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January/February 2015

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Crises, Wars, and Geopolitics: A Look at the Security of Energy Supply

Ensuring security of energy supply is one of the core objectives of energy policy. However, there is no consensus even among experts about how to define or measure security of supply. There is a lack of a generally accepted model of how to conceptualize security of supply and at which point it should be regarded as threatened. Nevertheless, public interest in the subject has grown steadily in recent years.

As part of the Energy Market Barometer, ZEW researchers ask energy experts from the areas of industry, associations, and academia about their perception of changes in the security of supply in Europe. Survey results since 2008 clearly show how the perceptions have been developing and have been revised from year to year. The current survey results illustrate how the events of 2014 have reverberated in the experts' estimations.

At the end of 2013, the great majority of surveyed experts (71 per cent) anticipated a broadly stable trend for the security of natural-gas supply in Europe. In fact, 26 per cent of the experts foresaw a positive development for the year 2014.

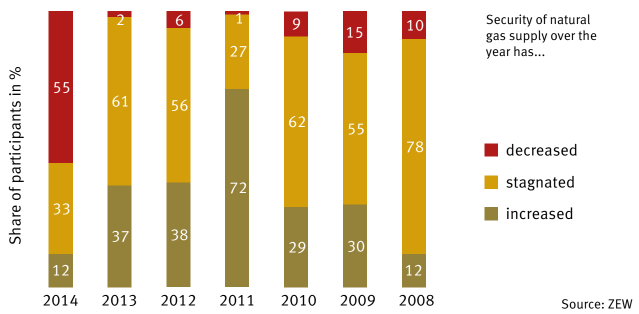
Estimates of natural gas security fell sharply in 2014

By the end of 2014, looking back at a turbulent twelve-month period marked by an unexpectedly intense conflict in Ukraine, there was a dramatic drop in the perceived security of energy supply: of the experts surveyed, 55 per cent perceived the security of Europe's energy supply with natural gas as having fallen in 2014. This is the worst assessment for any energy source that has ever been registered for this question in the ZEW Energy Market Barometer. However, it remains unclear whether the current decrease will completely erase the gains witnessed in past years in perceived energy security, and whether security of supply is actually threatened.

Energy experts are divided on the question of long-term natural-gas supply security

In fact, the majority of experts believe that the decline in security of supply has halted for the time being. Of those surveyed, 54 per cent foresee a stable trend for natural-gas supply security during the next twelve months. Nearly a third expect further worsening, while 16 per cent anticipate improved natural-gas supply security in 2015. With a view to the next ten years, the experts are more divided. Their estimations are split almost equally into three categories: 37 per cent expect natural-gas supply security to remain the same, 34 per cent expect it to decline, and 29 per cent expect it to rise. Looking back at the past year, we clearly see how sensitively supply security estimates respond to the geopolitical development. And it also shows how quickly the geopolitical situation can shift in unexpected directions.

RETROSPECT: SECURITY OF NATURAL GAS SUPPLY IN THE EU

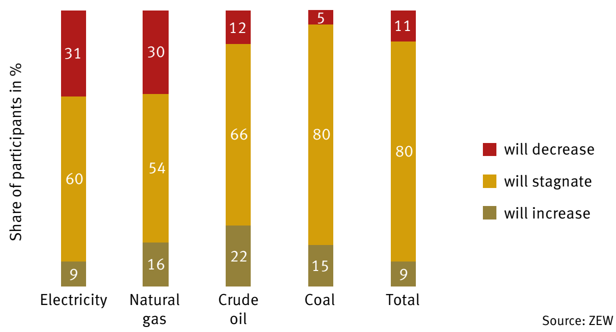


Stable expectations for electrical power

No comparably dramatic shifts in expectations were witnessed for other energy sources. For electrical power, crude oil, and coal, the majority of experts expressed the view that security of supply in Europe has remained static over the past twelve months. For electricity, 62 per cent of those surveyed believe security of supply has remained unchanged, thus only slightly more than the 57 per cent who had predicted such a development a year before.

Currently, 27 per cent of the experts are of the opinion that security of supply has fallen. A year ago, 35 per cent of participants predicted such a decline. Thus, the development has been slightly less negative than expected. Accordingly, the lack of change anticipated for the electrical power sector a year ago has been largely confirmed. For the next twelve months as well, almost a third (31 per cent) of the panel participants once again anticipated a decline in security of supply in Europe, while somewhat under two thirds (60 per cent) anticipated a stable trend. Looking at the next ten years, the pessimists hold a relative majority of 44 per cent.

SECURITY OF SUPPLY ON A 12-MONTH HORIZON



Crude-oil supply security on the rise

After the unrest in the Arab world, concern was once again palpable regarding supply security for petroleum products. The situation has apparently relaxed somewhat, following significant price reductions on the world market and the OPEC's (Organization of the Petroleum Exporting Countries) 2014 declaration that there would be no reduction in output despite falling demand and prices. Of the experts, 37 per cent expressed the opinion that oil supply security had improved over the past twelve months, while 53 per cent viewed the situation as unchanged. Looking ahead to the next twelve months, two thirds anticipate no significant change, while 22 per cent anticipate a further increase in oil supply security.

The range of opinions regarding the security of coal supply resembled the findings from past surveys: some three quarters of the surveyed experts saw no significant change in security of supply over the past twelve months, and a similar share anticipated no change in the near future (twelve months) or in the next ten years.

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The **ZEW Energy Market Barometer** is a semi-annual survey of about 200 experts, among whom are energy professionals in the areas of energy supply, trade, and services, as well as analysts and academics. The participants are surveyed about their short- and medium-term expectations concerning trends on the German and international energy markets. The complete results of the current survey (survey period: November 2014) are published in the January 2015 issue available at www.zew.de/en/publikationen → Energiemarktbarometer (in German).

