Patents versus Secrecy: Heterogeneous Costs of Disclosure and the Propensity to Patent

Is it better to patent or to keep a invention secret? A patent does not only protect an invention, it also requires its (potentially costly) disclosure: The patented knowledge could enable competitors to invent around and to legally enter the market. A ZEW study investigates to what extent the effect of disclosure requirement influences the decision to patent.

Disclosure costs have a negative effect on innovation and economic growth.

Patents have two major effects. First, they help to protect innovative ideas from imitation for a certain time. This allows inventors to appropriate the profits of their research efforts, thus providing them with incentives for further research and new ideas. Without patent protection, third parties may copy ideas, thereby diminishing returns for the inventor.

The second main effect of patents is that they are able to diffuse knowledge. Patents are publicly accessible documents containing detailed descriptions of inventions, for example concerning new technological functions, novel materials, or innovative pharameutical compounds. In this way patent documents enable third parties to appropriate new knowledge, to conduct their own research, and to develop further ideas.

The Effects of Disclosure

Most studies assume that disclosure requirements have no bearing on the protection provided by a patent. In other words, they assume that disclosure plays no important role until the patent expires. From this point of view, there is little connection between the disclosure requirement and a company’s decision to patent an invention or to keep it secret.

Analysing the Propensity to Patent

ZEW Discussion Paper No. 12-010 takes a closer look at the effects of disclosure. It investigates whether companies take disclosure costs into account when deciding whether to patent an invention or keep it secret. Disclosure may be expensive in that it enables competitors to invent around the patent and to enter the market with a variant of the patented subject.

The ZEW study evaluated data on some 800 industrial and service-sector firms. The data basis is the 2005 survey of the Mannheim Innovation Panel (MIP) provided by ZEW. In this year, besides the common innovation indicators the MIP...
also collected information on the companies’ competitive environment between 2002 and 2004. The empirical model used by the ZEW researchers in this study reflects the propensity to patent depending on the extent of disclosure costs. The researchers found a significant connection between the disclosure costs and a company’s decision to patent.

The analysis shows that the likelihood of filing a patent application is negatively related with the inventor’s believe that the divulged information would help competitors. In other words, the perceived harm of disclosure seems to outweigh the perceived benefits of patent protection if the company believes that the other competitors have much to gain from the disclosed information.

Relevance for Patent Legislation

The study’s findings are significant for the drafting of future patent legislation. This especially holds true for measures designed to strengthen the benefits of patent disclosure for third parties, such as the introduction or expansion of the research use exemption. In German patent law as well as in the patent provisions of many other countries, the research use exemption allows patented inventions to be used as inputs in third-party research without constituting a patent infringement. In this way, other companies are able to obtain information about inventions, develop and improve them, or discover new fields of application.

According to the findings of the study, however, the expansion of the research privilege – which, by extension, would be strengthening the disclosure effect for third parties – could motivate companies to keep their discoveries secret instead of patenting them. This, in turn, could have adverse effects on productivity and the strength of innovation systems.

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The ZEW study illustrates that funding strategies have a decisive impact on the success of product innovation processes. Pursing many different projects helps to avoid the risk of backing the wrong horse.
The Positive and Negative Effects of Market Concentration on Investment Funds

A new ZEW study investigates whether European financial market integration has created advantages for private and institutional investors. The study focuses in particular on decisions made by investment funds concerning where to locate their domicile.

More than 65,000 investments existed worldwide by the end of 2006. As a result of EU legal harmonisation, the competition between investment funds in Europe has increased markedly. So the introduction of a “European passport” for mutual funds that invest in defined asset classes and adhere to Undertakings for Collective Investment in Transferable Securities (UCITS) has spawned intense competition between investment companies concerning where to domicile their business.

More Possibilities with UCITS Passport

The UCITS passport makes it possible to register a mutual fund in any EU country and to conduct business in other member states without the need for further authorisation. Furthermore, fund companies headquartered outside the EU can conduct business in all EU Member States, provided they possess an authorised branch office in the EU.

The quick implementation of UCITS guidelines and favourable regulatory conditions allowed Luxembourg and Ireland in particular to grow into global centres of the fund industry. The extraordinary role of the mutual fund industry is best visible when comparing its relative size in European countries. According to calculated ratios, total net assets of funds amounted to 572 per cent of national GDP in Luxembourg, in Ireland even to 680 per cent compared to Germany (50 per cent) or Switzerland (74 per cent) in mid-2011.

