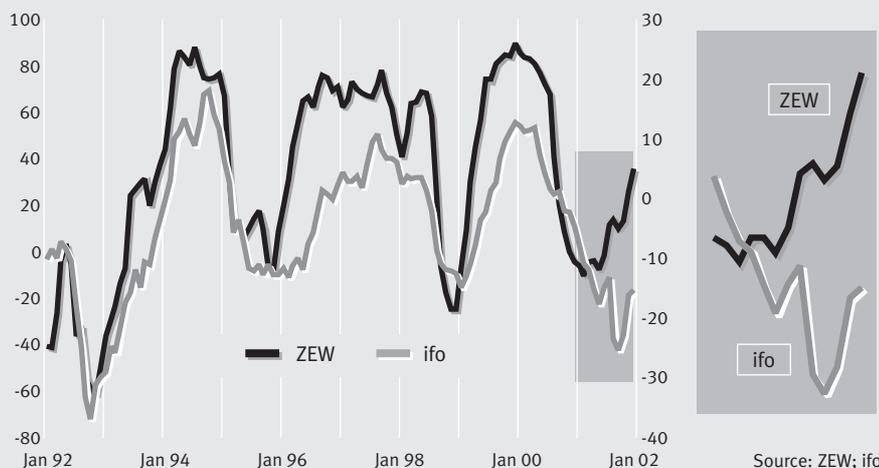


## ZEW Indicator of Economic Sentiment Shows Turnaround for German Economy

The German economy should stabilize in the first quarter 2002 and thus end the downswing for the time being. The ZEW Indicator of Economic Sentiment, based on a monthly survey among approximately 350 analysts and institutional investors from the German financial sector, already left the bottom of the trough in last year's Summer. In the meantime also several other leading indicators confirm this positive development.

### ZEW Indicator of Economic Sentiment and ifo business expectations



rate profits in today's price level, the stock market, from theoretical considerations, should have a lead regarding the economic cycle. The yield curve, i.e. the difference between long-term and short-term interest rates, is also a good leading indicator for the economic cycle, although it has a very long – and sometimes unstable – lead. In Euroland the spread between long- and short-term interest rates has continuously widened since the second quarter of 2001 and in the meantime has re-attained an average value in historical terms.

Business barometers for the US economy also seem to have reached their trough. The well known NAPM index of purchasing managers has also been

■ Econometric analyses (see ZEW Discussion Paper No. 04-01) have revealed that the ZEW Indicator has a significant lead of up to six months with regard to Germany's industrial output. As the index has left its trough since the beginning of the 3rd quarter 2001 positive news can be expected again from the economy soon. However, the indicator has gained momentum only in the past two months. Therefore a period of economic stabilization can be expected before there will be a stronger recovery in the second quarter 2002.

Increasingly, other leading indicators also seem to confirm this assessment:

ifo business expectations, which are part of the ifo business climate index, also rose since November 2001. The impact of September 11 on the German economy thus does not seem to be as strong as some experts had feared. This evaluation is confirmed by the performance of the stock market which normally has good forecasting qualities for the future economic development and thus is often part of economic leading indicators. The German stock index DAX, for instance, recorded an increase of approximately 22 percent in the fourth quarter 2001. As market participants discount expectations of the future development of corpo-

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## Research Findings

rising now for several months, and suffered a sharp slump only once due to September 11. But the NAPM indicator recovered quickly from this temporary drop, and in the meantime the indicator values have taken up again the positive trend of the summer months in 2001. Naturally, a recovery of the US economy, as it was forecast, for instance, by the NAPM indicator would also have a positive influence on Europe's and Ger-

many's economic activity. This underscores the evidence given by the leading indicators for Europe and Germany that there will be a trend reversal in the first half of 2002.

As the ZEW Indicator of Economic Sentiment sounded warnings for the economy and announced the downturn as early as in Spring 2000, the other leading indicators of the German economy, particularly the ifo business expectations,

now seem to be taking up the positive signs that the ZEW indicator has been giving for months. This confirms another insight of the aforementioned econometric analysis, namely, that the ZEW Indicator of Economic Sentiment has a longer lead than the ifo business expectations and thus can forecast trends in the economy sooner than the ifo indicator. ◀

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# What will Put the German Neuer Markt Back on its Feet Again?