EU Cartel Cases: The Amount of the Fine Impacts the Outcome of the Appeals Process

The losing party in a judicial verdict or administrative decision has the option of having their arguments reheard in an appeals process – including at the EU level. There has been no study until now examining the company characteristics affecting the likelihood of filing and winning an appeal. A new ZEW study of cartel cases finds the following: the greater the amount of the original fine, the likelier it is that a firm will succeed in obtaining a reduction of the penalty through an appeals proceeding.

EU cartel law provides for a one- or two-step appeals process. In the first instance, a cartel member objecting to the EU Commission's determination of a fine can file an appeal with the General Court (GC), an EU court downstream from the European Court of Justice. The firm that has been fined by the EU Commission can raise objections to the amount of the fine as well as procedural, evidentiary, and material aspects of the case. The GC can revoke the fine imposed by the EU Commission, increase or decrease the amount of the fine, or review the EU Commission's entire decision.

In the second instance, the unsuccessful party at the first instance (i.e. the convicted firm or the EU Commission) can turn to the European Court of Justice, the highest court of appeal in Europe. The Court of Justice can likewise revoke, raise, or lower the fine.

ZEW investigated the characteristics of companies that choose to appeal. In addition, the researchers sought to determine the factors that contribute to the success of an appeals proceeding. For this purpose, they considered data from 467 groups of firms that were involved in 88 cartels and were issued a fine by the EU Commission between 2000 and 2012. A number of the firms under examination had filed an appeal with the EU General Court, and some of them had gone on to file a further appeal with the European Court of Justice.

The ZEW analysis shows that, on average, the convicted firms belonged to a cartel for 83 months. The average fine handed down by the EU Commission amounted to 31 million euros. About five per cent of the convicted companies were cartel leaders and close to nine per cent were repeat offenders.

About half of the company groups examined (234) filed an appeal. Of these, a total of 47 per cent were successful. This means: approximately a quarter of all companies examined succeeded in getting the court to reduce the original amount of the fine imposed by the EU Commission – by an average of 8.4 million euros. Among the 109 successful appeals, 34 per cent were accepted on the basis of material grounds, and 20 per cent due to incorrect calculation of the fine.

A successful appeal reduces a company's fine

According to the study, a firm's chances of success in appeals proceedings are greater if it cites more than one justification for the appeal. By contrast, the chances of a successful appeal diminish when there are multiple appellants and when the EU Commission has prevailed in the appeals proceeding at the first instance. When firms cite primarily material grounds and incorrect calculation of the fine in their appeal, the fines are reduced more sharply than for all other cited justifications. In addition, the greater the original fine imposed by the EU Commission, the greater the reduction upon appeal.

From the viewpoint of political decision-makers and the participating courts of appeal, the ZEW findings suggest the advisability of increasing the transparency of the administrative and judicial decision-making process – for example, by issuing clear guidelines for rendering judgments. Transparency would reduce the number of appeals that are frivolous because they are unlikely to succeed. Another finding uncovered by ZEW researchers should provide further incentive for reform: both repeat offenders and cartel leaders can count on reduced fines after an appeals process. This runs counter to the deterrence concept in European competition law that seeks to punish cartel leaders and repeat offenders more harshly. Thus, the researchers recommend that cartel leadership and recidivism should be weighted more severely in the definition of aggravating circumstances when setting fines.

The study (ZEW Discussion Paper No. 14-063) is available for download at: www.zew.de/en/publikationen/7554

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IN THIS ISSUE

Corporate Taxation: IP Box Regimes in Europe

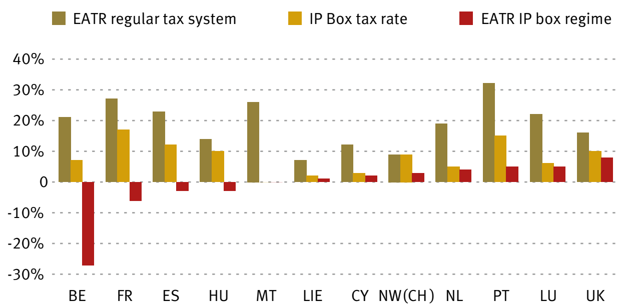
Intellectual Property (IP) Box regimes have become increasingly popular throughout Europe as an instrument to provide for a reduced tax rate on income from intellectual property such as patents, trademarks, and copyrights. On the one hand, governments hope that these incentives will encourage greater investment in R&D. On the other hand, IP Boxes allow multinational corporations to benefit from lower taxes on their earnings from intangible assets. A new ZEW study analyses the tax relief effects of IP Box regimes.

Intangible assets are of major economic importance and can be easily transferred to low-tax countries, allowing corporations to significantly reduce their effective tax burden. Against this backdrop, tax legislators in the EU are struggling with the question of how to best tax income from intellectual property (IP) so as to curtail the shift of IP and IP income to low-tax countries. The most important policy innovation in recent years in this area is IP Boxes, which provide for a reduced tax rate on IP revenues.

IP Box regimes in Europe vary concerning tax rates and other factors

Since 2000, twelve European nations have introduced IP Box regimes: Belgium, France, the UK, Liechtenstein, Luxembourg, Malta, the Netherlands, Portugal, Spain, Hungary, Cyprus, and, as of the beginning of 2015, Italy. The Swiss canton of Nidwalden has already implemented an IP Box regime, and the legislative process to set up a nationwide IP Box at the cantonal level in Switzerland has been initiated. The tax rates under these regimes vary significantly. They range from zero per cent in Malta to 16.76 per cent – including surcharges – in France. Besides variability in the amount of the IP Box tax rate, the different regimes also vary with a view to the qualifying types of IP assets and earnings, the calculation of the IP Box tax base, and the treatment of acquired intangible assets. The ZEW study concentrates on the effective tax burden associated with the use of IP Box regimes. The figure shows the effective average tax rates (EATR) for an investment in a self-developed patent and indicates that all European IP Box schemes are associated with a significant reduction in effective average tax burdens. Thus, IP Box regimes create considerable incentives for investment in the countries that offer them.

