

with M&A Report

Put to the Test: Opposition Party Proposals for Reforming the German Tax System

Although the last major German tax reform took place only a few years ago, Germany's company tax system is still in need of reform. A new study conducted by ZEW on behalf of the German Foundation for Family Businesses (Stiftung Familienunternehmen) examines the impact of different reform proposals put forth by various German political parties.

Until now Germany's current federal government has not launched any notable projects to reform the tax policy in the area of company taxation. The only noteworthy exceptions are a few amendments to measures enacted to offset the revenue

losses of the 2008 business tax reform. Tax reform proposals currently on the table are restricted to an adjustment of the income tax rate to counteract "bracket creep". However, Germany's opposition parties have made numerous far-reaching reform proposals. They uniformly recommend major increases in tax rates and the expansion of capital taxation. In the realm of company taxation, the following proposals are particularly notable: an increase of the corporate tax rate to 25 per cent (Die Linke, Germany's left-wing party); expansion of the tax base of the municipal trade tax to include a larger share of financing expenses (a proposal advo-

from 25 to 32 per cent (SPD); and the revival of the progressive taxation of capital income (Die Linke, Green Party). In addition, the introduction of a net wealth tax (Die Linke, SPD) or an one-off wealth contribution (Green Party) on individuals is being advocated.

Impacts of the Reform Proposals

In the study, ZEW economists quantify and analyse the effects of the parties' tax reform proposals on the effective tax burden of companies and their shareholders.

This analysis was performed using a computer-based simulation model called the European Tax Analyzer which allows for the calculation and comparison of tax burdens in various countries. The core of the European Tax Analyzer is a model company whose life cycle and tax assessment is simulated over a period of ten years. Focussing on the firm level the calculations show that the measures proposed by Die Linke would result in a major increase in

Effective Tax Burden and Impacts of the Reform Proposals



losses of the 2008 business tax reform. Tax reform proposals currently on the table are restricted to an adjustment of the income tax rate to counteract "bracket creep". However, Germany's opposition parties have made numerous far-reaching reform proposals. They uniformly recommend major increases in tax rates and the expansion of capital taxation. In the realm of company taxation, the following pro-

posed particularly by Die Linke); as well as revival of the net wealth tax for companies (SPD, social democratic party).

In terms of the taxation of individuals, proposals of particular note include: raising the maximum income tax rate from 45 to 49 per cent (a proposal advocated by the SPD and the Green Party) or to 53 per cent (Die Linke); raising the withholding tax (Abgeltungsteuer) on capital income

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RESEARCH FINDINGS

the corporate tax burden of nearly 47 per cent when compared to current tax law as of 2012. This change is primarily attributable to the proposed increase in the corporate tax rate from 15 to 25 per cent.

Looking at the tax effects on the shareholder level, the reform programme of Die Linke would actually increase the total tax burden by nearly 120 per cent. The reform proposals put forth by the SPD and the Green Party would likewise result in major tax increases in the amount of 19 and 32 per cent, respectively (at the aggregate level including the shareholder level). These increases are principally the result of a revival of the net wealth tax for individuals and an increase in the maximum income tax rate to 49 per cent (SPD and the Green Party) or to 53 per cent (Die Linke), as well as the progressive taxation of capital income (Die Linke and Green Party) or an in-

crease in the withholding tax on capital income to 32 per cent (SPD).

The figure on the first page clearly shows that – at the aggregate level – the reform programmes proposed by the opposition parties would essentially eliminate all of the major decreases in the effective tax burden that have resulted from tax reforms carried out in the past two decades.

Declining Tax Attractiveness

In the study, the economists have also analysed how the opposition parties' tax reform proposals would affect Germany's position among the EU Member States. This analysis reveals that the implementation of the examined tax reform proposals would probably have a severe negative impact on Germany's tax attractiveness as

a location for investment, as well as a negative effect on the competitiveness of German firms. This is revealed by a ranking of the EU Member States according to their effective tax burdens determined employing the European Tax Analyzer. While Germany (as of legal status in the year 2012) ranks 21st (at the company level) and 20th (at the aggregate level) among the 27 EU Member States (according to the 2010 legal status), the reform proposals put forward by Die Linke put back Germany to the next-to-last position (at the company level) and the last place (at the aggregate level). Focussing on the aggregate level (including the shareholder level), the reform proposals put forward by the Green Party and the SPD would likewise result in a significant deterioration of Germany's ranking by six places to the 26th rank.

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Experiment on the Patience of Child and Mother

Being in control of one's own behaviour is an important prerequisite for later success in school and the labour market. A new study examines self-control in 213 pre-school children and their mothers.

In the study (ZEW Discussion Paper No. 12-001), ZEW researchers evaluated experimental data that were gathered in 2008 in collaboration with the Socio-Economic Panel Study (SOEP) and the Institute for Empirical Research in Economics (IEW) in Zurich. The aim of the study was to investigate the level of patience exhibited by 213 children five and six years of age and to determine if there was any correlation between the patience shown by mothers and their children. The determinants of the time preferences of young children and their mothers have not been adequately researched to date. Given this backdrop, the study hoped to close an existing gap in the literature.

One or Two Bags of Gummy Bears?

In the experiment, children were asked to decide if they wished to obtain an immediate reward in the form of a bag of gummy bears or if they opted for two bags

of gummy bears instead, but at a later time point. The mothers were also presented with a choice between receiving a certain sum of money immediately, and obtaining a larger sum later. While the children had to wait an average of 47 minutes for the larger reward (i.e. the time it took to interview the mother), the mothers' waiting time before receiving the higher monetary reward lasted several months.

