Editorial

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Unintended Consequences of New Crisis Tools


Since 2007, a series of macroeconomic, financial and geopolitical shocks has expanded the borders of public interventions. The immediate policy pressures from crises in combination with the long-run transition goals related to decarbonisation and digitalization have led to numerous new policy tools. Central banks have established unconventional tools such as extensive government and corporate bond purchases; governments have tried to stabilize the financial system and the real economy through large public spending packages and rescue credit lines. National governments are also developing new strategies for more national autonomy in production. The international community has pushed forward extensive sanctions to punish misbehaviour of autocracies. The European Union has embarked on an ambitious strategy to green the European economy.

While these new government interventions often enjoy large popular support and seem target-oriented at first sight, a careful evaluation of their benefits and costs is often missing. With this issue, we want to contribute to the evaluation with a particular emphasis on possible unintended side effects. The policy papers shed light on various related topics such sanctions, monetary policy exit and the impact of increasing regulation on the economies. The Policy Forum takes a deep dive into the new European “Taxonomy” that is pushed forward with great expectations as a tool for climate protection, but has hardly been subject to a closer scientific scrutiny.

In their contribution Sanctions Are Costly for Citizens but Beneficial for Autocrats: A Political-Economic Perspective Reiner Eichenberger (University of Fribourg) and David Stadelmann (University of Bayreuth) examine the impact of

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economic sanctions on the power of autocrats. With reference to the current unprecedented sanctions against Russia, they ask how sanctions change the power equilibrium within the sanctioned country. They argue that sanctions, through their constraints on economic transactions, access to goods and services, and mobility could even strengthen autocrats’ power and thereby can be counterproductive. Their key argument, developed in great detail and with various case studies, is that the sanction-induced scarcity of resources provides the autocrat with even more tools to buy support and suppress the opposition.

Heribert Dieter (Stiftung Wissenschaft und Politik) and Johanna Biedermann (University College Dublin) explore in their paper *The New Advocacy for Autarky: Self-sufficiency Is Now Once Again Becoming Popular for Geopolitical Reasons* the “surprising new interest in autarky” and protectionism from a historical and geopolitical perspective. The focus is on the United States, the European Union, China and India as the most important geopolitical players. The authors find for all a preference for the domestic production of certain products, especially for semiconductors in the USA and the European Union. China is argued to have taken after a period of trade liberalization a decisive turn towards domestic production and self-sufficiency. India, which has long favored domestic producers is seen to have at least partially embraced self-sufficiency. In the light of the current sanctions against Russia the authors project significant losses of welfare, if the growing inclination toward protectionism remains unchecked.

Since the global financial crisis (2007–2012) many inflation-targeting central banks in industrialized countries have increasingly failed to achieve their inflation targets, which has triggered reforms of the monetary policy frameworks for instance in the United States and the euro area. David Papell and Ruxandra Prodan (both University of Houston) contribute in their paper *Policy Rules Consistent with the FOMC’s Longer-Run Goals and Monetary Policy Strategy* to the discussion on the appropriate monetary policy rule in United States. They argue that the Federal Open Market Committee’s revised Statement on Longer-Run Goals and Monetary Policy Strategy implements flexible average inflation targeting and mitigates shortfalls, rather than deviations, of employment from its maximum level. They show how the Taylor approach could be modified to be consistent with the revised statement.

After inflation has strongly increased in all industrialized countries, the central banks have become forced to tighten monetary policies. Zbigniew Polanski and Mikolaj Szadkowski (both Warsaw School of Economics) contribute to the understanding of the impact of the ongoing interest rate increases and of the reduction of assets in the balance sheets on the profitability of central banks. As interest rates increase, central banks have to pay higher interest rates on the large deposits of commercial banks at the central bank. When central banks
reduce their holdings of (inter alia) government bonds, they face the risk of realizing valuation losses. The case studies of seven central banks of industrialized countries show that in the current environment both factors have a negative impact on the equity of central banks. Although central banks in contrast to commercial banks can operate with a negative equity, the authors point to possibly undermined central bank independence, with the fiscal space of governments being constrained.

Adalbert Winkler (Frankfurt School of Finance & Management) explores whether the rise in inflation since 2021 can be ascribed to a confinement of central banks resulting from financial dominance. In such a regime, central banks are unable to fight inflation out of fear that higher interest rates could lead to insolvencies of financial institutions, bank-runs and financial crises. This paper *Does Financial Dominance Explain the Recent Rise in Inflation?* refutes the view that the slow reactions of central banks to the 2021/22 inflation mirror financial dominance. It identifies an erroneous perception about the duration of an underlying supply shock as the more convincing explanation for inflation. The final warning notice is that the ECB’s new Transmission Protection Instrument could signal a future risk of financial and fiscal dominance.