EFFECTIVE AVERAGE TAX RATE FOR AN EQUITY-FINANCED INVESTMENT IN A SELF-DEVELOPED PATENT



The calculations are based on the following economic assumptions: nominal interest rate of five per cent, inflation rate of two per cent, economic depreciation rate of 15.35 per cent, pre-tax rate of return of 20 per cent. The negative EATR in Belgium, France, Spain and Hungary occur because R&D expenses for a self-developed patent are deductible at the regular tax rate while revenues are taxed at the reduced IP Box tax rate. Source: ZEW

Are IP Box regimes primarily a strategic tax planning instrument?

However, tax concessions are not limited to self-developed intangible assets: with the exception of Belgium, the Netherlands, and Portugal, IP Box regimes also provide for low tax burdens on acquired intangible assets. Moreover, domestic corporations are not always required to conduct R&D activities within the firm in order to benefit from the tax concession. Thus, the question has arisen whether IP Boxes actually increase domestic R&D investment – as intended by policy-makers – or if instead, firms primarily utilise IP Box regimes as part of their strategic tax planning.

Especially in Germany, IP Box regimes have come under criticism for this reason. Investigations are currently under way at the level of the OECD and the EU concerning the extent to which the regimes may actually constitute "harmful tax practices". While these investigations may have political significance, it should be noted that their findings will not have any binding legal effects.

Recent compromise is making a reform of national regulations more likely

Nevertheless, the discussions at the OECD and EU level gained momentum in the autumn of 2014 with the publication of a draft proposal for a unified IP Box regime as part of the OECD's "BEPS" (Base Erosion and Profit Shifting) project. The draft is aimed at limiting the applicability of IP Box regimes to patents emerging from a firm's own R&D activity. This would require changes in the setup of existing IP Boxes in several European countries. The goal is to construct IP Box regimes as a tax instrument for promoting R&D.

The recent compromise on several critical issues between two major contenders in the debate about IP Box regimes – Germany and the United Kingdom – has paved the way for an agreement within the European Union and OECD states for a reform of national regulations that is likely to affect the future design of IP Boxes.

The study can be downloaded at: http://link.springer.com/article/10.1007/s10797-014-9328-x.

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Some regulation-induced innovations improve profit margins, but they may come at the expense of R&D funding.

Does Environmental Regulation Impair Firm Performance?

In past decades, nations such as the United States and Germany have progressively limited their emission of pollutants into the air, water, and soil. Yet emissions abatement technologies are often viewed as an impediment to economic growth and competitiveness. Has this assumption ever been justified, and what is its current validity? Several investigations conducted by researchers at ZEW show that regulation-induced environmental technologies do not necessarily impair firm performance – but they may get in the way of research and development.

More than 40 years after the introduction of the first major environmental regulations in industrial nations, the air is cleaner, the rivers are clearer, and the soil is less polluted. However, against the backdrop of mounting climate change concerns, debate on the mandated use of environmental technologies has not become any less intense. Quite to the contrary. Regulations to promote energy efficiency and green electricity as well as emission trading of greenhouse gases are only a few examples that figure in the debate about the potentially damaging influences of regulation on industrial competitiveness.

Researchers at ZEW investigated how the use of environmental innovations by firms impacted their financial success and productivity. A focus was placed on environmental technologies required by environmental regulation. The researchers concluded that it was not possible to generally correlate environmental innovation – that is, the use of new environmental technologies by firms – with negative effects on financial performance.

Some environmental technologies improve profit margins

Companies that introduced environmental technologies to reduce their consumption of materials and resources and increase their energy efficiency had higher profit margins – even when such innovations were introduced because of regulations. However, no such positive association could be found for other kinds of environmental innovation, such as for the reduction of air, water, or soil pollution. These findings were based on the 2009 Mannheim Innovation Panel, a representative survey of German firms that includes information on their use of various environmental innovations, profit margins, and productivity.

Another ZEW study shows that innovations that reduce the use of materials and resources or CO_2 emissions can be used more efficiently if they are introduced in conjunction with improvements in the organisation of operating structures and processes. It is important to note that both types of environmental innovations that were examined are integrated process innovations, i.e., not the use of filters or other downstream technologies. That is to say, environmental innovations are in no way an inevitable impediment to a company's success.

Regulation-induced environmental innovations can negatively impact R&D

However, the fact that the researchers found positive (or no negative) effects of environmental innovations on financial performance does not imply that they have no negative impact on competitiveness overall. For instance, the cost of introducing environmental innovations may come at the expense of R&D funding. Such expenditures constitute the basis for future competitiveness. For this reason, a ZEW study examined whether environmental innovations displaced expenditures in R&D. The results of the study add weight to the assumption that companies introducing environmental innovation in response to environmental regulations spend less, on average, on R&D. Even if no short-term effect can be shown, policy-makers must consider the long-term consequences of environmental policy measures so as not to endanger the competitiveness of domestic industry.

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Major research equipment like particle accelerators, research vessels, or large telescopes may exceed the R&D budget of single companies.

Q&A: What Are the Benefits of Government Investment in Research and Development?