The capacity for delayed gratification is considered a precursor for developing behavioural control, which in turn represents an important foundation for investment decisions that promote success in school and the labour market, as well as integration in society. From an economic perspective, time preferences have considerable importance for all decisions regarding investment and savings, especially about investment in education and human capital. This raises a number of issues and questions. For example, it

would appear worthwhile to examine whether and at what developmental phase it might be possible to improve children's perseverance and patience, and their ability to succeed in life. In the context of this debate, increasing research attention has been devoted to behaviour during the preschool age, since basic cognitive and non-cognitive capacities at this age have been shown to be predictive for later school success.

Patient Mother – Patient Child

The experiment showed that children's patience varies significantly at the preschool age. While 78 per cent of the children in the sample opted to wait for the delayed (but larger) reward, and thus exhibited patience, 22 per cent of the children chose the smaller reward they could obtain right away. Moreover, the results showed a significant correlation between the patience of the mother and that of the child. Thus, patience in the mother improves patience in the child, and this occurs as early as at preschool age.

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Q&A: Why Does Germany Fail to Attract Foreign Skilled Workers?

Germany Needs a More Welcoming Culture

Various measures aimed at encouraging direly needed skilled workers to immigrate to Germany have not been successful to date. Dr. Holger Bonin, a labour market expert at ZEW, explains what firms can do to attract foreign workers without having to rely on government programmes.

Many countries are successful in integrating workers from abroad into their labour markets, thus allowing them to profit from foreign skilled labour. Why does Germany have such a difficult time in this area?

First of all, we've been sending the message for too long that we are not a country that welcomes immigrants. In addition, relying on the immigration of foreign skilled workers as a means of securing the supply of skilled labour is by no means an undisputed policy, both in the political realm and in broader society. For this reason, recent improvements in the opportunities for highly skilled workers to immigrate to Germany have gone largely unnoticed abroad. Additional factors that play a role include the relatively low wages earned by workers at the upper end of the income scale (from an international perspective), high tax rates, and the language barrier. However, the conditions for attracting foreign workers to Germany have been getting better. Germany's booming economy has drawn international attention and should serve to encourage more workers to move here.

In large companies there are so-called diversity guidelines that aim to simplify cooperation between foreign workers and native German employees, as well as to

prevent discrimination. Have such efforts borne fruit?

The success of such efforts can only be judged on an individual basis. However, on the whole large companies tend to perform better at managing diverse workforces. Managing diversity is admittedly a complex process. Yet an open commitment to diversity and the definition of strategic guidelines by management are not sufficient unto themselves. In order to be successful, employees must breathe life into diversity guidelines with practical ideas and deliberate action. Many DAX companies have special managers to oversee diversity policies; this of course facilitates employee training and the monitoring of achievement.

Should we thus be concerned about diversity at small and mid-sized enterprises?

Indeed, leaders at SMEs often focus on more efficient production while neglecting human resources management and marketing. SMEs are also unable to leverage economies of scale in the area of diversity management. First, we need to inform SMEs so that managers at such firms are aware of the advantages of a welcoming business culture. For example, the successful integration of foreign employees can help firms to win the battle to at-

tract the best talent and aid in the effort to expand to new markets. Second, collaborative efforts are needed to reduce costs in the area of diversity management. One possibility is to form associations for the recruitment of foreign workers. Furthermore, SMEs could work together to offer joint intercultural training courses for their employees.

Is it possible to develop a welcoming business climate for foreign workers irrespective of the larger social environment?

Surely, but it is difficult. For this reason, efforts should be made at the national level to support firms in recruiting international employees. An essential first step would be for the political arena to send a clear and authentic message that Germany is a country that welcomes immigrants, and that we are working actively to respect and integrate immigrants in their diversity. Yet that alone, of course, is not sufficient. An open dialogue with social groups and citizens is necessary in order to translate these aims into concrete initiatives so that foreign workers truly feel welcome in Germany.

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ZEW DISCUSSION PAPERS

No. 12-022, Matthias Hunold, Lars-Hendrik Röller, Konrad Stahl: Backwards Integration and Strategic Delegation.

No. 12-021, Peter Heindl: Transaction Costs and Tradable Permits: Empirical Evidence from the EU Emissions Trading Scheme.

No. 12-020, Bernd Fitzenberger, Ute Leuschner: Up or Out: Research Incentives and Career Prospects of Postdocs in Germany.

No. 12-019, Gerard J. van den Berg, Pia Pinger, Johannes Schoch: Instrumental Variable Estimation of the Causal Effect of Hunger Early in Life on Health Later in Life.

No. 12-018, Fabio Bertoni, Tereza Tykvova: Which Form of Venture Capital Is Most Supportive of Innovation?

Dr. Holger Bonin is the head of ZEW's department of Labour Markets, Human Resources, and Social Policy. His research interests include employment problems among low-skilled workers, wage flexibility, the economic impacts of immigration, and the willingness of employees to accept risk. Bonin has been active as an expert advisor to the European Commission, the United Nations Development Program (UNDP), and several German ministries such as the Federal Ministry of Education and Research or the Federal Ministry of Finance.



Photo: ZEW

How to Assess a Tax on Financial Transactions

Europe is currently considering the introduction of a financial transaction tax (FTT) – that is, a type of sales tax on financial transactions. The following discussion examines the most important arguments in favour and against such a tax.



The financial transaction tax imposed by Sweden during the 1980s led to the exodus of many financial transactions, particularly to the City of London.

Advocates for the FTT argue that such a tax would accomplish the following aims: to increase government tax revenues, to reduce short-term speculation on capital markets, to prevent future financial crises, and to close the tax loophole created by the VAT exemption on financial transactions. Beyond evaluating whether these goals are achievable with an FTT, we will also estimate the costs associated with the introduction of an FTT.