Profitable Extent of Concentration

In the light of these developments, ZEW Discussion Paper No 11-085 examined the extent to which investors profit from market concentration. The study focused on the decisions made by funds concerning where to domicile their business, since market integration allows companies to concentrate their activities in specialised centres, thus reducing start-up costs for fund companies.

The study relies on data that concerns open ended mutual funds of many different types. The sample contained altogether 11,735 investment funds from 22 countries which represent 80 per cent of the fund volume issued globally between the years of 1997 and 2006. The period of investigation was restricted to 1997 to 2006 in order to exclude distortions created by the recent financial crisis.

The study’s findings show considerable differences in mutual fund fees between countries and fund types, with stock market funds being the most expensive and money market funds the most affordable. Furthermore, institutional funds are cheaper. The findings also show that investors profit from investment industry concentration. This is due to the relationship that exists between market size and mutual fund fees created by economies of scale and scope. The total cost rate of a fund is lower if the volume of invested capital is higher. Thus, as the size of the investment company increases (measured in terms of the managed volume of investment for all issued funds), fees for fund administration sink.

Disadvantages of Market Integration

Advantages, however, come with disadvantages. Generally, fund fees increase as the number of countries in which a fund is active rises, because cross-border business activities require additional partners and authorisations.

For instance, the total cost rate increases by almost 30 base points when a fund is offered in seven countries instead of only one. In this regard, the new implementation of the UCITS IV Directive of 2011 is very important, as it allows setting up and managing a UCITS fund in another EU Member State without having to comply with local “substance-criteria” of infrastructure. Overall, the results strongly indicate that market integration works in the globalised fund industry.

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Q&A: How Can we Contain the European Debt Crisis?

FIRE instead of Eurobonds: A New Solution Concept to Tackle the European Debt Crisis

Europe should address the crisis of confidence at the European bond markets through a direct equalisation of interest rates. Such a solution, as suggested by Friedrich Heinemann, rules out the collective liability of Eurobonds and is affordable even if applied to Spain and Italy.

What is the central idea of your recent proposal?

The basic idea is that countries like Germany and the Netherlands use a part of their crisis-related interest savings to ease the interest burden of countries with particularly high interest rates. The money of the countries benefiting from historically low interest rates would flow into the “FIRE Fund”. “FIRE” is the acronym for “fiscal interest rate equalization”.

Countries in crisis would receive a compensating amount when their bond issuances suffer from market interest rates exceeding a critical level. This support would be granted for one year subject to conditions. FIRE programmes would only be extended if the benefiting country would be able to submit proof of its reform progress.

What benefits would you expect if this approach was put into practice?

The establishment of such a FIRE Fund would result in an acceptable interest burden for new bond issues of troubled countries. Their efforts for consolidation would no longer be undermined by the high interest rates on the market.

What are the advantages of FIRE, compared to Eurobonds?

Eurobonds work with joint and several liabilities whereas FIRE does not imply any kind of mutual guarantee.

As opposed to Eurobonds, FIRE only reduces spreads in interest rates, it doesn’t entirely eliminate them. Transfers within the FIRE approach are, in sharp contrast to the hidden subsidies coming with Eurobonds, completely transparent. Transparency would reduce the danger of troubled countries relying on permanent support and slowing their reform efforts.

How expensive would FIRE be for German taxpayers?

Germany would come off cheaper with this system. Eurobonds imply a total interest rate levelling and thus conceal a significantly higher transfer volume. My own calculations show that the elevated interest burdens of the troubled countries are comparable in size to the savings of the creditworthy countries.

Can you give a specific size?

Assuming that FIRE finances a cap on Italian and Spanish interest rates at five per cent, this would require an annual equalisation payment of 5.7 billion euros for these two countries’ 2012 issues. The financing would be split among Germany (90 per cent), the Netherlands (8 per cent), and Finland (2 per cent), according to the advantages each country draws from low interest rates.

For all these reasons FIRE would be the better way compared to an extension of liability, notwithstanding the burdens linked with this concept.