After it peaked in Spring 2000 the NEMAX 50 has lost nearly 50 percent. Analysts and the media are speaking about a confidence crisis at the German Neuer Markt. For the ZEW Financial Market Test the ZEW surveyed approximately 350 analysts and institutional investors on the causes of this confidence crisis. The respondents specified particularly the lack of financial management in numerous companies, exaggerated corporate strategies, and subscription euphoria during the Neuer Markt's heyday at the end of the nineties.

■ For the ZEW Financial Market Test, the ZEW surveys approximately 350 financial experts from banks, insurance companies and large corporations about their predominant expectations about the development in six international financial markets. In August, the experts also expressed their view on what caused the confidence crisis at the German Neuer Markt: the entrepreneur himself, the company itself, or other factors.

More than 80 percent of the experts criticized the entrepreneurs for their insufficient market expertise, unsatisfactory financial management, the premature sale of their shares, and the wrong choice of managers. The financial experts criticize especially the financial management of the companies at the Neuer Markt: More than 95 feel that this is one of the reasons for the confidence crisis.

Things are more or less the same when taking a look at companies as a whole. Again 95 percent agree with the statement that the causes can be found in an exaggerated corporate

strategy. More than 90 percent of the respondents believe that corporate information policy is unsatisfactory and that the listing on the stock exchange was premature.

While about 56 percent of the interviewed financial experts feel

that lack of capital was one of the main reasons for the crisis of confidence at the Neuer Markt, less than 40 percent

believe that the confidence crisis is also due to the lack of personnel.

When interviewing the financial experts on the influence that third parties had on the crisis of confidence at the Neuer Markt, more than 95 percent cite subscription euphoria as a reason for the crisis and nearly 85 percent pinpointed problems regarding external control.

Furthermore, nearly 80 percent of the respondents hold the opinion that stock exchange requirements are too low, and as many as 60 percent believe that the current statutory accounting requirements are insufficient. For that reason the experts seem to feel that the tightening of stock exchange regulations and statutory accounting requirements is one step in the right direction to inspire more confidence again.

For further details see Lehmann, Hess and Lüders, Confidence Crisis at the Neuer Markt, ZEW Financial Market Report No. 9/September 2001, page 3. ◀

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## Research Findings

# An International Comparison of Funded Private Pension Schemes

When the promotion of individual old-age savings contracts (Altersvorsorgeverträge) and the extension of occupational pension schemes entered into force in 2002, Germany made a significant step towards enhanced advance funding of the pension system. This does not imply, however, that the discussion about pension reforms in Germany has come to an end. With the aim of obtaining some points of reference for further reforms, the Bertelsmann Foundation conducted an international survey of advance-funded supplementary old-age provision that was organized and evaluated by the ZEW.

■ Under the study, pension experts from Australia, Canada, the Netherlands, Sweden, Switzerland, the United Kingdom, and the US were interviewed, the focus being on the institutional structure of occupational and/or private pension schemes as well as on government saving incentives.

The findings show in all of the countries that in particular for people with higher incomes the



public pillar of old-age provision only ensures a basic provision. Accordingly, it is vital to make additional provisions to maintain one's standard of living. Occupational pension schemes play an essential role in the surveyed countries: with a few exceptions (US, Canada), membership in an occupational pension scheme is prescribed by law or collective agreements. Moreover, most countries promote private savings for retirement age.

### Additional provisions necessary

In most cases it is the deferred taxation of contributions to private pension schemes that creates the most important saving incentive. In the Netherlands, taxable income serves as the basis of assessment for social security contributions which are no longer paid at retirement age, thus creating an additional saving incentive for low-wage earners. In the United Kingdom, those saving for

their old age receive a national insurance rebate when leaving the public pension system ("contracting out"). The vesting periods of occupational pension schemes in most cases are shorter than in Germany, with the exception of the United States.

The Canadian model with its unusual flexibility offers some interesting possibilities. Unused tax deductions may be carried forward for an unlimited time. Pension contributions which exceed the deduction allowed for one year can be claimed as tax exempt in future assessment periods. Furthermore, Canadian tax authorities send out annual notices on the maximum deductible contribution to create additional savings incentives.

Other than the German reform, the systems in some of the countries allow (partial) lump sum payments instead of annuitising the occupational pension entitlements, and in the US and United Kingdom these payments are even given preferential tax treatment. Switzerland

is the only country where rigid investment regulations reduce the risks related to a capital investment. Usually, providers of private pension products are only subject to the general duty to exercise due care with regard to capital investment. In order to maintain the level of pension provision in the long run, occupational pension benefits often are ad-

justed to provide for price and wage increases, however.