The potential tax revenues generated by an FTT could be considerable. McCulloch and Pacillo (2010) estimate that a tax equal to ten per cent of normal transaction costs on stocks, bonds, and derivatives would yield revenues of 147 billion US dollars worldwide. Furthermore, if the tax included over-the-counter trades, it could generate revenues of 482 billion US dollars.

However, it is difficult to estimate the tax revenues that would be generated if only a few European nations introduced an FTT. The piecemeal introduction of an FTT might result in the widespread displacement of transactions to non-taxed stock exchanges, thus substantially reducing tax revenue. To counteract attempts to

evade taxation, the EU Commission has proposed what is known as an “issuance principle”. This means that every transaction would be subject to the tax if at least one of the transacting parties were located in the EU. The issuance principle would help to prevent trades from simply being relocated to a country that does not levy a tax on financial transactions. However, large financial institutions would probably find it relatively simple to relocate trades to subsidiaries headquartered outside the jurisdiction of the FTT.

Lessons Learned from Sweden

In any event, it is improbable that anything would occur of the magnitude of the disaster that befell Sweden between 1980 and 1987 after it imposed a financial transaction tax. On that occasion, the FTT led to a massive exodus of financial transactions to foreign stock exchanges, especially to London. There were two principal causes for this acute reaction in Sweden: Sweden is a relatively small country, so shifting transactions was a simple matter. In addition, the initial tax

rate was set very high – at 0.5 per cent – and it was even increased to two per cent in 1986. By contrast, the EU Commission’s recommendation anticipates introducing the FTT in Europe at a rate of 0.1 per cent for stocks and bonds and 0.01 per cent for derivatives.

Reactions on Capital Markets

A tax on financial transactions would likely lead to reduced short-term speculation on capital markets, with a corresponding increase in the share of transactions with a long-term focus. Virtually all analyses are in agreement on this point. However, this change would not necessarily mean a reduction in the volatility of financial markets, because a relative increase in the tax rate could result in a steep reduction in transaction volumes and liquidity. As a consequence, the range of price fluctuations could increase. This very phenomenon was observed when Sweden introduced its FTT.

Westerhoff (2008) applies what is known as agent-based modelling to simulate how market participants might respond to an FTT. He distinguishes between two kinds of market participants. The first group (“fundamentalists”) is composed of investors who are basically focused on a stock’s fundamental value. The second group, referred to as “chartists”, are oriented to short-term trends and attempt to extrapolate these trends into the future. Transactions made by the chartists tend to shift the price of a stock away from its fundamental value, and this can create price bubbles.

Within this explanatory framework, the introduction of a relatively low-rate tax on financial transactions would tend to squeeze out the chartists, and, as a result, diminish the mispricing of stocks. In addition, price volatility would also decrease. Consequently, an FTT could contribute to market stabilisation and a reduction in price bubbles. However, if one sets a relatively high tax rate, the FTT could actually have the opposite effect, leading to an increase in volatility and greater mispricing tendencies. Accord-

POLITICO-ECONOMIC ANALYSIS

ingly, the effects of a financial transaction tax critically depend upon setting tax rates at an appropriate level.

Increasing Transaction Costs

Essentially, FTT rates must be set low to avoid triggering undesirable effects. One can approximate what would constitute a low or high tax rate by comparing it to customary transaction costs. According to calculations performed by McCulloch and Pacillo (2010), a tax rate of 0.1 per cent for stocks (as proposed by the EU Commission) would be the equivalent of about nine per cent of transaction costs and thus would be in the tolerable range. However, for bonds, McCulloch and Pacillo estimate that a rate of 0.1 per cent is too high, because it would mean a 50 to 75 per cent increase in current transaction costs. However, because of lacking empirical evidence, it is not possible to provide a precise estimation of appropriate tax levels for the European stock market. Regarding the FTT on derivatives, the

0.01 per cent rate on exchange-traded derivatives turns out to be quite high, but would be relatively low for over-the-counter transactions. Thus, the evaluation of the relative level of a potential financial transaction tax clearly varies by market segment. In addition, there is a large degree of uncertainty regarding the burdens that would be placed on market participants by an FTT. On the one hand, the findings suggest that FTT rates should be customised to the affected market segments so as to equalise relative tax burdens. On the other hand, the proposed tax rate levels as a whole should be reduced from that recommended by the EU Commission in view of the uncertainty regarding attendant effects.

The FTT is a kind of gross tax on transactions. It can result in double taxation on single transactions at different levels of product development. For example, stocks and bonds may be components of certificates. An FTT would tax the transaction at level one (purchase of stocks and bonds), and again at level two (purchase of the cer-

tificate). When taxing ordinary goods and services, it is customary to implement a net sales tax that allows for a pre-tax deduction in order to avoid such duplicate taxation. In the context of financial transactions, one normally speaks in this connection of a “financial activities tax” (FAT).

Conclusions to Draw

Good reasons for introducing a financial transaction tax were illuminated in the foregoing discussion. When implementing an FTT, however, it would be advisable to begin with a tax rate that is significantly lower than that recommended by the EU Commission so as to avoid an exodus of financial transactions. Clearly, it would be easier to implement a subsequent slight increase in the tax rate than to deal with the negative effects of an excessively high rate at the outset. Furthermore, in light of tax policy considerations, there would be some advantage to introducing a FAT as opposed to a FTT.

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INSIDE ZEW

Baden-Württemberg Sustainability Days 2012 – Students Visit ZEW



ZEW researcher Dr. Claudia Hermeling explains the computer simulation “The Climate Protection Dilemma” to students from Schwetzingen.

