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Why and How There Should Be More Europe in Asylum Policies

EU Member States are currently trying to manage the refugee crisis individually by applying national measures, such as closing their borders and setting their own national limits on refugee numbers. A durable solution could be achieved if the individual states entrusted the EU with the competence to take charge of asylum policy on a European level. According to an analysis by ZEW, this would have the potential to not only reduce costs but also to facilitate a fairer distribution of refugees coming to Europe.

The current model of having the EU and its members states share responsibility for asylum policies has failed. Although the standards for the admission of refugees have been harmonised on paper, there are still drastic differences between the practices implemented by individual states. As a result, the costs of processing an asylum application in Europe, including providing accommodation and maintenance, vary between a few hundred euros and five-figure sums. Besides, the current system allows for each Member State to deter refugees by offering poor reception conditions and thereby to pass the burden to the other states. In the status quo, countries such as Germany, which do not engage in the systematic deterrence of refugees, have to bear particularly high costs. To that effect, ethical misconduct is even being financially rewarded. As a result, there are incentives for a "race to the bottom" in reception standards.

In comparison with a quota system, according to which the reception capacity of a country is determined on the grounds of its size, its GDP in absolute figures, as well as the level of unemployment, there are extreme discrepancies when it comes to the actual number of refugees accepted in each country. Whilst, for example, Germany and Sweden are accepting two to three times more than their calculated quota, EU Member States in Eastern Europe are accepting less than five per cent of the quota of asylum seekers which they should be. Some countries, including Slovenia and Slovakia, are even fulfilling less than one per cent of their reception capacity.

The study explores a number of alternatives to improve the current distribution of tasks. A quota, which would provide EU members with a binding distribution key, seems to be the most obvious solution. The implementation of such a system is, however, associated with a significant number of problems. Estimations made on the basis of estimates for last year's refugee numbers suggest that more than 900,000 people would have to be relocated. More than 100,000 people from Germany, Sweden or other receiving countries would, for example, be resettled in France and Spain. In the majority of cases, these relocations would be against the will of the asylum seekers, and would thus entail unacceptable humanitarian and financial costs.

EU budget would have to be increased

A further potential solution would be to finance the costs involved in processing asylum requests and providing accommodation from the EU budget. ZEW estimates, based on the refugee numbers from 2015, suggest that the necessary increase in the EU budget would amount to 30.3 billion euros. Germany's contribution to the EU budget would increase by six billion euros as a result of an expanding EU budget. This would, however, be set off by compensations received from the EU budget for the costs of housing and processing applications, amounting to around eleven billion euros. Net costs to Germany would therefore be reduced by around five billion euros.

A further, yet more far-reaching solution would be to make the EU responsible for the asylum procedure and for the provision of accommodation for refugees while their request is being processed. With this approach, an European Asylum Agency (EAA) would be responsible for implementing a Europe-wide infrastructure for the reception of refugees, and for carrying out asylum procedures according to common standards. Specialised case managers would enable the EAA to reduce both the cost per asylum application and the duration of the asylum application process. This would enable the total costs arising between the refugee's initial arrival and the completion of the asylum procedure to be reduced by between 16 to 40 per cent, or by between 4.8 to 12.1 billion euros per year, depending on how optimistically the advantages of specialisation are viewed.

Minimum standards for the reception of refugees

The objectives of implementing a quota system will only be achievable if an EAA with comprehensive, European-wide responsibility is established. The EAA would be able to distribute refugees between EU Member States according to the logic of a quota system. Establishing acceptable, common minimum standards for the reception of refugees in all EU Member States would improve the unfavourable admission standards which currently prevail in certain states. This would reduce the current pressure on those EU members that offer decent conditions. At the same time, the creation of a European institution to manage the intake of refugees would provide the infrastructure necessary for distributing refugees more evenly across the EU.

The study is available for download at:
www.zew.de/en/publications/8174

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An European Asylum Agency would reduce the current pressure on those EU members with the best reception conditions.

Personal Contact with Tax Authority Increases Tax Compliance of Businesses

Many countries around the world are confronted by the issue that companies fail to meet some, or even all of their tax obligations. Together with a researcher from the Swiss Federal Institute of Technology (ETH Zurich), ZEW carried out a field study in Slovenia in order to examine how the tax compliance of businesses may be increased.

The complete or partial failure of companies to meet their tax obligations is a problem faced by many countries around the globe. The tax gap, that is, the difference between the amount of tax due and the amount paid in a given fiscal year, often increases to a significant extent. This phenomenon particularly affects developing countries and emerging markets, but industrial nations also face the issue of insufficient tax compliance. But how can the tax compliance of businesses be improved? Possible suggestions include making an appeal on the basis of the moral aspects of taxation, providing information regarding the likelihood of tax audits, and instigating closer interaction with tax authorities. ZEW and ETH in Zurich considered this question within the framework of a field study.