"R&D Expenditures Are Important Drivers of Economic Development"

As a key foundation for innovation, R&D is crucial to a nation's economic strength. Accordingly, governments are typically willing to invest in R&D – but only when public coffers are flush. Between 2005 and 2013, the German government increased overall investment in R&D by 60 per cent to its current level of some 14.4 billion euros. By contrast, falling R&D investment has been witnessed in the European countries strongly impacted by the sovereign debt crisis. ZEW's Georg Licht, an expert in industrial economics, explains why government investment in R&D is essential – in both good times and bad.

Under what conditions is public sector investment in R&D advisable?

R&D doesn't just benefit the firm undertaking research, but other firms as well. Government subsidies for R&D reduce the costs of research and thus stimulate corporate R&D spending. In this way, governments can help to compensate for inadequate corporate R&D investment below the socially optimal level. At the same time, the public sector can conduct R&D at its own institutions and make the results available to all firms. This is especially important in instances when the public sector is the major consumer of the products generated by R&D – as is the case in the defence and health care sectors – and when the need for major research equipment such as particle accelerators, research vessels, or large telescopes exceeds the financial capacity of single enterprises or private individuals.

What are the particular problems facing government-sponsored R&D compared to private sector investment?

Government funding of R&D covers a wide range of research areas, from space and health care research to fundamental research on new product technologies or linguistics. Its impact is hard to measure, making it difficult to answer the question of how much the government should spend in each area. Of course, it is always important to ensure that government expenditure does not suppress private investment.

Can public investment stimulate economic growth?

R&D expenditure is an important driver of productivity and, by extension, of economic growth. This is true of R&D investment by private companies as well as by the public sector. Accordingly, the public sector R&D cuts that have been witnessed in the crisis-ridden eurozone nations have negative effects on their growth potential.

In nations such as Greece, Ireland, Spain, Italy, and Portugal, the European debt crisis has led to cutbacks in government R&D spending.

Indeed, these countries have drastically cut public R&D expenditure in recent years. Between 2009 and 2013, government R&D budgets in these nations shrunk by an average of 15 per cent, while during the same period, budgetary expenditures for R&D in Germany rose by 16 per cent. Government budgets have been thrown out of balance by falling tax revenues and rising costs of unemployment coverage in countries affected by the crisis, and are under considerable pressure. R&D budgets have not escaped the mounting push to reduce spending, and cuts have particularly affected discretionary spending not subject to contract or law. Moreover, cuts are encouraged by the impression that R&D can be easily postponed, since its productivity effects are only achieved over the medium term. This is especially true for government-funded basic research.

What incentives need to be provided at the European level to encourage EU Member States to devote more money to R&D?

First of all, Member States need to take action themselves, as they are responsible for the vast majority of public research funding in the EU – despite the large EU Research Framework Programme "Horizon 2020" and the R&D-related portions of the European Structural and Regional Funds. However, the EU could help encourage Member States to alter their spending priorities. One incentive we could think of is the co-financing for national research programmes within the Joint Programming Initiative, which the European Commission launched in 2008 with the aim of taking full advantage of public sector R&D potential throughout Europe.

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Dr. Georg Licht

is the head of the Research Department "Industrial Economics and International Management" at ZEW. He specialises in research on innovation and start-up activities. On 5 March 2015 he will moderate a panel discussion in Brussels as part of the ZEW Lunch Debates series on the topic of public sector R&D budgets during time of crisis.

Automatic Stabilisers Contribute to Economic Consolidation in Euro Countries

The recent financial and economic crisis has shown that the national budgets in the euro area absorb economic shocks to a larger extent than the US budget. Automatic stabilisers such as unemployment insurance, income taxes and social insurance contributions play a crucial role in this context. Stabilising mechanisms help to cushion the impact of economic downturns in the eurozone. The European Stability and Growth Pact has no negative impact on automatic stabilisers. This is the result of a study conducted by the Mannheim Centre for European Economic Research on behalf of the German Federal Ministry of Finance.

Does Europe need more substantial fiscal integration? The debate about this issue is continuing unabated. Observers stress that high debt levels in the euro countries are considerably constraining active fiscal policies. Automatic stabilisers are essential instruments against this backdrop. While critics argue that the Stability and Growth Pact leaves indebted member states too little flexibility to stabilise the economy, the ZEW study shows: the automatic stabilisers in all 18 euro countries largely contributed to consolidating the economy between 2007 and 2014. The Stability and Growth Pact had no negative impact on automatic stabilisers.

"Automatic stabilisers contributed a lot to keeping the European economy going during the financial and economic crisis," says Andreas Peichl, head of the ZEW Research Group "International Distribution and Redistribution" and professor of quantitative public economics at the University of Mannheim. In practical terms: without automatic stabilisers, the eurozone would have been hit much harder by the 2009 recession. "The eurozone gross domestic product dropped by 4.4 per cent – in the absence of automatic stabilisers, it would have dropped by up to 5.9 per cent," Peichl explains.

Automatic stabilisers in euro countries are more efficient than in the US

Moreover, the study shows that the automatic stabilisers of the euro countries are much more efficient than those of the US. Based on micro-level data for all 18 euro area countries and the United States, ZEW researchers simulated different shock scenarios for the economies on both sides of the Atlantic. The scenarios draw on figures from the 2008/09 crisis and the historical average. The central finding (based on the state of legislation as of 2013): "Tax and transfer systems cushion 47 per cent of the shocks in the eurozone, but only 30 per cent in the United States," says Professor Peichl. According to the analysis, a major part of this stabilisation gap between Europe and the US can be attributed to social security contributions and social benefits, which are significantly lower in North America.

Against the background of the ongoing debate on anti-cyclical mechanisms, the results of the ZEW study are of major relevance to Europe. The analysis shows that the national automatic stabilisers in the euro countries contribute significantly more to economic consolidation than in other industrialised countries, for example the United States.