Students from the Business Secondary School in Schwetzingen (Wirtschaftsgymnasium Schwetzingen) visited ZEW in the context of the Baden-Württemberg Sustainability Days.

At the end of April researchers from the ZEW Research Department Environmental and Resource Economics, Environmental Management informed the students and their teachers about the interdependen-

cies between economics and sustainable climate protection. In short presentations, ZEW researchers Dr. Claudia Hermeling, Dr. Oliver Schenker, and Simon Koesler illustrated the effects of the climate change by means of examples taken from everyday life. Furthermore, they introduced research instruments such as laboratory experiments, which are conducted to analyse the economic aspects of sustainable climate protection. Via the computer simulation “The Climate Protection Dilemma” designed by ZEW, the students and the teachers then had the opportunity to experience how complicated it is to find solutions that are acceptable for all parties involved.

Apart from ZEW, about 400 companies and organisations took part in the Baden-Württemberg Sustainability Days 2012. They launched different events touching on the topics of climate, energy, and sustainable economics.

CONFERENCE

International Conference to Celebrate the Kick-Off of the Leibniz ScienceCampus MaCCI

An international conference devoted to discussing international systems for protecting intellectual property rights as well as the competitive behaviour of firms was held at the end of March 2012 to kick-off the new Leibniz ScienceCampus “Mannheim Centre for Competition and Innovation” (MaCCI) at ZEW.



MaCCI director Georg Licht, Christiane Neumann, Simone Schwanitz, MaCCI directors Martin Peitz and Heike Schweitzer, Thomas Kohl, ZEW director of business and administration (from left to right).

ZEW and the University of Mannheim were proud to welcome about 100 attendees from academia, politics, and business to the Inaugural Conference of the MaCCI. The event was inaugurated with talks given by representatives from all institutions involved in the ScienceCampus. Dr. Simone Schwanitz, the ministerial director of Baden-Württemberg’s Ministry

for Science, Research, and the Arts, emphasised the importance of interdisciplinary networks for science and research, and thus praised the founding idea behind MaCCI – namely, to generate closer cooperation between law and economics disciplines.

Christine Neumann, general secretary of the Leibniz Association, explained the

importance of the “ScienceCampus” model. She also expressed her best wishes for the successful implementation of MaCCI. Following these opening presentations, two keynote lectures on the importance of the patent system were given by renowned academics: Prof. Frederic M. Scherer from Harvard University as well as Prof. Mary-Rose McGuire from the University of Mannheim.

Panel Discussion after the Opening

Scherer and McGuire also participated in the subsequent panel discussion on “Intellectual Property and Competition” which featured Prof. Mark Patterson from Fordham University, Prof. Hanns Ullrich from the European University Institute in Florence, and Reinhilde Veugelers from KU Leuven and Bruegel, Brussels. A presentation by Prof. Jean-Francois Houde from the University of Wisconsin at Madison concluded the first day of the conference. In his presentation, he discussed the merger between two Canadian mortgage banks and its effects on residential mortgage rates.

Scientific Discourse

The second day of the conference was dedicated to presentations of research papers on various specialised topics. In twelve parallel sessions, the results of recent research in the areas of competition, regulation, and innovation were presented. Highlights of the second day of the conference were keynote lectures given by Prof. Patrick Rey (University of Toulouse) and Prof. William E. Kovacic (George Washington University). Patrick Rey discussed economic implications of retail power and vertical foreclosure. William E. Kovacic inspired the audience with his practical experience concerning institutional design and the effectiveness of competition policy.

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The “**Mannheim Centre for Competition and Innovation**” (MaCCI) is a research centre financially supported by the State of Baden-Württemberg and the Leibniz Association. It aims to strengthen cooperation between legal scholars and economists in order to provide new impetus to the study of questions at the intersection of competition, regulation, and innovation policy. MaCCI is a joint project of ZEW and the School of Law and Economics at the University of Mannheim. Key topics that will be investigated by MaCCI include vertical restrictions to competition, the abuse of market power, the review of mergers by antitrust authorities, the private and public enforcement of antitrust law, the regulation of the telecommunication and energy sectors, and patent violation suits. For further information: www.macci-mannheim.eu

SEEK CONFERENCE

2nd SEEK Conference: The Green Growth Challenge

To kick-off the second conference of the research programme “Strengthening Efficiency and Competitiveness in the European Knowledge Economies” (SEEK) on 9 and 10 March 2012, Prof. Dr. Dr. h.c. mult. Wolfgang Franz, ZEW’s president, welcomed some 200 international participants from the realms of academia, politics, and business to ZEW.



Baden-Württemberg’s Minister for the Environment, Climate and Energy, Klaus Untersteller, advocated economic growth that provides an adequate standard of living, but which also protects the environment.

The second SEEK conference was dedicated to addressing the key challenges faced by Europe’s economies in their effort to achieve environmentally friendly and sustainable growth. The conference was inaugurated by Baden-Württemberg’s Environmental Minister, Franz Untersteller. The keynote speech of the first conference day was given by Prof. Klaus Töpfer, executive director of the Institute for Advanced Sustainability Studies (IASS) and the former executive director of the United Nations Environment Programme (UNEP). This speech was followed by a fruitful podium discussion that featured Dr. Georg Zachmann, an energy expert at Bruegel, a Brussels-based think tank; Prof. Fritz Vahrenholt, the chairman of the executive board of RWE Innogy; Peter Terwiesch, the chairman of the executive board of ABB; and Georg Müller, the chairman of the executive board of MVV Energie. The podium discussion focused on how to achieve growth that protects resources and the climate while also strengthening European innovation and competitiveness.

