Empirica (2011) 38:1–2
DOI 10.1007/s10663-010-9148-x

EDITORIAL NOTES

Introduction

Special issue: The aftermath of the financial crisis: Conference in Honour of Kurt W. Rothschild

Gerhard Rünstler · Ewald Walterskirchen

Published online: 14 December 2010

In November 2009, the Austrian Institute of Economic Research (WIFO) and the Austrian National Bank (OeNB) organised a conference on economic issues related to "the aftermath of the crisis"—whenever it may arise. The conference was held in honour of Kurt W. Rothschild, celebrating his 95th birthday. There have been quite a number of conferences on the roots and causes of the financial and economic crisis. This particular conference in Vienna focused on the economic and fiscal problems that are to be faced in the years after the end of the crisis.

Four of the conference papers are now published in this issue of Empirica. In addition, the issue includes two papers on the financial crisis that have not been presented at the conference.

The first paper by the US economist Thomas Palley deals with "America's Flawed Paradigm", which he identifies as relying on off-shoring production, growing household debt in the face of increased income inequalities, and asset price inflation. Rising mortgage-based loans and the house price bubble appeared to be the engines of growth during the last decade. Financial deregulation has kept the paradigm going for longer than would have been expected, but this meant also that the economy experienced a deeper collapse when the contradictions finally surfaced. Thomas Palley argues that the United States now need a new economic paradigm, which should feature an alternatively managed globalization scheme and new attitudes towards market regulation and labour market policies.

Jakko Kiander and Pentti Vartia discuss the lessons to be learned from Sweden and Finland during the early 1990s, which are among a few industrialised countries that have experienced financial and economic crisis during the last decades. The

Kurt W. Rothschild passed away on November 15th, 2010, shortly before this issue went into press (see Obituary in this issue)

G. Rünstler (✉) · E. Walterskirchen
Austrian Institute of Economic Research (WIFO), Arsenal Objekt 20, 1030 Vienna, Austria
e-mail: Gerhard.Ruenstler@wifo.ac.at

authors also discuss the relatively good performance of these two countries after the crisis compared to Japan: bank bailouts and currency depreciation in the Scandinavian countries played a crucial role. The abandonment of the earlier currency pegs was preceded by an intense and lengthy discussion, which highlights the high uncertainty faced by decision-makers in times of crises.

David Mayes from the University of Auckland tries to give answers to the question: How can we avoid another financial crisis? After summarising their basic characteristics he then drafts policy measures to prevent crises in the future. He emphasizes the needs of stricter regulation of the financial sector, the encouragement of prudential behaviour, and higher equity requirements. Meanwhile we can compare David Mayes' proposals with the measures already taken by international authorities (Basel III) and new regulations introduced in the US and the euro area.

High budget deficits and a huge public debt are among the most evident consequences of the policy measures to overcome the crisis and to prevent a depression similar to the 1930s. Historical experience suggests that economic growth is persistently lowered in the aftermath of financial crisis, making fiscal consolidation more difficult yet all the more essential. In his paper, Paul Van den Noord deals with the following questions: What will happen with public debt if no actions are taken at all? When should we start with fiscal consolidation? By which measures should the budget deficit be reduced? Most governments are now planning to reduce their budget deficits and may learn something from Van den Noord's proposals.

The present volume contains two further contributions that were not presented at the conference but fit well to the topic. Inspired by Dornbusch's model of exchange rate overshooting, Fritz Breuss presents a model of stock market behaviour, where stock market prices deviate from their fundamentals due to different speeds of adjustment in money, stock and goods markets. The model explains the genesis of the current global financial crisis primarily as the result of loose monetary policy in the US. The paper also studies the spillovers of a financial market crisis between countries by introducing the transmission channels of external trade or cross-border financial transactions.

Using official publications by central banks and international institutions, Gunter Tichy investigates the extent to which authorities have identified the risks that had built up prior to the current crisis. He concludes that authorities were well aware of macro-economic imbalances, high leveraging and heavy risk-taking at financial markets. However, action was prevented by their beliefs in self-regulating markets and in the potency of monetary instruments. Further, there was a tendency to enumerate a long list of potential risks whilst assigning them an extremely low probability. Gunter Tichy argues for reducing the complexity of the financial system in order to avoid financial crises in the future.