Researchers carried out a field study in cooperation with the Slovenia tax authority in January 2014. In total, 142 small accounting firms located in the Slovenian town of Kranj were included in the study. None of the firms were told that they were participating in an experiment. The annual profits of these businesses amounted to an average of 10,000 – 12,500 euros. They employed on average 2.3 staff members. The tax authority provided the researchers with data concerning the tax base which the businesses concerned had provided in their annual tax declarations for 2012 and 2013.

The businesses were randomly divided into three groups. The first group consisted of 32 businesses and served as a control group. Firms in this group were not contacted by the research team. The second group contained 80 businesses. Firms in this group received a letter from the tax authority by mail. In each of the 30 businesses in the third group, two staff members from the local tax authority personally delivered the letter to the highest ranking representative of the business available and read it out. They did not, however, answer any subsequent questions. The second and the third group of firms received identical letters.

The letter reminded the company that the payment of taxes is a civic duty and explained that taxes are required for the maintenance and development of schools and public infrastructure, as well as for the provision of the health service. In addition, the letter informed its recipients that ten per cent of accounting firms would be subject to a tax audit in April 2014, after the experiment. The experiment enabled researchers to analyse how tax compliance is influenced by making an appeal to the moral basis, and also by suggesting that companies may be subject to a tax audit. The researchers could also analyse whether personal delivery of the letter by the tax authority has an effect.

The analysis carried out by ZEW shows that the tax base of the businesses in the first group, the control group, remained almost constant with a slight increase of 1.87 per cent. In contrast, the tax bases for 2013 of businesses in the other groups clearly exceeded those for 2012. The businesses in the second group reported a 2013 tax base which was 12.63 per cent higher than that for the previous year. In the third group, the tax base for 2013 exceeded that for the previous year by 20.28 per cent. This suggests that the letter from the tax authority had a positive effect on tax compliance. This effect was even greater if employees from the financial institution personally delivered the letter to a representative of the business.

A degree of caution must be taken, however, when interpreting these findings. Due to the small number of firms included in the experiment, the results of the empirical analysis are not statistically significant. It is also impossible to determine exactly which factor addressed by the letter (appeal to morality or suggestion of a tax audit) actually influences tax compliance. But even if the reasons for the letter's impact cannot be explained, the study provides tax authorities and policy-makers with evidence concerning strategies to increase corporate tax compliance.

The study is available for download at:
www.zew.de/en/publications/7889

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IN THIS ISSUE

German Businesses Maintain High Level of Innovation Expenditures

The German industry is renowned for its innovative products. Among Germany's strengths are high-tech exports, technology-based innovations as well as the close cooperation between science and industry. To assess the current developments in the field of innovations, the ZEW Innovation Survey looks at the innovation activity in the German industry.

German enterprises spent 145 billion euros on innovation in 2014. The German economy was thus able to match the high level achieved in the previous year (2013: 145.2 billion euros) with respect to innovation expenditures. For 2015 and 2016, companies plan to increase their innovation budgets by up to six per cent. Small and medium-sized enterprises (SMEs), however, showed restraint in 2014, with their innovation expenditures decreasing by nine per cent. These are the findings of a current survey carried out by the ZEW on the innovation behaviour of the German economy, conducted on behalf of the Federal Ministry of Education and Research (BMBF). Since 1993, the survey has been carried out annually in collaboration with the infas Institute for Applied Social Sciences and the Fraunhofer Institute for Systems and Innovation Research (ISI).

With 145 billion euros, the 2014 innovation expenditures of the German economy largely remained at the previous year's high levels. Considering the main sectors included, however, the survey shows that in 2014 innovation expenditures have decreased in three out of four sectors. While the research-intensive manufacturing industry increased their innovation spending by 1.6 per cent, enterprises from other industrial sectors (minus 1.9 per cent), from the knowledge-intensive services sector (minus 2.5 per cent) and from other services sectors (minus 7.4 per cent) spent less on innovation.

The ZEW Innovation Survey
The annual ZEW Innovation Survey – the Mannheim Innovation Panel (MIP) – represents the industrial sector (mining, manufacturing industry, energy and water supply) as well as a range of services sectors (wholesale, transport, postal services, telecommunication, financial services, IT/software, technical services, public relations and business consultancy, other business services, media, and waste management). The survey includes German-based legally independent companies with five or more employees. About 7,500 companies participate in the annual written survey. In addition, a telephone survey of about 8,500 companies addresses specific parameters of innovation behaviour. On the basis of the company data, innovation activity figures are projected for individual sectors, business sizes and for East and West Germany.

All in all, the German economy has held its course and maintained a high level of innovation, despite the challenging global economic climate. The increases in the research-intensive industry provide clear evidence for the great significance of innovation for international competitiveness. Export-oriented companies in particular cannot afford to halt investment in new products and processes.