In his lecture, Franz Untersteller, Baden-Württemberg’s Environmental Minister, asserted that it was necessary to pursue economic growth that provides an adequate standard of living and social security, but which also protects the environment and conserves resources. To this end, Untersteller cited three factors for success: progress in the realm of energy and materials

efficiency; a private-sector focus on key technologies; and the accelerated expansion of renewables. Furthermore, Untersteller argued that it would be necessary to significantly reduce energy consumption, and pointed to Baden-Württemberg’s goal of reducing energy use by 50 per cent from its 2010 levels by 2050.

More Efficient Production

Resources are becoming scarcer worldwide, Untersteller said, and this fact is particularly evident in the state of Baden-Württemberg’s key branches: the motor vehicle and machine building industries. In order to produce more efficiently, new environmental innovations are needed, Untersteller said, mentioning a study conducted on behalf of his ministry that showed that green technologies are also a driver of growth in the labour market. According to the study, green technology could create one million new jobs nationwide by 2020. For this and other reasons, Untersteller said, Baden-Württemberg was seeking to be a technological leader in the area of green technology.

Klaus Töpfer, the executive director of the Institute for Advanced Sustainability Studies, began his presentation by posing a question: What common feature is shared by the crises we are currently experiencing, including the financial, economic, and environmental crises? According to Töpfer, all



Klaus Töpfer, executive director of the Institute for Advanced Sustainability Studies, criticised short-term thinking which dominates many policies – such as the environmental policy.

SEEK CONFERENCE



The panel of the first conference day: Fritz Vahrenholt, Georg Zachmann, Andreas Löschel, Georg Müller and Peter Terwiesch (from left to right).

of them serve to illustrate the “bankrupt nature of short-term thinking”. Even global environmental policy is characterised by the paradigm of short-term thinking, Töpfer said. Developed nations have apparently forgotten that their prosperity was built on the much-maligned economic practices of emerging nations today – namely, the pollution of the air and water, clear-cutting of forests, and shameless exploitation of natural resources. Töpfer said that developed nations are unjustified for criticising the attitude of nations such as China, India, or Brazil: “Let’s get rich first and clean up later”. Nevertheless, Töpfer said that the world must address the challenge of developing sustainable economic systems. For Töpfer, green economic systems are distinguished by the reduced generation of emissions, the efficient management of raw materials, and the social participation of all strata of the population.

Efficiency Augments Acceptance

As Töpfer sees it, environmental consciousness and prosperity are not contradictory concerns, as “green ideas” are often the very ones that generate economic success. This is important to remember when promoting environmental responsibility, Töpfer asserted, mentioning that used plastic used to be thrown away as normal garbage in Germany. By introducing the Green Dot system, however, policymakers incentivised responsible behaviour for both producers and consumers. As a

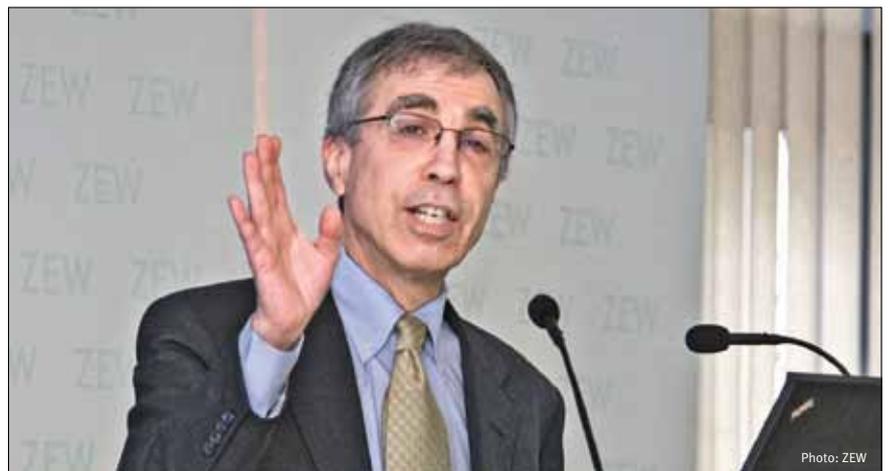
consequence, Töpfer said, Germany now manufactures the best waste-sorting machines in the world and is exporting them abroad. In this way, Töpfer suggested that society needs to ask whether greenhouse gas emissions are “garbage”, or if, instead, behaviour could be incentivised here as well to encourage greater responsibility.

Töpfer sees Germany as setting a positive example with regard to the social components of green energy. Germany is demonstrating the characteristics of a genuine

omy if they choose to participate in generating their own electricity with wind, solar, or biomass. Communal initiatives give reason for optimism that Germany and Europe are on the right track, Töpfer said. He expressed the optimistic hope that innovation could produce a paradigm shift, thus enabling new growth in Europe and throughout the world.

Innovate and Invest

Georg Müller outlined the historical development of energy systems in Germany over the past 150 years. At the end of the nineteenth century, Germany had a decentralised energy system characterised by very small local providers. Over the course of the twentieth century, however, efficiency concerns led to a more centralised system, which Müller said remains largely intact to this day. Yet according to Müller, there are now compelling reasons to return to a more decentralised system for energy supply, including the exhaustion of fossil fuels, dependency on resource imports, and Germany’s abandonment of nuclear energy. Müller suggested that the success of this restructuring process will hinge on innovation and investment efforts.