The complete publication is available for download at: http://www.zew.de/en/publikationen/7769

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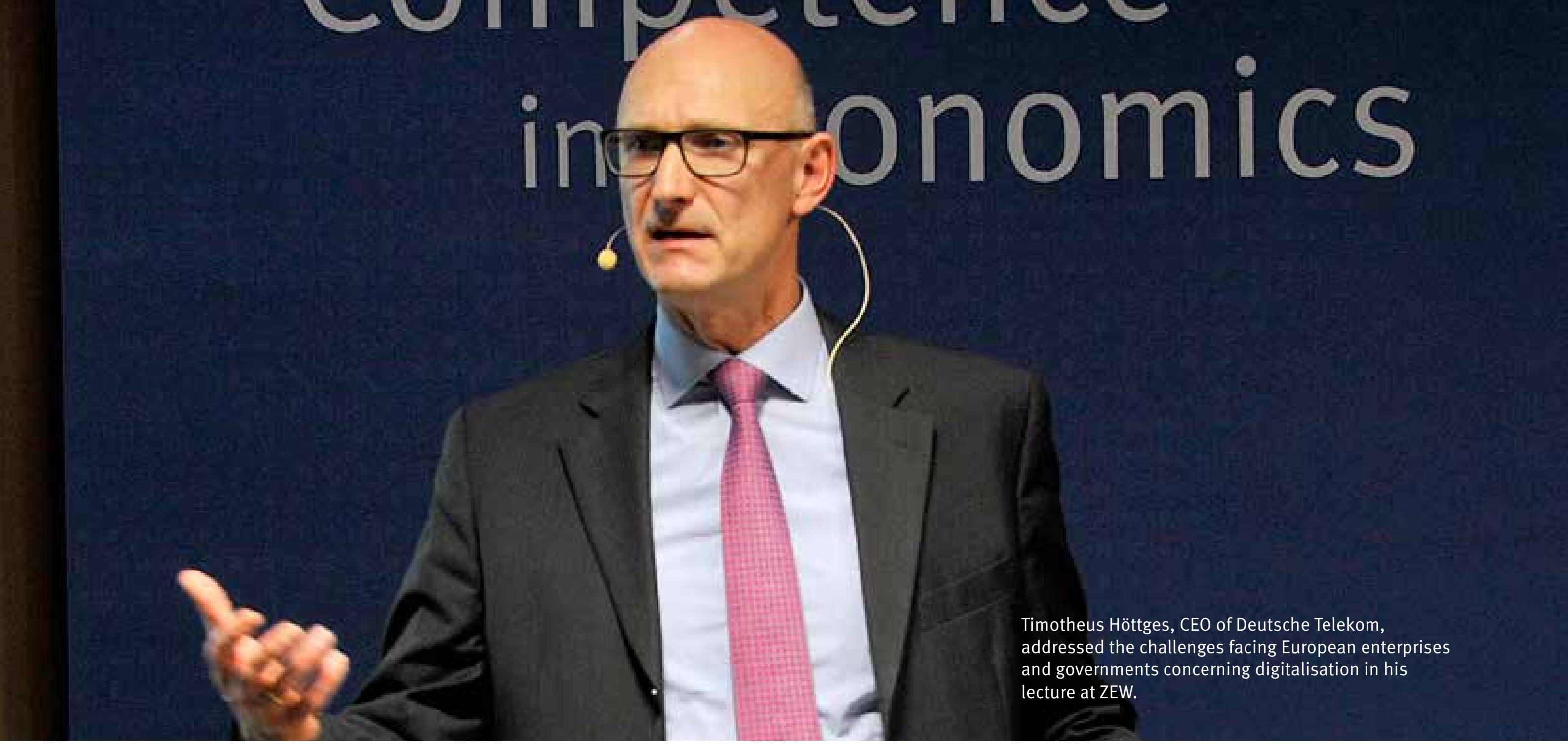
Automatic stabilisers like unemployment insurance schemes helped to cushion the impact of the recent economic crisis in the euro countries – to a greater extent than in the US.



Timotheus Höttges, CEO of Deutsche Telekom, addressed the challenges facing European enterprises and governments concerning digitalisation in his lecture at ZEW.

First-Hand Information on Economic Policy: Ensuring Competitiveness in the Digital Era

Now that the Internet has permeated virtually all areas of private life, the digitalisation of the working world is moving ahead apace. As a guest speaker at ZEW, Timotheus Höttges, the CEO of Deutsche Telekom, took a look into our digital future – and saw enormous challenges confronting Germany and Europe.

Whether we are ordering books, calling for a taxi, comparing prices for airline flights, or simply communicating with others – the Internet is everywhere. And yet, digitalisation is only just beginning, prophesied Deutsche Telekom CEO Timotheus Höttges in his lecture, “The Networked World – Opportunities and Challenges of Digitalisation”. Höttges spoke at ZEW on 15 December 2014 before an audience of some 200 guests within the series “First-Hand Information on Economic Policy”. In the future, Höttges said, we will need to come to grips with the Internet’s transformation of the productive economy – a transformation referred to by the catchword “Industry 4.0”. “Europe dare not sleep through this development,” warned Höttges. In the areas of chip technology, the semiconductor industry, and router technology, firms from the US and Asia are dominating the market. Europe generates less than ten per cent of global sales in information and communication technology. As a result of digitalisation, Höttges predicts that the industrial sector will continue to shed jobs. Yet, “for every industrial job lost, 2.7 new jobs will be created in the information sector. The only question now is where – in Silicon Valley or in Europe,” Höttges emphasised.