More investements in innovation in 2015 and 2016

For 2015 and 2016, companies are planning to intensify their investment in innovation. At the date of the survey (spring and summer of 2015), they planned to increase their expenditures by 2.6 per cent to 149.5 billion euros in 2015. In 2016, companies in the German economy plan to increase their total innovation expenditures even by 5.7 per cent to 158.1 billion euros. The automotive industry is expected to account for the by far greatest contribution to the increase. The mechanical engineering industry, financial services, the transport sector and the electrical industry are further major contributors to the increase in expenditure until 2016. In 2014, expenditure growth was exclusively driven by large enterprises. Small and medium-sized enterprises (SMEs) reduced their expenditures on innovation to 32.2 billion euros (minus nine per cent). The current results confirm a long-term trend: Large enterprises increase their innovation budgets, whereas innovation spending of SMEs develops in a rather restrained way. For 2015 and 2016, however, SMEs are planning to increase their budgets as well. They expect their innovation expenditures to increase by four per cent in 2015 and by six per cent in 2016.

Total share of innovaters slightly decreased

Innovators are companies which have introduced product or process innovations within the three-year survey period (2012 to 2014). Their share in the total number of companies decreased slightly by 0.3 per cent and currently stands at 36.8 per cent (2013: 37.1 per cent). The current share of innovators in Germany is at a comparatively low level, however, considering the pre-crisis figure of 47.0 per cent. All four main sectors were affected by the slight decrease in 2014.

The decline in the share of innovators is expected to continue in 2015 and 2016. In 2014, 39.7 per cent of companies spent money on innovation. For 2015, 33.6 per cent planned to spend money on innovation, while 10.0 per cent were unable to provide a definite answer as to their innovation activities. For 2016, the share of companies planning to spend money on innovation is 30.6 per cent, while 15.1 per cent are still undecided.

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China: Tax Reforms Affect State-Owned and Private Companies Differently

Does the ownership structure influence the way companies respond to taxation? A recent study by ZEW has examined how tax reforms in China have affected state-owned and privately owned companies. The study also finds differences in how each type of company adjusts employee wages and investments.

China's transformation from a centrally planned economy to a market economy has been one of the most important changes in the global economy in the past decades. Especially important steps were the gradual privatisation of state-owned companies and the introduction of a company taxation that applies to private companies based in China and abroad as well as to state-owned companies and collectively owned companies. The Chinese government has reformed business taxes multiple times in recent years. This provided a unique chance to investigate how tax reforms affect companies with different ownership structures under otherwise identical conditions.

The ZEW study focuses on the tax reforms enacted in 2006 and 2008. Before 2006, only foreign companies could deduct total employee wages from their tax base, while domestic companies could only deduct a certain percentage. In 2006 the percentage was raised significantly for domestic companies, and in 2008 it was eliminated entirely, creating a common tax base for all companies. Then, in 2008, China introduced a uniform statutory tax rate of 25 per cent for all companies operating in China. Previously, domestic companies had a tax rate of 33 per cent, while foreign companies had a tax rate of 25 per cent.

Share of private domestic companies rises sharply

The ZEW analysis is based on company data in 41 branches recorded yearly by China's National Bureau of Statistics. The study considers five different company types. Among the domestic companies included are companies owned by the central government or provincial governments; companies owned collectively by regional and communal administrations or by their employees; and domestic private companies. The foreign enterprises considered, all of which are private, include subsidiaries of multinational corporations and companies whose corporate headquarters are located in Hong Kong, Macao, or Taiwan. The last type is often owned by Chinese investors who transfer their capital in one of China's three special administrative zones only to return it to China, camouflaged as foreign investment. The likely reason for these manoeuvres – known as round-trip transactions – is the preferred treatment received by foreign direct investment.

The number of companies in China increased significantly between 2003 and 2009. In particular, this can be attributed to the rapid increase of private domestic enterprises, which now make up almost 97 per cent of domestic companies. From 2003 to 2009, the share of state-owned companies among all companies sank by 20 per cent to less than two per cent, while the share of collectively owned companies dropped from 19 to around three per cent. By contrast, the share of domestic private companies increased from 41 to 78 per cent, with the share of foreign companies remaining stable at around 18 per cent.

No wage increase for state-owned companies after the 2006 reform

ZEW's empirical study first investigates the effects of China's 2006 tax reform. It has found that state-owned companies did not raise wages significantly, while collectively owned companies and private companies raised wages for their employees by 4.7 and 1.3 per cent, respectively. The higher deductions introduced in 2006 brought collectively owned companies a 22 per cent tax benefit, while privately owned companies saw a seven per cent benefit. This suggests that the employees of collectively owned companies converted a larger share of the tax benefit into wage increases than did the employees of private companies.

The ZEW study also analyses how the 2008 tax reform affected the quantity of outside funding and company investment. Though the reform scarcely influenced the foreign financing of state-owned companies, debt levels and foreign capital levels sank in collectively owned companies and private companies. The eight per cent cut in the corporate tax rate led to a 1.4 and 0.7 per cent lower debt ratio, respectively. Capital investment increased by 12.6 per cent in private companies, but not in state-owned companies and collectively owned companies. Interestingly, the capital assets of private companies based in Hong Kong, Macao, and Taiwan decreased after the 2008 tax reform – an indication that the Chinese investors' incentive for round-trip transactions has waned due to the unified tax rate for domestic and foreign companies.