Robert Stavins from Harvard University explained the “energy paradox” and formulated policy recommendations in order to provide solutions.

democracy, Töpfer argued, as large numbers of individuals are taking an interest in local forms of energy generation. He said that communities and individuals can become living examples of a green econ-

According to Peter Terwiesch, the chairman of the Executive Board of ABB, Germany has set very ambitious targets for itself regarding the transformation of its energy systems, adding that the next

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step is to actually attain the goals set forth. From a technological perspective, Germany can achieve these goals, Terwiesch contended. As the transformation of the energy economy impacts many sectors, interdisciplinary collaboration between firms and researchers is imperative, Terwiesch stated. He added that technological lifecycles have become extremely short, yet new technologies must spend enough time on the market for investment in their development to be worthwhile.

Georg Zachmann explained that climate protection is inherently pro-growth, for various models have shown that the cost impacts of climate change far exceed those of emissions avoidance. In order to make European climate policy successful over the long-term, Zachmann argued that the emissions trading system must be enhanced and expanded. "EU emission trading must become wider, longer, and deeper", Zachmann said, explaining that more countries need to participate ("wider"), a longer time horizon must be targeted ("longer"), and additional sectors need to be incorporated into the system, such as the transportation sector ("deeper").

In his presentation, Fritz Vahrenholt characterised German politics as being driven by fear of climate change. As a result, Vahrenholt said, policy-makers have lost sight of the need to assure the competitiveness of the economy and prosperity of society. Germany cannot manage the transition to a sustainable energy economy alone, he said. Europe as a whole must get involved in the project to transform energy systems, Vahrenholt contended. Otherwise, the consequence would be greater dependency on electricity imports as well as higher electricity prices.

The Energy Paradox

The second conference day was dedicated to the discussion of scientific topics. The diverse factors and complex interrelationships governing innovation, technological change, and green economic growth were illuminated in 36 presentations as well as keynote addresses by the renowned economists Prof. Robert N. Stavins of Harvard University and Prof. Richard G. Newell of Duke University.

The keynote presentation given by Robert N. Stavins of Harvard University focused on the "energy paradox". Stavins explained that this paradox is distinguished by a failure to adopt new technologies, despite the fact they would lead to greater energy efficiency, and, as a result, would be cost-effective for users. The theory of asymmetrical information offers one possible explanation for the energy

Each day the world consumes nearly 90 million tonnes of petroleum and 20 million tonnes of coal, Richard G. Newell said at the outset of his presentation, adding that the burning of these fuels produces greenhouse gases that lead to global warming. According to Newell, the challenge now facing the energy sector is to innovate alternative ways of generating energy instead of increasing the use of



Richard Newell from Duke University spoke about current innovations in the energy sector and focused on recent developments in the United States.

paradox. By way of illustration, Stavins cited the example of individuals who construct their own homes. As such individuals often lack knowledge about home-insulation methods, Stavins said, inefficient designs are often the result. In addition, Stavins indicated that market failures can lead to the energy paradox – if, for example, the actual costs of greenhouse gas emissions are externalised.

Stavins argued that researchers need to formulate policy recommendations based upon such insights. By way of example, Stavins said the introduction of efficiency standards could help to encourage inefficient technologies to disappear from the market. He went on to suggest that the externalisation of the costs of environmental damage could be remedied by assigning prices to the costs of such damage. The pricing of externalities has already shown considerable success in the form of the EU emissions trading system, Stavins noted. He indicated that this system could serve as a model for other nations, including the United States.

fossil fuels. He pointed out that rising prices for energy generated by conventional methods have served to intensify the demand for energy-sector innovation.

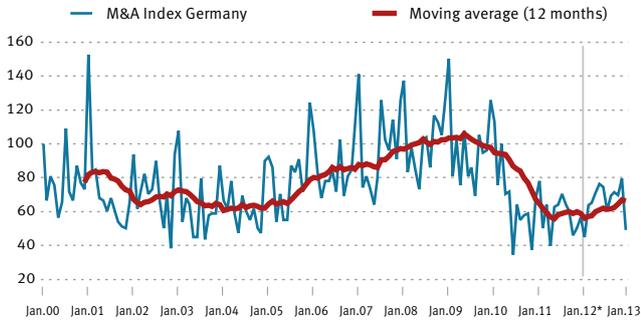
Energy Innovations

As an example Newell cited developments in the United States, where rising natural gas prices and dependency on gas imports have helped to stimulate a new breakthrough in gas extraction technology known as fracking. Fracking involves the injection of chemicals into shale rock under high pressure in order to release natural gas located at great depths and bring it to the surface. Whereas in 2006, the United States only satisfied about one per cent of its natural gas requirements using this technology, this figure now stands at 30 per cent. Newell emphasised that due to this change the proportion of coal in overall energy production has fallen in favour of the increased use of natural gas, which creates fewer emissions.

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FACTS AND FIGURES

Increasing Dynamics on the German M&A Market

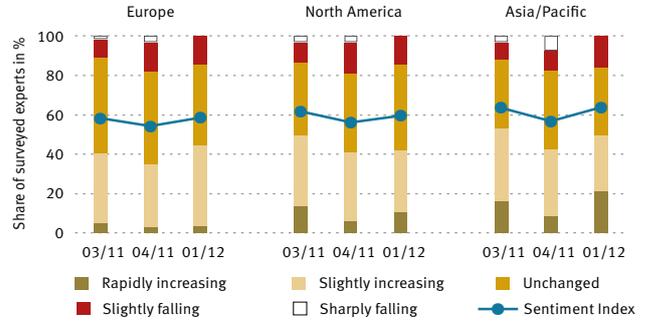


* From January 2012 to December 2012 forecast. Source: Zephyr-database, Bureau van Dijk, Computing ZEW

The M&A Index for Germany currently stands at nearly 60 points, ranging below its initial level of 100 points in 2000. During the previous months the index has gone through ups and downs. The current forecast, which portrays the development of the M&A Index for Germany from January to December 2012, shows a higher M&A intensity in Germany until the end of 2012. ZEW calculates the M&A Index for Germany on the basis of Bureau van Dijk's Zephy-database, and forecasts its further course for the next 12 months.