You can find a long version of the FIRE concept at: www.zew.de/fire2012

PD Dr. Friedrich Heinemann

PD Dr. Friedrich Heinemann is the head of the Research Department of Corporate Taxation and Public Finance at ZEW. His research focuses on empirical public economics, federalism in Europe, and tax competition. In 2010 he received his venia legendi for economics from the University of Heidelberg. Along with work in several research groups, Heinemann is a board member of the Arbeitskreis Europäische Integration e.V. and a member of the Scientific Board of the Institute for European Politics in Berlin.

ZEW DISCUSSION PAPERS

No 12-046 Daniel Dreßler, Uwe Scheuerer: Empirical Evaluation of Interest Barrier Effects.
No 12-044 Simon Koesler, Martin Achtenicht, Jonathan Köhler: Capped Steam Ahead – A Case Study Among Ship Operators on a Maritime ETS.

No 12-043 Hanna Hottenrott, Sascha Reithäuser, Reinhilde Veugelers: Green Innovations and Organizational Change: Making Better Use of Environmental Technology.
No 12-042 Martin Achtenicht, Reinhard Madlener: Factors Influencing German House Owners’ Preferences on Energy Retrofits.
No 12-041 Bodo Aretz, Nicole Gürtzgen: What Explains the Decline in Wage Mobility in the German Low-Wage Sector?
Selection of Potential Energy Policy Indicators

Indicators can help identify which energy policies are successful – and which aren’t. Selecting the right indicators, however, requires a transparent and clearly comprehensible approach. This is the conclusion of a study commissioned by the Federation of German Industries (BDI) that was recently published by ZEW.

Securing a sustainable energy supply for private households and for the economy is one of the greatest challenges of the 21st century. Governments create framework conditions and incentives to reach this goal. Multiple impacts of political decisions on the environment and on economic growth have to be taken into account. In this context the traditional goal of energy policy is to ensure that energy supplies are reliable, environmentally friendly, and economically efficient. Energy policy has to meet these three goals to be successful and to gain the necessary public acceptance.

Yet energy policy is an extremely complex domain of activity, making it difficult to obtain a clear picture of the actual situation. For this reason, indicators can be useful. They can point to new developments and urgent problems, provide a simple description of complex issues, and raise public awareness.

Evaluation of Potential Indicators

There is an extremely wide range of potential energy policy indicators. In the study commissioned by the Federation of German Industries (BDI) alone, ZEW researchers evaluated over 100 potential indicators and determined which measures provide the best results.

To conduct the study, ZEW economists drew on monitoring reports, recent literature, as well as expert opinions. The study’s authors found that most indicators are prone to problems and neglect important aspects of energy policy goals.

Furthermore, they found that attempts to reduce the number of indicators to a manageable size necessarily result in the loss of crucial information. To address these problems, the authors argue that indicators must be selected in a transparent and clearly comprehensible manner.

Indicators for Reliability, Environmental Friendliness, and Economic Efficiency

The authors based their study on the three key objectives of successful energy policy mentioned above: reliability, environmental friendliness, and economic efficiency. First, the authors subdivided these objectives into their constitutive elements. For each element suitable indicators were then proposed and, where possible, quantified with data.

For the objective of reliability, the authors examined the energy supply chain, beginning with demand elasticity. This measure provides an indication of the potential severity of a supply disruption. Indicators for “grid reliability” and “reserve capacities” measure supply reliability from a technological perspective; “resource availability” puts into relief the political risks of a supply disruption; and “price security” assesses the supply risks impacting global energy markets.

Environmental friendliness turned out to be a particularly multi-faceted objec-
For this reason the study identified at least ten relevant dimensions, including climate change, soil and water acidification, particulate emissions, and resource depletion. The proposed potential environmental indicators measure, among other factors, pollutant emissions and resource depletion, and permit conclusions about the environmental friendliness of an energy system.

The authors defined economic efficiency as the total economic efficiency of energy supply. The accompanying indicators were designed to verify whether the conditions for efficient energy supply have been satisfied, such as competition on energy markets, the internalization of externalities, information transparency and the economic costs of energy policy interventions.