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Financially Strong Companies Are the More Successful Innovators

The expected research and development (R&D) budget, as well as the expected long-term return, influence a company's decision as to whether to invest in R&D. Based on data from five high-tech manufacturing sectors, ZEW has analysed how this decision is influenced by a company's financial strength.

The decision whether to invest, and indeed how much capital to invest in R&D, is made by comparing upfront costs with future returns of an uncertain amount. Companies will be keen to invest in R&D if the long-term expected return exceeds the expected costs. Their decisions are subject to two kinds of uncertainty – technological uncertainty about whether R&D investments lead to successful innovation, and market uncertainty about how innovation affects revenue and productivity.

The company's financial strength plays a key role in the investment decision. Financially strong companies will find it easier to finance their R&D investments using current cash flow, retained profits or loans. Financially weak companies will have only limited access to such financial resources. Financially strong companies are also more likely to be able to invest in a larger number of R&D projects as they are more likely able to bear the cost of R&D infrastructure. Last but not least, companies with strong finances can put more resources into marketing new products. ZEW researchers developed a dynamic structural model in order to empirically estimate how a company's financial strength affects its long-term returns from R&D and, as a result, its R&D decision.

1,200 German companies in five high-tech sectors

The ZEW study is based on data from the Mannheim Innovation Panel (MIP) for the period between 1993 and 2008. The study includes 1,200 German companies in five high-tech sectors (chemicals, mechanical engineering, electrical engineering, vehicle manufacturing and instruments). The data includes information on the companies' revenues, variable costs (i.e. expenditures on labour, raw materials and energy), capital stock, innovation expenditures, product and process innovation. A product innovation is a new or significantly improved product, and process innovation is a new or significantly improved production or delivery method aimed at reducing costs. The short-term profit of a company is calculated as the difference between revenues and variable costs, with the company's revenues depending on its productivity. The company's firm value is measured as the discounted sum of expected future profits.

Creditreform, Germany's largest credit rating agency, provided the data for the companies' credit scores, which is used to measure financial strength. Amongst other things, the respective credit rating takes the companies' business development strategy and past bill payments, as well as corporate form, growth, revenues, capital, age and order situation, into account. The companies are divided into groups of strong, medium and weak financial strength, depending on their respective credit scores.

The data shows that the credit scores of the companies considered in the study remain largely stable over time. From one year to another, 95.5 per cent of financially strong companies, 91.4 per cent of companies with medium capital strength, and 87.3 per cent of financially weak companies have therefore remained in the same respective financial strength category. Over the entire observation period, 25.1 per cent, 31.6 per cent and 20.6 per cent of the companies, respectively, have exhibited continuously strong, medium or weak financial strength. Merely 22.7 per cent of the companies considered in the study have moved into an alternative credit rating category.

Innovation boosts productivity

The study shows that R&D decisions made by companies depend on their past R&D experience but also on their financial capacity. Financially strong companies are most likely to invest in innovation. The likelihood of such companies which already have previous R&D experience investing in further innovation activities is 86.1 per cent, while this figure falls to 55.9 per cent for "innovation rookies". In companies with medium capital strength, the corresponding probabilities are 85.5 per cent and 43.2 per cent, and in financially weak companies, 74.6 per cent and 33.0 per cent.

The researchers identified two channels for this behaviour. First, financially strong companies are more likely to achieve innovation when they invest in R&D. Secondly, companies with a strong financial base record the biggest productivity growth induced by innovation. Product innovation boosts productivity by 8.6 per cent and process innovation increases productivity by 9.0 per cent. If companies introduce both types of innovation simultaneously, productivity rises by 11.5 per cent. In companies with a medium or weak capital base, product or process innovation raises productivity by 3.9 or 3.2 per cent (0.8 or 0.6 per cent). Simultaneous implementation of both innovation types increases productivity by 5.8 per cent (3.8 per cent).

Both mechansims lead to higher long-run returns from R&D for financially strong companies. Their firm value increases by 11.6 per cent on average, compared to 5.5 per ccent and 2.3 per cent for companies with medium or low financial strength.

The study is available for download at: *www.zew.de/en/publications/8126*

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Large Administrations Hamper Reform Opportunities in a Crisis

Even after five years of crisis, Greece does not seem to be making much progress in the modernisation of its administration. This is true despite the fact that since 2010, all Greek governments have committed themselves to reforming tax administration. Privatisations have been announced on multiple occasions, but only a fraction of these have actually been implemented. Despite claims that steps are being taken to contain corruption and nepotism in the public sector, a civil servant's career still remains to a substantial degree determined by party membership, rather than by skills and competence. A collaborative study carried out by ZEW and WIFO Institute in Vienna analyses the conditions under which crises trigger successful public sector reforms.