Many of the recent government interventions reduce economic freedom. The rise of the shadow economy could be one of the negative side effects, because the flight from officially recorded transactions offers an escape from the additional regulatory burden. Andreas Freytag (Friedrich-Schiller University Jena), Friedrich Schneider (University of Linz) and Sebastian E. Spiegel (Friedrich-Schiller University Jena) conduct a panel analysis for 141 countries to study the link between economic freedom and the shadow economy. Their paper *The Influence of Economic Freedom on the Shadow Economy in Developed and Developing Countries* establishes a negative correlation between economic freedom and the size of the shadow economy. Among the different dimensions of economic freedom, the quality of the legal system, the protection of property rights and the freedom of international transactions turn out to be of particular importance.

The Policy Forum illuminates different aspects of the European Union’s Taxonomy, which is a classification system that intends to identify sustainable economic activities through EU legislation. Sustainable economic activities could with the help of this label benefit from more favourable financing conditions, regulatory privileges, and financial support from EU and national budgets. Given the pivotal role of the EU Taxonomy for the future economic conditions in the European Union, the Policy Forum provides important insights into the working mechanism and possible unintended side effects.

Clemens Fuest and Volker Meier (both ifo Institute) focus on the interplay between the Taxonomy and the system of tradable emission rights as it is in place in
the European Union. According to their analysis, a binary classification system that leads to a financing advantage of the “green” technology in combination with an emission trading system distorts the allocation of resources. In their short paper *Green Finance and the EU-Taxonomy for Sustainable Activities: Why Using More Direct Environmental Policy Tools Is Preferable* the authors conclude that the unintended side effects of green finance constitute not only a welfare loss but possibly even an increase of global emissions. The reason is that trade-flows will react to the Taxonomy-related distortions as the production of “brown” goods is relocated to countries with less strict environmental legislation.

Stefan Kooths (Institut für Weltwirtschaft) delivers in his short paper *EU Taxonomy: Mission Impossible* a critical assessment from an ordoliberal perspective. He claims that the Taxonomy stands in sharp contrast to the principles of a market economy. It requires regulatory knowledge that cannot be expected to exist and hampers entrepreneurial initiatives for coping with socially relevant scarcities. Apart from allocative inefficiencies, the Taxonomy opened the door for hidden political agendas and lobbying, with the side effect of creating a massive bureaucratic burden. Given the fundamental flaws, the EU taxonomy should be stopped rather sooner than later to prevent significant welfare losses.

The article *EU Green Taxonomy Data – A first Vendor Survey* of Andreas Hoepner (University College Dublin) and Fabiola I. Schneider (Dublin City University) present results from a unique survey among data providers. The results indicate which share of corporate activities of European companies comply with the Taxonomy’s criteria for sustainable development. It turns out that medium-sized companies tend to have a higher share of eligible activities compared to large companies. In addition to their detailed empirical findings, the authors add reflections on the preconditions for an unbiased reporting and classification of corporate activities by data providing companies.

Monika Köppl-Turyna and Wolfgang Schwarzbauer (both EcoAustria) present an analysis to which extent the Taxonomy could have an impact on trade specialization and trade patterns in the EU. Their article *Will the EU Taxonomy Impact the Trade Specialisation of European Economies?* offers insights into the sectorial specialization of EU economies and its cross-country heterogeneity. It turns out that European economies typically have a competitive advantage for those sectors that should perform well in the light of the Taxonomy’s criteria. The analysis concludes with reflections how the Taxonomy should be integrated into a coherent international policy framework.

Karolin Kirschenmann (ZEW) focuses on the impact of Taxonomy-led green finance on bank lending. Her article *The EU Taxonomy’s (Potential) Effects on the Banking Sector and Bank Lending to Firms* summarizes fundamental theoretical reflections and surveys the existing empirical evidence. The existing research
indicates that – already before the introduction of the Taxonomy – green projects have benefited from lower interest rates. The author points out that small and medium enterprises might be overburdened with reporting requirements on the sustainability of their activities. High compliance costs of banks and borrowers leave the cost-benefit ratio of the Taxonomy regulation uncertain.

Prominent ECB representatives have stressed the goal of the ECB to green its monetary policy, inter alia by moving from market neutrality to (green) market efficiency as guiding principle of monetary policy making. Gunther Schnabl (University of Leipzig) explores in the paper *EU Taxonomy and ECB Monetary Policy: Moving Towards Centrally-Directed Green Capital Allocation?* the link between monetary policy and Taxonomy. Taking the ECB’s Targeted Longer-Term Refinancing Operations (TLTROs) as a blueprint – he shows how the EU taxonomy could become the benchmark for the monetary policy of the ECB. By influencing the credit allocation of commercial banks on the basis of the Taxonomy, the European Central Bank would fundamentally disturb allocation efficiency and growth in the European Union.