For all the detailed specificity provided by the study, the authors came across many areas in which further research is urgently needed. For instance, although there are many good indicators for energy reliability, much more work must be done on demand flexibility and elasticity, an area likely to gain much more importance in the future. In addition, the indicators for the political risks of energy disruptions require empirical verification, and researchers must develop a proven indicator for the quality of electricity supply if power grid assessment is to improve significantly. When examining environmental friendliness, the study’s authors encountered a variety of gaps in the data for soil and water emissions, resource depletion, and land use. The authors concluded that emission indicators need to be checked regularly to make sure they stay relevant. Furthermore, definitional problems arose in the measurement of resource depletion and land use that still need to be addressed.

### The Problem of Measuring Efficiency

According to the study, the greatest challenge lies in measuring economic efficiency, especially when it comes to the effects of external factors and market regulations. For both these areas, there is a shortage of solid, undisputed indicators for cost measurement. While indicators for individual aspects such as bureaucratic costs have been used in other countries, the total economic costs of energy policy measures – including, for example, cost effects related to international competition – are hard to measure with indicators alone.

### Indicators Point the Way to Further Research in Specific Areas

While the approach to indicator selection presented in the study may help identify informative metrics for measuring the success of energy policy, much more research is required.

There are gaps in data and a lack of suitable parameters for some areas. As emphasized in the study, energy policy cannot be adequately evaluated with indicators alone. Simple statistics do not suffice to represent complex causal relationships or fully explain the rise of specific trends. Researchers who want to know whether they are on the right track must undertake prospective analysis in addition to retrospective observation, and evaluate the individual measures taken to reach energy policy goals. Indicators can supplement this work, but their greatest value is to point the way to further research by indicating areas that warrant closer scrutiny.

The study “Indikatoren für die energiepolitische Zielerreichung” (“Indicators for the Identification of Successful Energy Policies”) that was commissioned by BDI and published by ZEW can be found in German language in the Internet at: http://www.zew.de/publication6622

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Q&A: How will Cloud Computing Change the Way we Work?

Working Anywhere, Anytime is Now Possible

More and more companies are shifting to cloud computing, where services like information storage and software applications do not depend on in-house data centres. These services are now offered by cloud computing providers in the Internet. ZEW researcher Dr. Jörg Ohnemus discusses the influence of cloud computing on business and work.

Why is it worthwhile for companies to use cloud computing for IT applications instead of keeping them on site?

First and foremost, cloud computing can help companies to cut costs. Investments in in-house IT systems usually have to be designed to match peak demands. If services and processes that require those investments only occur occasionally, these investments rarely pay off. By deploying services “in the cloud”, companies can forgo those expensive investments. IT costs thus become variable depending on usage. Cloud computing reduces need for IT specialists.

Which businesses profit most from cloud computing services?

Small and medium-sized companies probably profit most from cloud computing, since they do not have to buy, for example, expensive and only temporarily needed software licences. Cloud computing allows them to use those services flexibly on request and in the required scope when they are really needed.

Furthermore, especially start-ups and young companies that have not yet established their own IT infrastructure benefit from cloud computing services, since they do not have any adjustment costs by switching to cloud services.

What are the risks faced by the users of external IT services?

When you decide to use cloud services, you become of course to some extent dependent on your cloud service provider. Yet despite service level agreements like these, technical problems of the service provider can lead to interruptions in services and loss of data. Unfortunately for cloud service providers there have already been some prominent cases where this has happened, triggering heated discussions about the reliability of cloud computing.

What challenges does cloud computing still face?

Many companies are very careful and reluctant to use public cloud computing due to legal uncertainties. In Germany, for instance, data privacy laws require that companies maintain strict control over client data at all times. This is not always guaranteed when client data are stored on a public cloud server, especially when the data centre is located for example in the United States. To date, German companies have been able to store client data only within Europe without encountering legal trouble. This has led to the development that some cloud service providers establish data centres in Europe, although most of their cloud infrastructure is located in North America.

At least in part, cloud services free companies from having to invest in hardware, software, and in-house IT support. Will this effect lead to large IT department layoffs?

This is very unlikely to happen. Of course, some IT jobs will be lost, but on the other side new personnel will be needed for other positions due to the overall increasing digitalization of business operations of the companies. At least medium and large-sized companies are currently trending toward hybrid cloud solutions – a mixture of internal cloud services, which further requires in-house IT personnel, and public cloud applications. In addition, IT service providers themselves have a large and growing need for IT specialists.