Greece's continued failure to reform the public sector seems to contradict a central conclusion drawn from 40 years of European economic policy. Since the 1970s, fundamental economic crises have always been a catalyst of change in Europe, including the public sector. High unemployment rates, cash-strapped public coffers, high public debt and low rates of growth have historically served as an impulse, motivating governmental bodies to finally address long-known problems in the administration. Against this backdrop, it remains a puzzle why the Greek crisis has yet failed to catalyse reforms in the country's public sector.

Governments need the support of their bureaucracy

The study identifies conflicting arguments on a theoretical level. On the one hand, periods in which there are high rates of unemployment and a large public deficit should put considerable pressure on public administration to increase efficiency. On the other hand, politicians who are under pressure to implement pervasive economic reforms are extremely dependent on their staff in public administration. Governments such as that under Prime Minister Tsipras can only implement reforms with the support of its bureaucracy, not against their resistance. This means that members of the bureaucracy become particularly powerful in times of crisis. They are capable to thwart any attempts at reform in their respective areas of responsibility.

Administration reforms could decrease the budget

To make things even more complex, administration reforms in the public sector are associated with particularly large risks for civil servants when government budgets are a disaster. It is fairly easy for employees in the public sector to figure that governments will cut budgets when they succeed in increasing administrative efficiency. This further fuels resistance to change on the part of administration staff. The situation is different in periods of favourable fiscal conditions. In this case, improving administrative efficiency might lead to wage increases for employees in the public sector. Members of the bureaucracy might thus even benefit from reforms. These considerations indicate that during times of crisis, administration reforms are met with exceptionally strong resistance from the bureaucracy.

To shed light on this phenomenon, the researchers have analysed administration reforms in the EU from the period from 2000 until 2012. Reform activity was measured in reference to a database run by the European Commission containing information about administration reforms. Examples for such modernisation include the introduction of new management techniques, investment in electronic innovations ("E-government"), and streamlining of administration procedures concerning the foundation of new businesses. Researchers investigated whether such reforms are conducted more frequently in times of crisis, when unemployment rates are going up, and when consolidation is necessitated by high debt levels.

Trapped in Bureaucracy

The central finding of the analysis is that high levels of debt and unemployment do not drive modernisation of administration in all countries. Wherever the public sector employs a large number of people, crises fail to catalyse reforms. The political influence of the bureaucracy grows in proportion to the size of the public sector, which enhances the ability of civil servants to thwart reform efforts within their respective domain. Under such conditions, urgent reform pressure is unable to overcome opposition towards reforms. Countries such as Greece could therefore be described as trapped in bureaucracy. On the one hand, size and inefficiency of the public sector are central obstacles to economic recovery. On the other hand, the political influence of civil servants prevents this problem from being solved.

The study also shows that external incentives may be effective. Modernisation of bureaucracy is noticeably encouraged by specific financial incentives within the framework of the EU cohesion policy. Small, targeted EU programmes for technical administrative assistance have in particular had measurable success in supporting modernisation. In the future, countries such as Greece should therefore receive financial support from the EU specifically intended to support efforts to develop an administration that is characterised by more efficiency and integrity. Since resistance from the profiteers of the old system is to be expected, however, any financial aid given must be accompanied by strict performance monitoring.

The study is available for download at:
www.zew.de/en/publications/7983

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Q&A: What Can We Expect from the European Banking Union?

"Fiscal Stability and Sustainable Growth Remain a Distant Hope in Europe"

What began in 2007 as a crisis in the financial sector expanded into a government debt crisis that continues to plague European politics and economy. The banking system has a double-edged role: While it is partially responsible for the problem, it is also an aspect of the strategy for resolving the crisis. By establishing a European banking union, policy-makers hope to restore the financial stability of the eurozone. Yet in view of the problems faced by various eurozone states, how is such a banking union supposed to help? ZEW economist Sascha Steffen discusses the European banking union.

With its banking union project, the European Commission hopes to provide a "secure and solid financial sector in the domestic market". How will the taxpayer benefit?

The banking union consist of three components: a Single Supervisory Mechanism; a Single Resolution Mechanism for illiquid banks, and a Deposit Guarantee Scheme. The aim is to ensure a stable financial sector and economic growth. Through the reform, it is hoped that Europe will no longer need taxpayer money to prop up ailing banks. Policy-makers hope to put a stop to the downward spiral that can result when governments step in to cover bank liabilities. For bank customers, not much will change on the surface. While bank services may become more expensive due to costs associated with more robust regulation, the banking union is certainly not the sole cost driver. However, customers are also taxpayers and will be impacted if, say, money from German taxpayers is used to bail out Greek banks.

The goal of the Deposit Guarantee Scheme is to ensure that the savings of everyday citizens are not arbitrarily risked. Thus, it seems we are paying for greater financial security by foregoing a degree of financial sovereignty.

A Deposit Guarantee Scheme is needed in order to avert disastrous bank runs. In Greece we saw how billions of euros were rapidly withdrawn as it became obvious that the bankruptcy of the country and its banks was a legitimate possibility. The liquidity problems that the banks were suffering thus became worse, accelerating the path toward bankruptcy. A Deposit Guarantee Scheme could have prevented this scenario. However, if a similar situation occurs again, a Deposit Guarantee Scheme would mean that we are jointly responsible for the banks' liabilities. Accordingly, taxpayers could suffer losses without Europe's national governments having any say in the matter.