In their overall evaluation, experts emphasize that pension risks are well diversified due to their division into a public and an occupational pillar. They criticize the systems for their complexity (United Kingdom, Switzerland), insufficient provision for the low-paid (United States), rigidity of investment regulations (Switzerland), and the low degree of competitiveness in the system of occupational pension schemes (Netherlands). Systems with a particularly high degree of freedom are criticized by experts for offering too much choice between different forms of investment (e.g. in the US or Sweden) and for allowing consumers a high degree of discretion whether or not to participate in a pension scheme (US).

The expert contributions and the summarized evaluation of the ZEW are available at [www.vorsorgestudien.de](http://www.vorsorgestudien.de). ◀

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## Research Findings

# Protecting the Climate with Emissions Trading in the Transport Sector

The transport sector is all but a shining example for the introduction of emissions trading. The flat refusal, however, to acknowledge this concept's feasibility for the transport sector does not seem to be justified. A joint analysis of the ZEW and the Institute for Energy and Environmental Research (IFEU) shows that there are in fact opportunities to contribute to emission abatement in transport by means of certificate trading.

■ A joint study of ZEW and IFEU shows that emissions are not the only starting point to introduce emissions trading. As regards CO<sub>2</sub>, it is possible, without constraints to ecological effectiveness, to choose fuel input as a starting point since there is a constant correlation between the carbon contents of a fossil fuel and the emissions released through combustion. Therefore, fuel-based certificate trading could be implemented at the level of fuel trade or the refineries.



Thus, each refinery would have to furnish the number of certificates corresponding to the volume of refinery products sold. The number of emission entitlements to be furnished would depend on the carbon contents of the fuel quantity sold. However, companies have only limited abatement options. Most likely they will add the costs for the purchase of entitlements to the prices of their products. However, the benefit of certificate trade – which is that those affected still have the choice of how to reduce emissions – would only take a restricted effect here. It depends on the extent to which an appropriate incentive for emission reduction actually arrives at the

lower levels of the value chain (i.e. manufacturers, transport service providers or consumers) in the form of an adequate price markup. This will not happen as long as fuel retailers do not pass on the certificate costs to the consumer and charge other products in their range with the extra costs instead (cross-subsidization). Nevertheless, thanks to the restricted number of participants and the resulting low transaction costs, fuel-based emissions trading bears enormous advantages compared to other solutions.

### Certificates entail only little extra cost

Unlike fuel retailers, car manufacturers are able to influence transport emissions by optimizing the efficiency of the fuel input required by their products. One solution would be to oblige all manufacturers to cover the emissions that the vehicles sold by them are expected to produce with a corresponding number of certificates. The number of certificates required would depend on the fuel consumption specified by a certificate and the expected total mileage of the specific type of vehicle. Assuming a certificate price of 25 Euro per ton CO<sub>2</sub> and a reduction target for the specific emissions of 30 g CO<sub>2</sub> per kilometer, the total sales price of a passenger car would increase by up to 150 Euro if certificate trading was in place. However, a markup of only 150 Euro compared to a sales price of 15,000 to 25,000 Euro for a new car is not very likely to play a major role in the purchase decision of consumers. Furthermore, the solution might miss the target when the anticipated mileage differs from the actual mileage reached, which is very likely to be the case.

The last starting point for certificate trading identified by the ZEW and the IFEU in their analyses is the consumer. A system which allocates emission entitlements to consumers would provide immediate control of demand, the root cause of emissions. However, establishing such a regime at the consumer level will entail severe implementation problems. The question emerges, for instance, how basic needs are to be fulfilled, how they are to be defined and by whom. Furthermore, this approach is not likely to meet with a lot of acceptance. In many areas, enforcement would be extremely laborious and costly. Thus, this approach has proven unfeasible. One possible ex-



ception are passenger cars. Here, a chip card for emission credits, similar to a credit card, could be introduced. At the petrol station, an account would be debited with the emissions corresponding to the petrol quantity filled in the tank. Given the circumstances, this approach seems to be a vision for the future rather than a viable option due to a lack of acceptance in the population. ◀

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## Research Findings

# Financial Services in the European Union: Is the Internet a Myth?

On the one hand the Internet offers consumers the opportunity to choose among a large number of suppliers. On the other hand companies can render services to customers without actually having to be present in the respective country. On the market for online brokerage, however, consumers hardly ever seize this opportunity. The consumers' preference for domestic companies seems to be one of the main obstacles to the integration of the European markets. This is the result of a recent ZEW study.