A defeat at half time

Especially in its competition with North American rivals, Höttges tells us that Europeans must admit they “have been defeated at half time”. Now we need to make structural changes, he insists, so that we can prevail in the second half of the digitalisation game. The Deutsche Telekom head was not surprised that there is no German Google, French Amazon, or Spanish Uber. He pointed out that for one thing, the United States is a huge, homogeneous market with 320 million consumers, offering its firms greater advantages of scale than any European nation. In addition, he said, Americans are able to collect more data because of laxer regulation. And, says Höttges, data are the ultimate drivers of digitalisation, something he expressed in the following simple formulation: “More data means better analysis, which means better offerings.” So just on account of their size, US corporations succeed in creating standards that Europeans are simply left to accept.

Creating equal opportunities for competing with the US

To put Europe back on the path to success, independent standards need to be created on this side of the Atlantic, Höttges insists. Industry needs to synchronise its languages, work more with open systems, and shift from vertical industries to horizontal partnerships. In this process, he stated, the Internet offers opportunities to link suppliers and process chains. In addition, Höttges favours equal treatment of European and non-European firms in the collection of data in Europe. For this purpose, he sees the need for a binding European Data Protection Regulation, which must apply to all who wish to conduct business using European data. There are also further steps needed, he feels, in the interests of data security and to combat cyber crime. Only in this way can we enhance consumer trust, he says. “A basic precondition for any new technology is further investment in infrastructure,” said Höttges. He stated that Deutsche Telekom is making an annual investment of some 13 billion euros in network expansion, and that, of this amount, four billion euros are being invested in Germany alone. If Europe can implement the required changes and make the necessary investments, it could create symmetrical competitive opportunities with the United States – and thus make it possible to win the digitalisation game during the second half.

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ZEW Starts into 2015 at Annual Meeting of the Allied Social Science Association

ZEW held job interviews with researchers at the ASSA meeting.

ZEW participated in the ASSA Annual Meeting in Boston from January 3–5, 2015. The widely-attended event, which is organised by the American Economic Association, is the world's most important conference for economists. ZEW researchers took this excellent opportunity to strengthen their international networks. Moreover, the ZEW stand provided comprehensive information for conference participants on the institute, cooperation opportunities and research stays in Mannheim. The ZEW human resources department conducted job interviews with international researchers at the ASSA job market.

Annual Conference of the Association of Competition Economics at ZEW

The Association of Competition Economics (ACE) met for their 12th Annual Conference at ZEW on December 5 and 6, 2014. Some 170 participants attended the meeting with nine parallel sessions on recent competition cases and developments, a panel discussion on exclusionary pricing practices, and the keynote lecture by Professor Aviv Nevo from Northwestern University, US. Nevo, who is the former chief economist of the US Department of Justice, discussed the role of econometric analysis in competition cases.

US economist Aviv Nevo spoke at the 12th Annual ACE Conference in Mannheim.

ZEW President Fuest Appointed to Minimum Wage Commission

In January 2015 a general minimum wage of EUR 8.50 per working hour entered into force in Germany. ZEW President Clemens Fuest has been appointed to the federal government's standing Minimum Wage Commission, which is responsible for determining the gradual increase of the minimum wage. Professor Fuest sits on the commission as an advising scientific member. The advisory members contribute their scientific expertise to the committee's work.

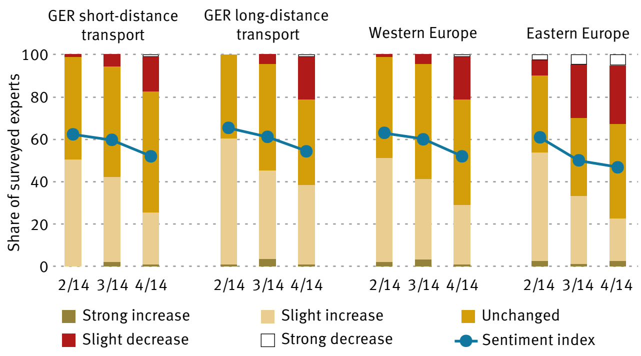
MaCCI Conference Focuses on Financial Market Regulation and Competition

Financial market regulation is a determinant of competition on financial markets. Even though a robust set of rules can result in competitive advantages, banks and financial service providers try to avoid regulatory requirements. The objective of the MaCCI (Mannheim Centre for Competition and Innovation) conference hosted by ZEW on November 6–7 was to assess the impact of financial market regulation for competition among financial service providers.

Enrica Detragiache, an IMF expert in financial sector regulation, gave a lecture at the MaCCI conference at ZEW.

In their lectures, Enrica Detragiache from the International Monetary Fund (IMF) and Roberta Romano from Yale Law School, US, addressed economic and legal issues of financial sector regulation. The panel sessions focused on the implications of a two-tier banking system in Europe, the introduction of a financial transaction tax, and a salary cap on bank managers' income. MaCCI is a joint interdisciplinary project of ZEW and the University of Mannheim.

Prospects for Road Freight Further Dampened



Source: ProgTrans/ZEW Transport Market Barometer

The sentiment for road freight traffic has further deteriorated. Regarding short-distance transport, only one quarter of experts participating in the Transport Market Barometer expect an increase in volumes. It remains to be seen if the planned stimulus packages have a positive impact. Interestingly, the sentiment indicator for Eastern Europe has dropped only slightly compared to the previous quarter. This raises the question whether the Ukraine crisis has become less acute, or whether the experts believe that it has a smaller impact on transport activities than expected.