In light of the dangers posed by the design of the banking union, does it have any chance of success?

The key goal of the banking union – that is, to ensure financial stability and economic growth in Europe – will indeed not be reached over the short to mid-term. The banking union started with a stress test that aimed to ensure that all of Europe's banks are stable. And where are we today? Greece remains on the brink of bankruptcy, and the country's banks are insolvent. As the banking union was introduced about a year ago, the forecasts were different. The banks that experienced the greatest losses as part of the stress test were located in Italy and Greece.

Who will benefit from the plans of the EU Commission?

Greece, Italy, Ireland, Portugal and Spain are among the countries that will benefit from the banking union; these countries were also the major beneficiaries of the introduction of the euro, and have since amassed tremendous public and private sector debts. Among Europe's stable countries are states such as Germany, the Netherlands and – at present – France. It is correct that banks on the eurozone's periphery are "riskier", as they have lots of bad debts on their books and they are located in countries prone to crisis. But there are ailing banks in every country, and Germany is no exception. The key question is: Have we successfully identified them? In this regard, I am sceptical.

Another proposal is the Capital Markets Union, which is supposed to increase access to funding to European firms. Can this proposal be effective as to bring Europe back to a sustainable growth path?

The Capital Markets Union is an important step for the Eurozone. Non-financial firms have been very dependent on bank financing and it is necessary that we change that. The dependence on banks has caused the loan cost differential between core European and comparable firms in, for example, Italy and Spain, to substantially increase. The Capital Markets Union is supposed to increase funding for firms and reduce the cost of capital differences across the euro area. However, the Capital Markets Union in Europe can only work when the Banking Union is fully implemented. Again, there seems to be very limited consent on important issues as to how to complete banking union. Thus, I am sceptical whether a Capital Markets Union will have the desired impact. There is still a long way to go.

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ZEW Held a Panel Discussion at COP21 Climate Summit in Paris

The new climate agreement was hotly debated at the UN Climate Summit (COP21) in Paris. The conference involved over 40,000 participants. During COP21, ZEW and the German Federal Ministry of Education and Research (BMBF) jointly hosted a panel discussion on the question: Who are the losers and who are the winners of climate policy measures?

Photo: ZEW

The panel at COP21 was aimed at discussing the link between climate policies, competitiveness and innovation with a focus on Germany – a global pioneer in clean technologies and climate policies. While climate policies may negatively affect economic competitiveness and employment, they can also inspire environmental innovations and thus have a positive effect on the economy. The panel opened an interesting discussion both for the panelists and the audience on current research findings over this matter.

Panel member Dr. Oliver Schenker, acting head of ZEW's Research Department "Environmental and Resource Economics, Environmental Management", argued that it is essential to understand how the costs and benefits of climate policy are distributed. Especially current research on German Electricity Tax shows that this policy had almost no measurable impact on competitiveness. The other panelists were Dr. Florens Flues from the Organisation for Economic Co-operation and Development (OECD), Ingmar Jürgens from the European Commission's Representation in Germany and Professor Joachim Schleich from the Gernoble École de Management and Fraunhofer Institute of Systems and Innovation Research (ISI). ZEW researcher Dr. Katrin Sommerfeld moderated the discussion.

All panelists agreed that it is important to foster empirical research on climate policy topics, while policy-makers should not hesitate to push ambitious climate policy measures forward.

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Former ECB President Jean-Claude Trichet Calls for Increased Integration of Fiscal Policy

Had the European Central Bank (ECB) not made exceptional interventions in order to prevent collapse, the financial crisis in 2007 may have pushed Europe to the brink of ruin. This is the view held by Jean-Claude Trichet, who himself witnessed the crisis from very close quarters at that time. According to the former President of the ECB and current Chairman of the Board of Brussels-based think tank Bruegel, the financial crisis is yet to be overcome. Trichet spoke at the Mannheim Economic and Monetary Talks at ZEW on December 8, 2015.


Photo: ZEW

Trichet believes that the crisis has made at least one thing clear. Namely that "we need joint governance." This was also the key conclusion in his lecture "Economic, Financial and Budgetary Governance of the Euro Area – Lessons from the Crisis and Future Development" held at ZEW. "The financial crisis continues to cast its shadow", emphasised the French financial expert. This is mostly due to the fact that in 2007, as is still the case today, the EU lacked greater fiscal integration.

According to Trichet, "we have failed to respect the Stability and Growth Pact." Even if Europe has complied with the literal points agreed upon, the overarching aim of the Pact has not been fulfilled. Further reasons for the crisis were the insufficient monitoring of macroeconomic indicators, the lack of a banking union and of an emergency crisis programme, the fragmented domestic market, and Europe's failure to implement structural reforms. "But, we have survived, made progress and learned something from the crisis." In the short term it is vital that the European banking union is fully implemented. In the long term, policy-makers must prevent the eurozone from becoming a permanent transfer system. Moreover, Trichet recommended that the position of a joint Finance Minister for the eurozone be created and that greater competence be attributed to the European Parliament.