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Freight Rates for Maritime Shipping Increase

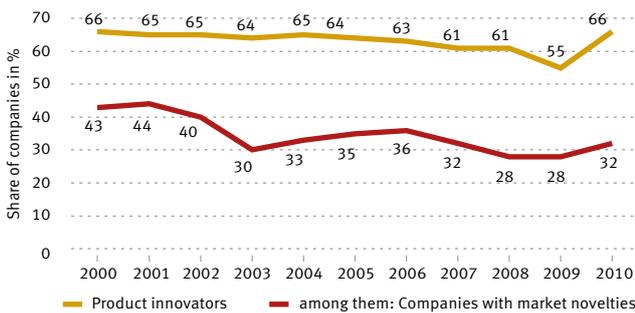


Source: ZEW/ProgTrans Transport Market Barometer

The experts surveyed by the ProgTrans/ ZEW Transport Market Barometer expect freight prices to rise in the maritime shipping sector within the next six months. Increasing prices are especially predicted for the routes from Asia towards Europe. Here capacity adjustments have obviously opened up scope for price hikes. For the Asia/Pacific transport 50 per cent of the experts forecast freight rates to increase. 45 per cent of the surveyed experts envisage price hikes within Europe while almost half of the respondents expect prices to remain stable.

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Product Innovations in the German Engineering Sector on the Rise

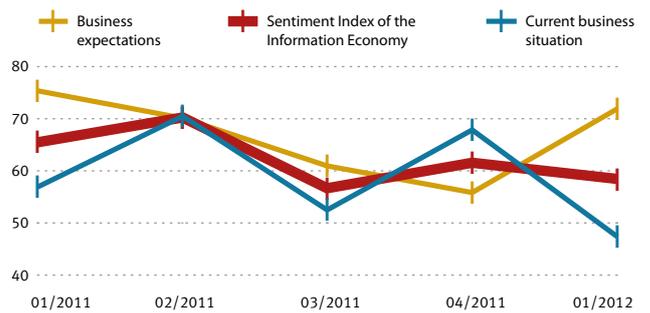


Values for 2000 to 2005 adjusted to new industry classification. Source: ZEW, Mannheim Innovation Panel

German engineering companies took advantage of the economic crisis in 2009 by renewing their range of products. The share of companies that offered new products and services ("product innovators") climbed from 55 per cent (2009) to 66 per cent (2010) in the first year after the crisis. Thus, the peak figure from 2000 was reached. The share of companies whose new products are genuine innovations in their markets ("market novelties") rose from 28 per cent to 32 per cent. Nevertheless, the record values of about 40 per cent from the beginning of the decade are still out of reach.

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Tarnished Situation but Positive Outlook



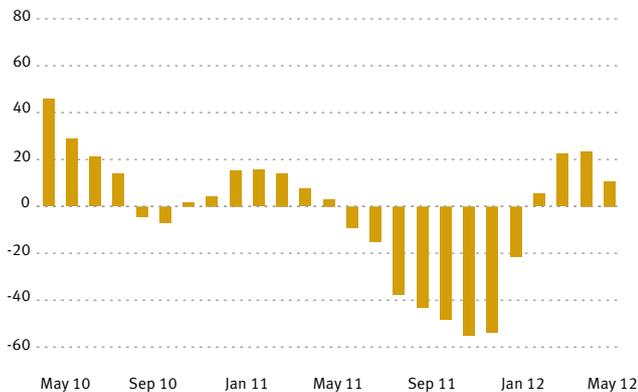
Source: ZEW

The economic sentiment within the information economy has tarnished slightly during the first quarter of 2012. The respective indicator drops by 3.2 points to 58.4 points. Nevertheless, with a value of more than 50 points, it still indicates a positive development. This is the finding of the business survey conducted by ZEW in March 2012 within the information economy. The information economy consists of the following branches: information and communication technologies, media service providers and knowledge-intensive service providers.

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FACTS AND FIGURES

ZEW Financial Market Test May 2012

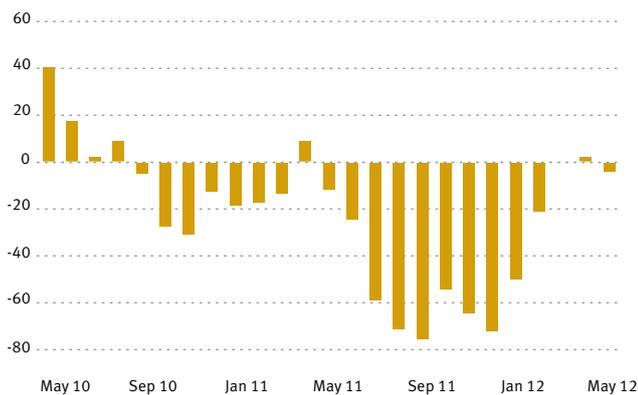


Balance of positive and negative assessments concerning economic development in Germany on a six-month-horizon.
Source: ZEW

Germany: Expectations Still Positive Despite Decline

The ZEW Indicator of Economic Sentiment for Germany has decreased by 12.6 points to a level of 10.8 points in May 2012. As a result, expectations about the development of the German economy in the next six months are still at positive territory, but have tarnished compared to the previous survey. It may have contributed to this month's decline that the outcomes of the elections in Greece and France has given rise to doubts that the European governments will resolutely fight the sovereign debt crisis. According to the financial market experts economic risks have risen during the previous weeks. The assessment of the current economic situation for Germany has improved slightly in May. The corresponding indicator has increased by 3.4 points to the 44.1 points-mark.