Will cloud computing turn our working environment upside down?

Cloud computing will not totally change our working environment overnight and turn it upside down. The requirements placed on cloud services by companies are too specific for that. Together with the trend toward the mobile Internet, however, cloud computing will eventually allow us to work anywhere in the world and at any time.

This will certainly affect how companies organise their business processes and how individuals manage their working and free time in the future.

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POLITICO-ECONOMIC ANALYSIS
Spring Meeting of Young Economists at ZEW

At the end of April 2012 some 200 scholars assembled for three days to take part in the 17th Spring Meeting of Young Economists (SMYE) at ZEW in Mannheim. Organized by young economists for young economists, the SMYE is the largest conference in Europe especially geared toward young academics in the field of economics.

The conference is designed to give PhD students, post-docs, and junior professors the chance to meet in a friendly atmosphere and develop new ideas.

The SMYE takes place once a year, each year in a different European country. Past locations include Istanbul, Luxembourg, and Groningen. For this year’s conference, ZEW had the honour of hosting the event in Mannheim. The SMYE was successfully organised by some of the institute’s young researchers.

Of the 650 applications received, about 200 of the top candidates were invited to present their economic research and to discuss common problems.

As in past years, this year’s SMYE featured three internationally renowned researchers as keynote speakers. The first speaker was Professor Armin Falk of the University of Bonn, whose research focuses on the empirical examination of human decision-making.

The second keynote speaker to address the participants was Dr. Ayhan Köse of the International Monetary Fund (IMF). The research carried out by Köse and his colleagues has provided important insights into international dependencies between national economies and the transmission mechanisms of economic cycles. Dr. Mary Amiti, economist at the Federal Reserve Bank of New York, was the third keynote speaker. After summarizing current efforts to explain the economic crisis that began in 2008, she showed how the scarcity of financing for commercial transactions played a crucial role in the crisis.

Understanding the importance of fostering the next generation, the keynote speakers showed exceptional generosity. Not only did they waive their speaking fees, they each met with young scholars after their talks and attended lectures by other participants.

For more information about the conference go to: www.smye2012.org

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Some 200 young economists presented their research and discussed common economic problems.

ZEW Economic Forum: Perspectives for the Euro

ZEW President Prof. Dr. Dr. h.c. mult. Wolfgang Franz welcomed some 400 guests to the ZEW Economic Forum in June. Renowned political representatives, financial experts, and researchers discussed reasons for and possible solutions to the eurozone debt crisis at the event titled “Perspectives for the Euro”.

Prof. Dr. Clemens Fuest (Oxford University), Dr. Ulrich Kater (Deka Bank), and Prof. Dr. Manfred Neumann (Bonn University), as well as Prof. Dr. Dr. h.c. Hans-Werner Sinn (ifo Institute) debated on the question of how growth can be stimulated, even when there is no alternative to reducing the states’ debt burdens. The second part of the ZEW Economic Forum was dedicated to “science for practice”. ZEW researchers presented findings from their current research on investments and taxes, the financial centre Frankfurt, and the German export boom. The event was concluded with the lectures of Dr. Jens Weidmann, President of Deutsche Bundesbank (German Federal Bank), and Prof. Dr. Dr. h.c. mult. Wolfgang Franz, Chairman of the German Council of Economic Experts and ZEW President. Weidmann lectured on the medium-term role of monetary policy. Franz discussed perspectives for the euro and gave a résumé of this year’s Economic Forum.

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ZEW Researchers Receive Sakip Sabanci International Research Award 2012

Atılım Seymen and Florian Misch (from the right)

The ZEW Study “The Effectiveness of Countercyclical Fiscal Policy in Turkey During the Recent Economic Crisis—Evidence from a Natural Experiment” received the Sakip Sabanci International Research Award 2012. The authors of the paper are ZEW researchers Florian Misch, PhD, and Dr. Atılım Seymen. The award includes an endowment of 20,000 USD, and was given to them during a ceremony in Istanbul in June 2012. The topic of the 2012 competition was “Performance of the Turkish Economy during Global Crises”.