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Photo: ZEW

ZEW Labour Economist Holger Bonin Appointed to German Migration Council

Against the backdrop of the current political situation, migration and asylum are hotly debated issues in Germany and the other Member States of the European Union. Professor Holger Bonin, head of the ZEW Research Department "Labour Markets, Human Resources and Social Policy", was appointed to the migration council as a labour market expert in December 2015. The council brings together researchers from various fields of research, including specialists in social and scientific disciplines. Council members contribute their expertise to place the debate about migration, asylum and integration in Germany on a more objective, fact-based footing.

ZEW Economist Sascha Steffen Appointed Professor at the University of Mannheim


Photo: ZEW

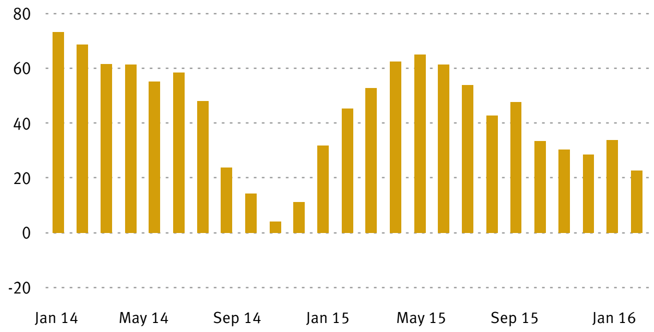
Professor Sascha Steffen, head of the Research Department "International Finance and Financial Management" at ZEW, has officially taken over the professorship for financial markets in the Area Finance of the University of Mannheim Business School. The professorship at the University of Mannheim is linked to Steffen's position as head of research department at ZEW. Professor Steffen has held the position at ZEW since September last year. His primary research interests lie in the areas of European banking regulation and financial market stability as well as financial intermediation. His most recent papers address topics such as the effects of monetary policy on financial markets and the European corporate sector. Sascha Steffen's research findings have received multiple awards and have been published in renowned scientific journals, including the "Journal of Finance", the "Journal of Financial Economics" and the "Review of Financial Studies".

ZEW at ASSA: Many Positive Talks and Productive Scientific Exchanges

ZEW's participation in the annual conference of the Allied Social Sciences Association (ASSA) in the US at the beginning of 2016 was an enormous success. High-quality sessions enabled the participating ZEW researchers to partake in top-level scientific exchanges. The presentations given by ZEW's Professor Sascha Steffen were met with great approval. Steffen, the new head of the "International Finance" Research Department at ZEW, presented his research papers on "The Effects of the ECB Policy on Deposit and Lending Rates" and "Systematic Risks for Banks". Aside from benefiting research work, the ASSA job market also gave ZEW the opportunity to meet and talk to numerous potential research staff members. As in previous years, ZEW had its own information stand at the conference. ASSA participants who visited the ZEW stand showed particular interest in the two research areas of financial and labour markets, and in the topic of migration.

Photo: ZEW

ZEW Financial Market Test January 2016



Balance of positive and negative estimates of economic expectations in the eurozone for the coming six months. Source: ZEW

Eurozone: Economic Expectations Worsen

Economic expectations for the eurozone worsened in January 2016. The respective indicator has fallen by 11.2 points from the previous month's levels, to a total of 22.7 points. The weak dynamics of the global economy are thought to be particularly to blame for this fall. According to financial market experts, the eurozone shall continue to recover throughout the coming six months, the rate of improvement will, however, slow to some extent. In January, the indicator for the eurozone's economic situation climbed by 2.1 points, reaching minus 7.5 points.

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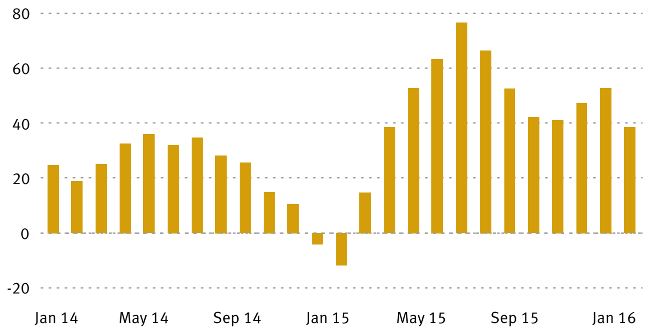

Balance of positive and negative estimations of changes in annual inflation rate in the eurozone in the coming six months. Source: ZEW

Eurozone: Inflation Expectations Fall

Inflation expectations for the eurozone fell in January 2016. The respective indicator has fallen by 14.3 points and now stands at 38.4 points. Inflation expectations have also fallen for Great Britain, as well as for Japan and the United States of America. The decline is closely linked to the further falls in oil prices. At the end of the survey period, the prices per barrel for WTI and Brent crude oil were less than 30 US dollars. The most significant impact of this fall in oil prices, relevant to the inflation rate, is said to have been a fall in heating and petrol costs.