■ The Internet is the only distribution channel that the online brokerage market uses. One would expect that consumers buy and sell securities from online brokers that satisfy their needs best – independent of the fact where their company is based. Here, the price plays a decisive role. Direct brokers should be able to attend to foreign customers by translating the “domestic” homepage. Against the background of this cross-border competition there should not be any considerable price differentials between European countries in an integrated market.

### Price differentials

In fact, however, there are still huge price differentials between online brokers from different European countries. This becomes obvious when comparing the annual costs resulting from transaction and administration charges arising for different investors for the purchase or sale of shares via the twelve leading European direct brokers. For example, an investor of the type “student” pays on average two and a half as many charges at leading German online banks compared to the Italian market leader. British online banks charge most of their investors more than the European average. Usually German as well as Italian direct brokers are below the average in Europe. It is also astounding that online brokers with subsidiaries in other European countries fix different prices in different countries. The analyses reveal that the subsidiaries are strongly oriented towards the respective market leader.

These price differentials, which in some cases are extremely high, should



cause investors to move their assets to a cheaper, foreign company. With the Internet this entails hardly any problems and would not be any different from acting via a domestic direct broker. A survey among leading European online brokers, however, revealed that such direct, cross-border activities are hardly ever the case and are unknown to most of the suppliers.

### Preference for domestic suppliers

Apparently, there are obstacles in the EU hampering cross-border activities. Politicians have partially already addressed some barriers, such as the high costs for cross-border transfers or the settlement of cross-border recourse claims. Traditional barriers, such as sunk costs resulting from investments in a network of branch offices, should no longer be important due to the Internet. According to nearly all online brokers surveyed the

investors' preference for domestic suppliers is the largest obstacle to the integration of the European markets.

Particularly with respect to financial transactions the “personal handshake” seems to play a role that should not be underrated. The Internet does not allow such a handshake so that consumers at least need to have a sound knowledge of the online bank receiving their money transfer – this is a necessary prerequisite to balance an online account. As there is normally less information available about a foreign supplier than about a domestic supplier, consumers prefer domestic direct brokers, even though this might entail higher costs. In the short and medium term it seems to be quite difficult to dismantle this obstacle to the integration of the European markets. Therefore, the Internet does not knock down any borders – it will weaken them at best. ◀

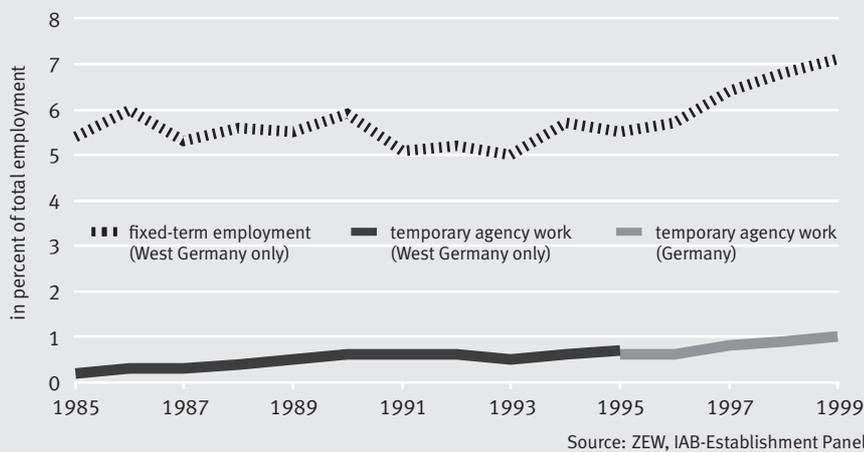
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## Research Findings

# Co-Determination Stimulates Atypical Employment in West German Firms

The regulation of atypical work, such as work on fixed-term contracts, temporary agency work, and the employment of freelancers, has been an important issue for German labour market policy for many years. Deregulation of atypical work is often recommended in order to increase firms' employment flexibility. In January 2001, regulations on the use of fixed-term employment contracts were tightened, while conditions for the employment of temporary agency workers were relaxed. The ZEW analysed the importance of atypical work and the circumstances under which West German firms make use of flexible employment contracts.