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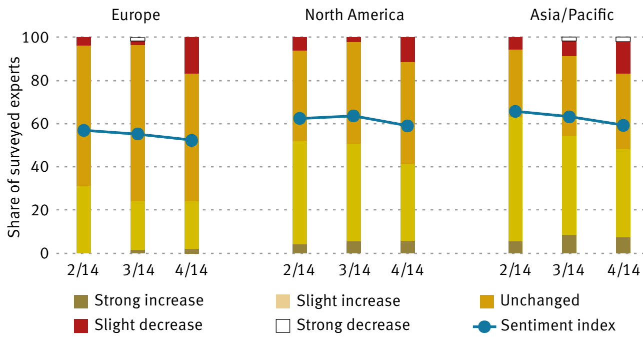
All Sea Freight Markets Show Downward Trend



Source: ProgTrans/ZEW Transport Market Barometer

Expectations have deteriorated for all sea freight markets, in particular for the European and Asia/Pacific traffic, in the fourth quarter of 2014. This is the result of the Transport Market Barometer survey conducted by Prognos AG Basel and ZEW. Only about half of the survey participants are still expecting a slight increase in freight volumes in the traditionally strong Asia/Pacific traffic. At the beginning of the decade 80 to 90 per cent of experts forecast growing freight volumes. Merely 40 per cent of experts expect an increase of freight volumes in the North America traffic.

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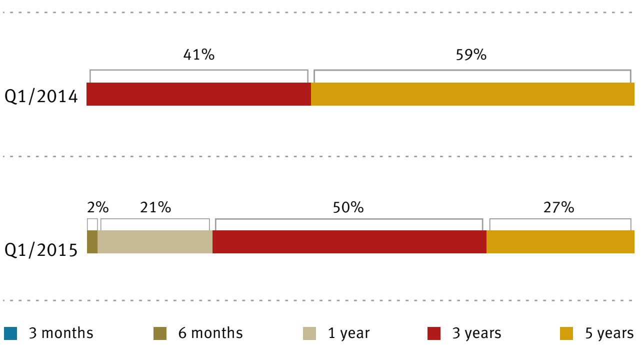
ZEW-PwC China Economic Barometer: More Flexible Renminbi Exchange Rate Soon



Responses are shown as relative shares. Source: ZEW-PwC China Economic Barometer Q1/2015

More and more German companies in China expect greater flexibility of the renminbi exchange rate. According to the ZEW-PwC China Economic Barometer (Q1 2015), almost 75 per cent of the surveyed company executives forecast a notably more market-based exchange-rate formation in the next three years. A year ago, less than half of the managers expected this development. Major causes include the planned liberalisation of China's financial sector as well as the relaxation of rules allowing greater participation of foreign investors in the Shanghai Stock Exchange.

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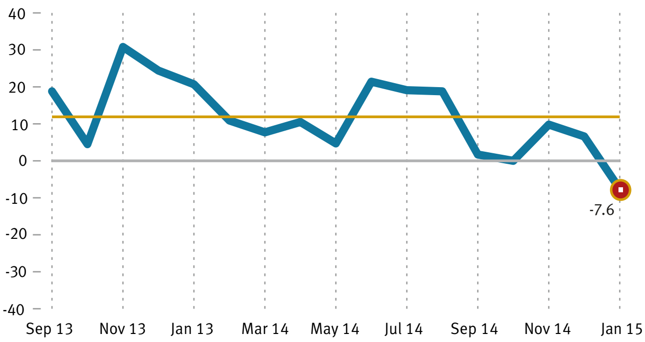
Economic Outlook for China Weakens Further



Source: ZEW/Fudan University

Economic expectations for China declined further in January 2015. The CEP Indicator, which reflects the expectations of international financial experts regarding China's macroeconomic development over the next twelve months, decreased by 14.2 points to a level of minus 7.6 points. The CEP Indicator has reached negative territory for the first time since the survey began in 2013. Decreasing by six points compared to the previous month, the assessment of the current macroeconomic situation in China fell to minus 3.8 points.

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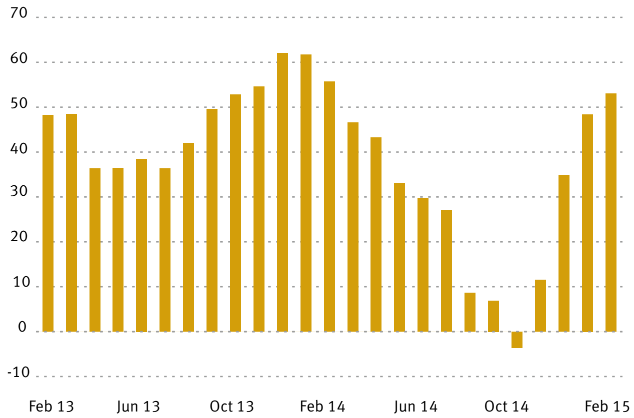
ZEW Financial Market Test February 2014



Balance of positive and negative assessments concerning economic development on a six-month horizon in Germany.
Source: ZEW

Germany: Fourth Consecutive Increase

Gaining 4.6 points in February 2015, the ZEW Indicator of Economic Sentiment for Germany stands at 53.0 points. Reaching its highest value since February of 2014, the indicator has increased for the fourth consecutive time. While the aggravation of the Ukraine crisis and the collision course of Greece's new government have a negative impact on economic expectations, quantitative easing by the European Central Bank and an unexpectedly strong economic growth in the fourth quarter of 2014 have improved sentiment among financial market experts. The survey participants' assessment of the current situation in Germany has also improved significantly. Increasing by 23.1 points compared to the previous month, the index stands at 45.5 points in February of 2015.