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Transport Market: Prices for Road Freight Recover

Expectations have undergone a complete turnaround since the third quarter of 2015, when a general fall in prices was expected. The transport market experts surveyed for the Prognos/ZEW Transport Market Barometer expect to see prices rise across all transport markets in the fourth quarter of 2015. More than 42 per cent of the experts expect prices to increase in the local transport market, and 47 per cent expect to see price rises in the long-distance transport market.

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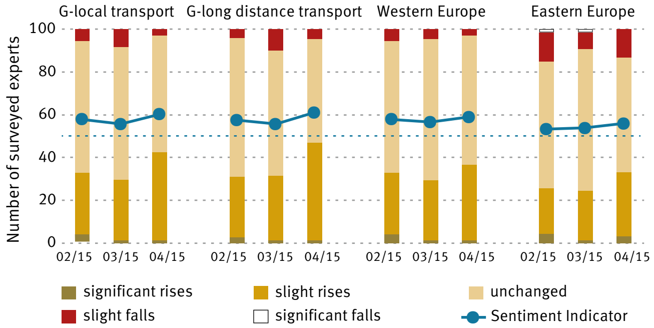

Source: Prognos/ZEW Transport Market Barometer

CEP: Expectations for Chinese Economy Worsen

Expectations for the Chinese business cycle have worsened in January 2016 (survey period 18/01/2016 – 03/02/2016). The CEP Indicator, which reflects the expectations of financial market experts regarding China's macroeconomic development over the coming twelve months, has deteriorated, falling to a level of minus 20.7 points. The worsening expectations are thought, above all, to reflect fears that a weaker development in the global economy shall result in losses in revenues gained from exports.

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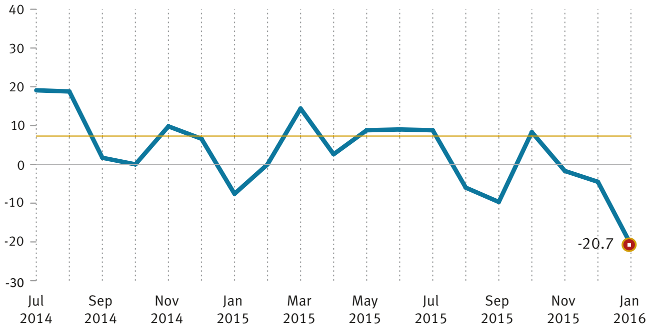

Balance of the symmetrically weighted positive and negative assessments regarding the macroeconomic environment in China in twelve months. Source: ZEW/Fudan University

Chinese Economic Policy Needs a Change

2016 began with a shock from China: in a span of a few days, the Chinese stock market plunged 15 per cent, startling investors around the world. Since then, the rash of bad news from China has continued. Prior to 2008, the Chinese economy had expanded at a rate of eight to 14 per cent per year, and remained astonishingly robust during the global economic crisis. Since 2011, however, the growth rate has tumbled. By 2014, it was seven per cent; this year it could sink to five to six per cent, and there is doubt whether even this can be maintained.

What do these developments mean for Europe? China has become a key market for Europe, Germany in particular. In 2014, German exports to China totalled 75 billion euros, making it Germany's fourth largest export market. What's more, the customers of German companies in all of East Asia would also be hit by the end of the Chinese boom.

What is the outlook for the coming years? The biggest challenge is eliminating China's excessive and inefficient investments without triggering an economic slump. The government in Beijing responded to the global economic crisis that began in 2008 with a massive investment programme. The rate of investment before 2008 was, at 42 per cent of GDP, already very high. During the crisis, this rate increased to over 48 per cent. Now it is 43 per cent. In other developing countries such as India or Indonesia, the rate of investment is around 33 per cent; in the Western industrialised nations, it is around 20 per cent. High levels of investment are welcome if they are productive. But there are many signs that China has invested poorly on a massive scale. A significant portion of investment has landed in mostly unproductive construction projects. In addition, current studies show that state-owned enterprises in China frequently make investment decisions based on political, and not on economic criteria. The IMF has estimated that China's overinvestment is ten per cent of GDP. Cutting these investments drastically could precipitate an economic downturn. However it is urgently needed to provide more space for personal consumption and for investments of small and medium-sized private companies.

In the medium term, China needs to overcome its reliance on technology and expertise from the US and Europe and achieve growth through its own innovation. China has been pouring significant amounts of money into research and development and the expansion of universities. As a result, current innovation indicators, such as the number of patent registrations, show a steep upward trend. Recent studies by ZEW, however, have found that the quality of patents is sinking. While China is producing large quantities of knowledge, the quality is all too often poor.

Chinese economic policy needs a change. It must concentrate on improving the framework for innovation and entrepreneurship and abandon short-term growth targets that are only obtainable via government-sponsored economic stimulus plans. If China succeeds in implementing such reforms, it will continue to serve as a global economic engine in the future.

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