### Share of atypical work among all employees



■ Economic theory provides several hypotheses concerning the demand for atypical work. Most of them are based on the presence of adjustment costs arising for a company due to the hiring or firing of employees. To a large part, these costs are caused by institutions, such as the requirement to set up social plans, dismissal notice periods, or the interposition of Works Councils. Avoiding these costs may be a reason for the use of atypical employment. This may be particularly relevant if companies are faced with uncertain demand conditions or if demand for additional workers is known to be temporary in advance, such as in the case of maternity or illness of regular employees. By hiring loan workers from a temporary employment agency, companies may also reduce recruitment costs. Temporary working contracts, however, may also help firms to screen prospective employees. The use of flexible

working contracts may be particularly profitable for small businesses, which can assign specific tasks to temporary workers or freelancers. Finally, cost savings in social security contributions are often seen as another incentive to engage freelancers.

### Econometric Analysis

The ZEW conducted its econometric analysis on the basis of the Establishment Panel from the Institute for Employment Research of the Federal Labour Services in Germany (IAB). The study identifies the effect of firing costs due to the Protection Against Dismissal Law on the use of atypical employment (ZEW Discussion Paper No. 01-33). In October 1996, an amendment increased the minimum employment threshold level for the application of the law from six to eleven employees working in the com-

pany. If the law causes significant firing costs, firms that did no longer fall within the scope of the law after 1996 should have used less atypical employment than prior to the reform. No changes should be observed for firms that were not affected by the amendment.

Concerning fixed-term employment, this prediction is confirmed in the empirical investigation. Firms for which legal dismissal protection ceased to be applicable in 1996 were less likely to conclude fixed-term contracts than before. However, no such effect was found for freelance and loan workers. Apparently, fixed-term workers are closer substitutes for regular employees than temporary agency or freelance workers.

The study also found that the probability of employing atypical work increases with the level of sales. The presence of a works council increases the probability that a company uses fixed-term contracts. This is in line with the hypothesis that co-determination raises firing costs for permanent employees. Firms make use of fixed-term contracts in order to replace employees on maternity and child care leave, while this motive is not present in the demand for temporary agency and freelance workers. Trade unions seem to reduce the employment of freelance workers, since firms bound by collective wage agreements are less likely to use freelance work. The estimation results also indicate that specialised activities, such as the maintenance of computer networks, are often contracted out to freelancers. ◀

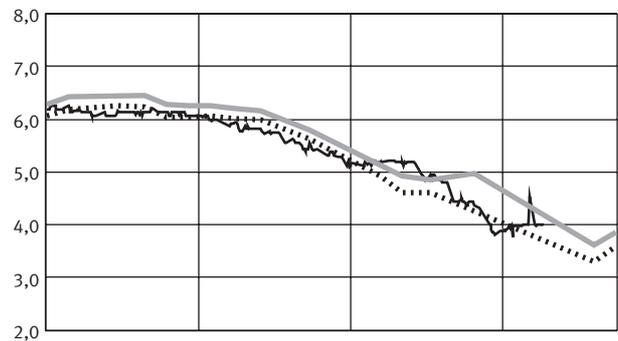
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## ZEW Financial Market Test

# Results of the Survey in January 2002

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## ZEW Conference

### ZEW-Conference: Indices and the Measurement of Quality Changes

April 25/26, 2002 in Mannheim

This ZEW-Conference with support from the Federal Statistical Office Germany and Eurostat deals with the impact of quality change and new products on economic measurement. The conference's objective is to bring together statisticians, academics and others using price statistics. Recent scientific contributions on the issue of quality measurement are discussed together with experiences from the day-to-day use of applied statistics.

For more information please contact Dietmar Moch, Phone +49/621/1235-187, Fax -170, E-Mail [moch@zew.de](mailto:moch@zew.de)

### Call for Papers: 2nd ZEW Conference on the Economics of Information and Communication Technologies

June 24/25, 2002 in Mannheim

The conference's objective is to discuss recent scientific contributions to the understanding of the economics and the diffusion of information and communication technologies (ICT) and the economics of ICT industries. Theoretical, empirical and policy oriented contributions are welcome.

The deadline for the submission of full papers is March 15, 2002.

For further information please see [www.zew.de/ICT-Conference/index.htm](http://www.zew.de/ICT-Conference/index.htm)

or contact Dr. Irene Bertschek, Phone +49/621/1235-350, Fax -225, E-Mail [ict-conference@zew.de](mailto:ict-conference@zew.de)

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# ZEW

Zentrum für Europäische  
Wirtschaftsforschung GmbH

IMPRINT

**ZEW news English edition** – published quarterly

**Publisher:** Zentrum für Europäische Wirtschaftsforschung GmbH (ZEW) Mannheim

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**Reprint and further distribution:** only with mention of reference and sending of a voucher copy

**Print:** Offset-Friedrich, Ubstadt-Weiher, Germany