Using an innovative statistical approach, the awarded paper analyses the effects of a temporary consumption tax cut, implemented by the Turkish government during the 2009 global economic crisis, on firm sales. The research findings show positive effects of consumption tax cuts on firm sales. This is consistent with predictions of the theory, thereby providing new evidence on the effects of a specific countercyclical fiscal measure.

ZEW Researcher Receives First-Ever Best Paper Award of the UniCredit & Universities Foundation

Christiane Bradler (centre) works at ZEW’s Research Department of Labour Markets, Human Resources and Social Policy.

ZEW’s researcher Christiane Bradler is a recipient of the first-ever Best Paper Award of the UniCredit & Universities Foundation for the category “The Social Dimensions of Organizations”. This honour was given to her after the same titled workshop at the Central European University in Budapest at the end of April. The award was presented to Bradler and her co-authors – Susanne Neckermann (ZEW/University of Rotterdam), Robert Dur (University of Rotterdam), and Arjan Non (University of Maastricht) – by the CEO of the UniCredit Bank of Hungary during a ceremony on April 28, 2012 at the Central European University. Her paper, titled “Employee Recognition and Performance: A Field Experiment” investigates how acts of appreciation affect employee motivation.

Researchers of Fudan University Visit ZEW

A delegation of researchers from the renowned Fudan University in Shanghai visited ZEW in July. The Chinese delegation was headed by the director of the Institute of World Economy at Fudan University, Professor Hua Min, and attended a workshop. During two days, problems and phenomena like trade surpluses or the impacts of the euro crisis on the Chinese economy have been discussed under the title “Challenges and Countermeasures for Manufacturing-Based Economies: Resource Scarcity, Currency Appreciation, and Trade Surplus”. A focus was on the exchange of experience with trading CO2 emissions certificates in Europe and China, an area in which ZEW and Fudan University are already cooperating. Apart from scientific exchange, the event was also devoted to exploring the possibilities for an even more substantial cooperation in the future.

Researcher of Fudan University during their visit at ZEW in Mannheim.
In 2010 the companies of the German Vehicle Construction Sector have caught up the cuts in innovation expenditures realised in 2009. For 2011 innovation budgets are planned to rise further. For the automotive sector, investments in new products and processes reached almost 33 billion euros in 2011. In other vehicle construction branches, innovation expenditures have summed up to more than four billion euros in 2011. Due to the unclear economic developments, the planning figures for 2012 have been calculated quite cautiously.

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On a five-year time horizon prices of 10 to 20 euros per tonne CO2 on the European emission markets seem likely. A majority of 53 per cent of the experts surveyed by the ZEW Energy Market Barometer holds this view. Furthermore, roughly one third of the experts expect emission prices of 20 to 30 euros per tonne CO2. Some five per cent forecast a price range between 30 to 35 euros. The ZEW Energy Market Barometer is an industry-specific indicator of economic sentiment based on a semi-annual survey of more than 200 experts.

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Germany: Expectations Decline Slightly

The ZEW German Indicator of Economic Sentiment stands at a level of minus 19.6 points in July 2012. It has dropped by 2.7 points. "The decline of the economic expectations concerning the end of 2012 is flattening out gently. This could possibly be an early sign of an encouraging development in 2013. However, risks should not be underestimated," says ZEW President Prof. Dr. Dr. h.c. mult. Wolfgang Franz. The indicator reflecting the assessment of the current economic situation in Germany has dropped by 12.1 points in July. It is now standing at the 21.1 points-mark. Economic expectations for the Eurozone have declined by 2.2 points to minus 22.3 points in July. The indicator for the current economic situation in the eurozone remains almost unchanged at minus 72.9 points (up 0.3 points).

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Switzerland: Economic Expectations Stabilise

Economic expectations for Switzerland have improved slightly by 0.9 points in July 2012. The ZEW-CS-Indicator is now standing at minus 42.5 points. The share of analysts expecting the economic development in Switzerland to stay unchanged over the next six months has grown by 5.9 percentage points to 53.7 per cent. After the steep fall in the past month, the assessment of the current economic situation declined slightly by 1.3 points to 18.4 points. The majority of analysts appraises the current Swiss economic situation as "normal" (70.4 per cent). ZEW-CS Indicator is calculated monthly by ZEW in cooperation with Credit Suisse (CS) and reflects the expectations of the surveyed financial market experts regarding the economic development in Switzerland on a six-month-time-horizon.

