitute a serious policy proposal. In a second step, the article demonstrates that, besides the more popular debate on a Gesell tax as a means of removing the zero bound on nominal interest rates, there is a class of neoclassical search-models that advocates a negative tax on money as efficiency enhancing. This strand of the literature has so far been largely ignored in the policy debate on negative interest rates. Therefore, Menner and Ilgmann argue that negative nominal interest rates are indeed a potentially viable policy measure for stimulating effective demand in a recession and that the issue deserves more attention by the scientific community.

The third paper deals with foregone earnings of West German mothers, due to child care and intermittent labour market participation. The work deals with the effects of the resulting implicit child costs in a dynamic household bargaining model. The regression results of a Mincer-type wage equation, with German Socio-Economic Panel Data (West) for the period 1984–2005 and correcting for sample selection (Two-step Heckman), indicate considerable wage penalties due to birth-related employment withdrawal. On the closure of the fecund window, mothers are subject to gross hourly wage cuts of up to 25%, compared to their equally educated, non-stop full-time employed counterparts, and the total annualized losses in Germany amount to as much as 201 000 Euros. Although foregone earnings do not matter as much in stable partnerships, they turn out to be a veritable asymmetric specialization risk that can prevent women from having children, if divorce seems sufficiently probable. The results indicate that Germany needs to foster an economic policy that allows women to combine work and childcare—or at least to offset the foregone earnings—in order to raise birthrates.

The fourth and final paper deals with the implication of homeownership for labour market performance. Using German regional data for 1998, 2002 and 2006, Oliver Lerbs examines the Oswald hypothesis, that high levels of homeownership are linked to inferior labor market outcomes. Applying a set of control variables, three different econometric models are specified and estimated: a cross-sectional model, a pooled data model, and a model taking into account unobserved regional heterogeneity. Once unobserved regional effects are accounted for, the findings are consistent with Oswald's hypothesis. However, the economic significance of the relationship is at best marginal. Thus, an economic policy which aims at increasing the number of homeowners will not affect labour markets.

Each of the articles in this issue contributes uniquely to a better understanding of practically relevant economic issues and thus to our ability to solve real economic problems. The variety of methods chosen by the authors should not be regarded as a flaw but as an additional asset, because the field of economics is far too complex to be tackled successfully through a monolithic methodology, as the recent crisis reminds us yet again.