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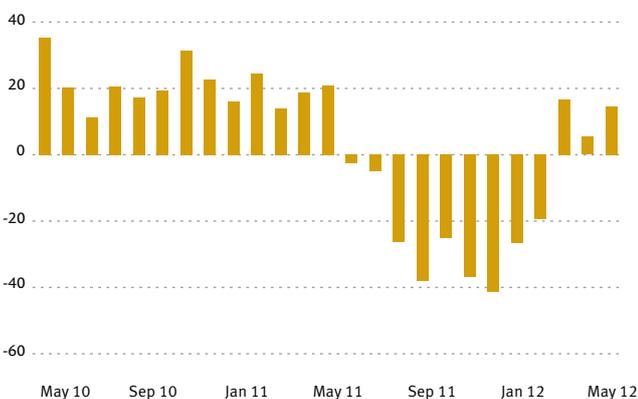


Balance of positive and negative assessments concerning economic development in Switzerland on a six-month-horizon.
Source: ZEW, Credit Suisse

Switzerland: Economic Expectations Tarnish

In May 2012 the Credit Suisse ZEW Indicator dropped by 6.1 points to minus 4.0, down from 2.1 points in April. This is the first decline of the indicator since December 2011 and after its strong rebound of 52.3 points between January 2012 and April 2012. The surveyed analysts are slightly more negative in May (22.0 per cent, up 2.4 percentage points) than in April, while the share of analysts expecting the overall macroeconomic situation to remain unchanged reached a 1-year high at 60.0 per cent. The assessment of the current economic situation in Switzerland improved by 7.8 points to the 10.0 points-mark – the highest level since October 2011. The ZEW-CS Indicator is calculated monthly by the Centre for European Economic Research (ZEW) in cooperation with Credit Suisse (CS).

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

CEE Region: Economic Expectations Brighten up

Economic expectations for Central and Eastern Europe including Turkey (CEE) have increased by 9.2 points in May 2012. The ZEW-Erste Group Bank Economic Sentiment Indicator CEE currently manoeuvres at 14.6 points. The indicator remains in positive territory for the third consecutive month. The assessment of the current economic situation for the CEE region has slightly decreased by 2,8 points. The respective indicator now stands at the 2.7 points-mark. The CEE region consists of Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania, Serbia, Slovakia, Slovenia and since October 2010 of Turkey. The economic sentiment indicator for the CEE region and further financial market data have been surveyed monthly since 2007 by ZEW in cooperation with Erste Group Bank.

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Web Chatter

The term of “social” is provided for most people with a sense of well-being or at least with positive connotations. So many institutions use this adjective in various contexts starting with social market economy to social partners. When it comes to “social”

networks such as Facebook, Google+, and Twitter, however, the connotations have not been universally positive in past months, even for many formerly ardent supporters. The ends pursued by these networks are often not “social”, but rather commercial, and profit-oriented as marketer of user data. Indeed, it is almost shocking to observe the naiveté with which not just younger users have contended that the operators of such networks have altruistic motives. Perhaps such notions would be halfway acceptable if it weren't for recent developments.

After recent efforts to enforce the requirement that Google+ users provide their real names, Google upped the stakes in March of this year with the introduction of its new privacy policy, which provides for the linkage of user data between various services, including Google Search, Google Mail, Picasa Web Albums, Google Chat, Android smartphones, and Google+ messaging. Google is now allowed to save all telecommunications data generated by Android users, including information about who phoned or exchanged a text message with whom, as well as when and where. While politicians in Germany have been conducting heated debates as of late concerning the constitutionality of data retention by telecommunications providers, this issue has long been a moot topic at Google, even not talking of the highly praised right of privacy, for “that which Google does, it does in secret” (to quote Thilo Weichert, Schleswig-Holstein's data protection officer).

At Facebook, meanwhile, users are required to grant their permission for personal data to be transferred to the U.S. for “further processing”, whatever that may mean. Facebook users can of course restrict public access to their profiles and posts, yet Facebook itself records all user data. With regard to Twitter, users should know that the British company DataSift has rights to

sell the entire Twitter archive since January 2010, and also offers the linkage of Twitter data with Google+ and Facebook information (C. Kurz, Frankfurter Allgemeine Zeitung, 02.03.2012). Yet escaping online social networks often proves to be difficult for users, because there are no real alternatives when all of one's friends are at a single site and the barriers to market entry for new competitors are high.

However, the issue at hand is not to demonise Facebook, Google, or Twitter, for these companies also provide many valuable services. Users nevertheless need to be aware of what is going on in social networks. Customised advertising based on user behaviour is not bad per se, and for many users, it may even be welcome. But users should know that customised ads are placed by Google in the same way as other online ads: based on how much the advertiser has paid. While it would perhaps be an exaggeration to refer to the customized placement of advertisements as a deprivation of the individual's right to choose freely, there are certainly users who reject Google's gathering of information about their online behaviour and who would prefer to enter a few keywords more to find the information they are seeking. Facebook users should know that HR departments regularly study the Facebook profiles of job applicants in order to obtain information they are not allowed to ask about during an interview or which an applicant may conceal. The police are also not strangers to social media, and there are numerous instances of individuals being apprehended for crimes based on information obtained through Facebook. While we can certainly applaud the successful prosecution of criminals, what about the collateral damage such arrests may cause sheerly through association?

My recommendation? Google to your heart's content, but consider disabling your cookies.

Wolfgang Franz

ZEW

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