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CEE Region: Expectations Decline

Economic expectations for Central and Eastern Europe including Turkey (CEE) have decreased by 7.6 points in July 2012. The ZEW-Erste Group Bank Economic Sentiment Indicator is standing at minus 7.6 points. The assessment of the current economic situation for the CEE region has slightly fallen to a level of minus 2.7 points in July. The economic sentiments for the eurozone have slightly improved by 4.0 points to a level of minus 6.1 points. Experts’ assessment of the current economic situation for the eurozone has remained almost unchanged in July. The respective indicator has decreased by 1.3 points to a value of minus 68.0 points. The economic sentiment indicator for the CEE region and further financial market data are surveyed monthly by ZEW with the support of Erste Group Bank, Vienna.

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Growth

Like a deus ex machina, growth has mutated into the great hope of 2012. Inspired by the election promises of the new French president, increasing support is being garnered by voices of opposition to German-led austerity who would put an end to ostensibly destructive belt-tightening and return us to the easy days of larger deficits. In this connection, past experience and insights concerning effective growth policies are being largely ignored – and not just at the EU level, where misinformation abounds, from the unsuccessful Lisbon Strategy of 2000 to more recent discussions concerning “project bonds” that would be granted by the European Investment Bank. One cause for consternation is the frequent confusion between business cycles and growth.

Growth, as we know, is trend development of real gross domestic product under normal capacity utilisation – in other words, it is a measure of expanding output potential. The factors that contribute to growth are well known: human capital, physical capital (including infrastructure), technological innovation, and effective regulation with a view to flexible and open labour and product markets, sound public finances, and efficient social systems. As achieving growth at a national or European level necessitates policy measures that take these growth factors into account, it is contradictory to advocate growth while at the same time ignoring public debt problems.

Business cycles, on the other hand, are fluctuations in capacity utilisation triggered by swings in macroeconomic demand. In times of recession, countercyclical policies (such as economic stimulus plans) can help to counteract slowdown, although such measures have their limits. Indeed, we can be sort of glad if stimulus spending leads merely to a proportionate increase in GDP – i.e. if the “fiscal multiplier” is one. Yet as policy-makers typically ignore the flipside of Keynes’s prescriptions – that is, to run budget surpluses and pay down debt during times of expansion – countercyclical spending leads to ever increasing public debt, the repayment of which is postponed in perpetuity. The excuses are always the same: When times are good, we shouldn’t undermine the recovery. And when times are bad, we can’t risk intensifying the recession. So when is time to pay down debt?

Many European countries proclaim that current deficit spending is directed at preventing a collapse in output, and that fiscal consolidation is still on the agenda, yet must be delayed due to current headwinds. This argument is not without its merits, and would be acceptable if the problem countries within the eurozone made credible promises to reduce deficits and debt. Yet I am reminded of a line from Goethe’s Faust: “I hear the message well, but lack faith’s constant trust”.

The problem countries within the eurozone must rapidly and comprehensively reform their regulatory and social systems if fiscal consolidation is to be slightly postponed. Reforms are needed to flexibilise labour and product markets, including the elimination of barriers to entry, excessive bureaucracy, and other hurdles to competition. Furthermore, amendments are needed to restrictive social protection policies that discourage entrepreneurial initiative. Beyond such reforms, in Spain efforts must focus on recapitalising key parts of the financial sector. If the Spanish government provides for this recapitalisation (and not the EFSF), then the country’s public debt levels will of course increase. But this recapitalisation, in conjunction with other reform measures, would have a positive signalling effect for financial markets, and could win acceptance for a prolonged timetable for fiscal consolidation.

Pro-growth policies and fiscal consolidation don’t have to contradict each other; in fact, they are symbiotic. As a complement to the European Fiscal Compact, a growth pact could transform existing subsidies, such as those for agriculture (without – horribile dictu – sparing the French), at least partially into pro-growth investment. In Germany it is difficult to understand why parts of the opposition in the Bundestag call for the ruling coalition to adhere more closely to the country’s “debt brake” regulations, yet at the same time claim that restrictions to deficit spending represent “ruinous cutbacks” in the problem countries of the eurozone.