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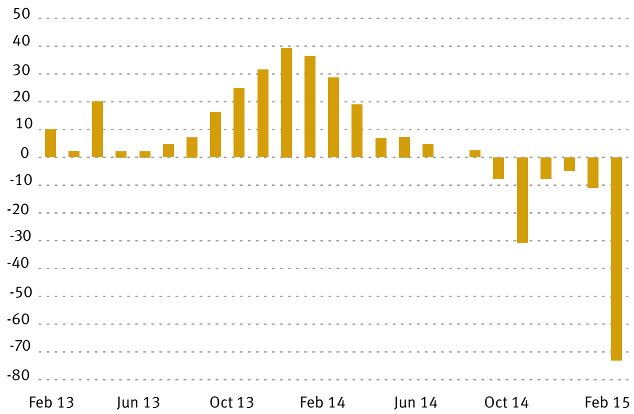

Balance of positive and negative assessments concerning economic development on a six-month horizon in Switzerland.
Source: ZEW, Credit Suisse

Switzerland: Economic Outlook Plunges

The ZEW-CS Indicator plummeted by 62.2 points in February 2015 to a reading of minus 73.0 points. This nosedive – the biggest monthly drop in the history of the indicator – shows that the surveyed financial analysts are forecasting a much weaker performance for Switzerland's economy in the aftermath of the Swiss National Bank's decision on 15 January to scrap the EUR/CHF exchange-rate floor. The last equally strong consensus about a dismal economic trend was in September 2011. The assessment of the current economic situation also suffered in February 2015, decreasing by 45.9 points to a reading of minus 5.4 points. The indicator is calculated monthly by ZEW in cooperation with Credit Suisse (CS), Zurich, and tracks analysts' expectations for Switzerland's economy for the coming six months.

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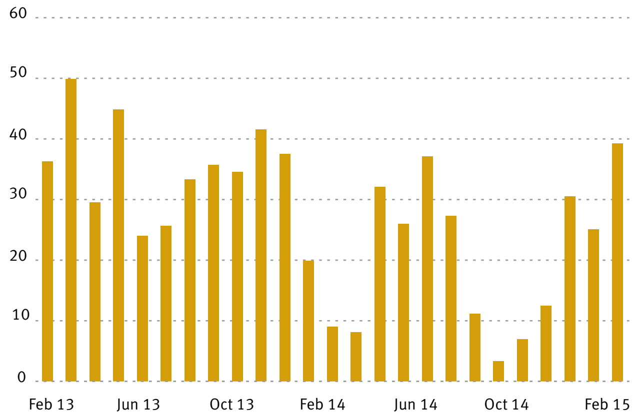

Balance of positive and negative assessments concerning economic development on a six-month horizon in the CEE region.
Source: ZEW

CEE Region: Economic Prospects Brightening up

The ZEW-Erste Group Bank Economic Sentiment Indicator for the CEE region (Central and Eastern Europe including Turkey) increased by 14.2 points in February 2015, reaching a value of 39.3 points. The surveyed experts' assessment of the current economic situation for the CEE region improved by 13.1 points and has reached a level of 21.4 points. A large majority of survey participants (71.4 percent) assess the current situation as normal. The ZEW-Erste Group Bank Economic Sentiment Indicator reflects the surveyed financial market experts' expectations for the CEE region on a six-month time horizon. The monthly survey has been running since 2007 as a collaboration between the Mannheim Centre for European Economic Research and Erste Group Bank AG, Vienna.

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Greece's New Government

An eventuality that was long feared is now reality. The Greek electorate no longer appears willing to accept budget cuts and economic policy reforms. Voting in droves for Syriza, the Greeks have chosen a party promising radical change. During the electoral campaign, the new Greek prime minister Alexis Tsipras made clear that he would expel the 'troika' from the country, stop servicing Greece's sovereign debt, and reverse painful reforms, including reductions to the minimum wage and downsizing of the public sector. Instead of privatising public enterprises, he proposes nationalising private firms; he has also vowed to scrub the labour market reforms negotiated with the troika. What does the election mean for the future of the eurozone and for Greece's continued membership?

Of course, we should not lend absolute credence to everything that politicians claim during an electoral campaign. Nevertheless, Alexis Tsipras has made enormous promises, and far-reaching changes seem inevitable. What might they look like? Two scenarios are conceivable.

One possibility is that the new Greek government will assume that fears of a disorganised Greek bankruptcy will make other governments in the eurozone susceptible to blackmail. In such a case, Alexis Tsipras could press for a new round of debt relief and an end to the reform programme overseen by the troika. If he were successful, dire consequences would result for the eurozone. Greece would remain permanently dependent on help from the rest of Europe, and the country would become a bottomless money pit. The only lesson that voters in Italy, Spain, and Portugal could draw from this development is that radical and populist parties are better at securing foreign assistance than moderate forces that rely on cooperation with European partners. Accordingly, Europe must steel itself against such blackmail and take precautions to mitigate the costs of Greece's possible exit from the eurozone. For example, there needs to be a plan to recapitalise banks that would find themselves in trouble in the event of Greece's departure. The aim of such measures would not be to bring about Greece's exit. Rather, they would be directed at preventing the destabilisation of the eurozone that could result from a collapse of cooperation between member states and abandonment of economic policy reforms.

Another scenario is also conceivable: during the electoral campaign, Syriza not only criticised European crisis management but also denounced deficiencies in Greece, especially corruption and cronyism, as well as the unfair distribution of the burdens of the crisis. The parties that have ruled Greece for decades failed to address these issues. Insofar as the new government places the elimination of these shortcomings at the centre of its policies and, for example, seeks more effective taxation of well-heeled Greeks or ramps up the fight against corruption, it will deserve support. In order to set new priorities in these areas, it is entirely possible that the programme of reform negotiated with the troika could be modified.

As for any democratically elected political leader, Alexis Tsipras deserves the chance to be judged not merely by his words – let alone words from an electoral campaign – but rather by his (hopefully) well-considered actions.

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