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Regional Transfers Augment the Positive Attitude of Citizens Toward the European Union

Regional transfers are assumed to be an effective strategic instrument for influencing voter opinion. A new ZEW study empirically investigates how EU regional policy transfers affect people's attitudes toward the EU.

EU regional transfers have a positive impact on the European Union's image.

Enormous resources are invested every year as part of the European Union's cohesion policy, particularly in the poorer regions of EU member states. For example, in the period from 2007 to 2013, some 350 billion euros will be distributed under the EU's regional policy. In addition to achieving structural policy goals, European institutions are apparently hoping that these transfers will improve the opinion of European citizens regarding European integration. By combining a comprehensive database (comprised of structural fund payments) with opinion survey data, ZEW Discussion Paper No. 11-011 investigates whether this effort to improve attitudes has been successful.

The study evaluates information from the EU Commission's annual reports on the Structural Funds. These data make it possible to calculate how much money flowed into each region of the EU between 1995 and 1999. In addition, the study employs data from the Eurobarometer obtained over the same time period. The Eurobarometer is a bi-annual survey of about 1,000 individuals in every EU nation regarding a wide range of subjects, including their general opinion of the EU. In order to estimate how European transfers have influenced the attitude of citizens in the regions involved, the information about funding and about public opinion is correlated for the same geographic areas.

ZEW calculations show that regional transfers have had a considerable positive impact upon public opinion of citizens in the EU. A 100-euro increase in per capita transfers increased the likelihood of having a positive opinion regarding the EU by about five to 15 per cent. In addition, it is shown that the opinions of EU citizens did not depend solely upon the amount of funding that their home region received, but also (to a lesser extent) upon how greatly their home nation was benefiting from structural fund payments overall.

EU Well-liked by Old Members

Citizens from countries that had been members of the EU for a long time generally had a more positive image of the union than people from more recent EU member states. Furthermore, the study examines the visibility of EU structural funds. According to ZEW calculations, the greater the funding received by a region, the likelier its citizens were to be aware that their country was receiving EU support. Beyond this, an individual's perception

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of benefiting from transfers depended on a range of additional socioeconomic factors. Education played a particularly important role, as the perception of benefit held by better-educated citizens responded stronger to the magnitude of regional transfers than the perception of benefit held by citizens who were less well educated. In addition, the perception of benefit typically lead to greater overall approval for the EU. This effect was significantly contingent upon the information source through which citizens were informed about funding. A significant effect is found for direct recipients of EU funds. Furthermore, other information sources, such as TV reports and information placards, had a positive, although significantly smaller, effect on peoples opinion.

These findings conducted by ZEW close a gap in the literature concerned with the use of regional transfers by federal systems as a strategic tool for securing votes. This literature has clearly assumed that transfer intensity has a positive effect upon public opinion; however, until now, this effect had only been demonstrated in a few studies.

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Leniency Policies Stimulate Competition

To break up cartels, anti-trust authorities have been increasingly relying on leniency policies, which provide for a reduction in fines when cartel members expose the existence of a cartel. An empirical study by ZEW confirms that leniency policies provide for increased competition.

Free market competition is among the most important goals of competition policy. Cartels represent a threat to free competition. Anti-cartel regulators have been increasingly relying on leniency policies to uncover the existence of cartels and to destabilise them. Leniency policies give cartel members the opportunity to avoid or at least significantly reduce cartel fines in exchange for exposing a cartel. The utility of such regulation as a potentially effective tool to detect and destabilise cartels has been extensively demonstrated in the theoretical literature. However, negative effects are also possible. For example, it is conceivable that the introduction of a leniency policy may result in an overall decrease in expected cartel fines, thereby potentially stimulating cartel formation. It is unclear whether the potential success of the leniency policies – as measured in terms of an increase in the number of cartels discovered – represents more efficient detection or merely a larger baseline of existing cartels.

In order to empirically test the effectiveness of leniency policies, the ZEW study used several different OECD datasets, including the OECD Structural Analysis Database, the OECD Reference Series and the OECD Product Market Regulation Database. These databases provide industry level information, including total production and input costs, for 23 OECD nations and encompass a 20-year time period. In addition, the study evaluated information about leniency policies that have been instituted by anti-cartel authorities in the 23 OECD nations.

Photo: digitalstock

Leniency policies grant reductions in fines to cartel members that disclose the existence of cartels.

Growing Intensity of Competition

The data make it possible to calculate the effects of leniency policies on the intensity of competition in a particular industry. The price-cost margin was used as a measure of competitive intensity. This measure reflects the difference between the price of a good or service and its production costs. According to economic theory, the price-cost margin shrinks as competition increases in the marketplace – for ultimately, competition leads to lower prices. Econometric estimates reveal that in the nations that were examined, leniency policies had a positive effect on the intensity of competition. Thus, leniency policies led to a lower price-cost margin by three to five per cent in the OECD nations under study. This clearly demonstrates that leniency policies are an effective means for uncovering and destabilising cartels. Thus, the hypothesis that leniency policies might promote illegal collusion as a result of generally lower penalties is not substantiated by the data.

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RESEARCH FINDINGS

International R&D Results in Higher Returns

It remains a matter of controversy whether the costs of research and development abroad exceed the benefits. An empirical study by ZEW has now shown that German firms greatly benefit from international research and development (R&D) activities.

Photo: digitalstock

On average, firms that also conduct R&D abroad achieve higher returns on revenues.

Companies are increasingly shifting part of their R&D activities abroad. The internationalisation of R&D allows them to gain through a better access to new knowledge, markets and more efficient production technologies worldwide. However, internationalisation entails increased costs, in part as a result of increased expenditures for coordination and oversight plus a loss of synergy effects in the firm's home country. So are firms more profitable if they conduct R&D activities abroad? ZEW Discussion Paper No 11-002 examined this question. The study was based upon information from 1,364 German firms surveyed as part of the Mannheim Innovation Panel. The study exploited whether and to what extent firms conducted foreign R&D activities, and the locations where such activities took place. Profitability was measured using return on sales (calculated in terms of pre-tax profit as percentage of revenue). The study related R&D activities in 2005 to future profitability in 2008. Econometric analyses reveal that firms that conduct R&D activities achieve significantly higher profits than innovative firms without any own research activities. This is true for companies that only undertake R&D domestically as well as for companies that pursue research activities both domestically and abroad. While firms with exclusively domestic R&D raised their revenue returns by an average of one percentage point (compared to innovative firms without own R&D), this effect virtually doubled to 1.9 percentage points for firms with both domestic and foreign R&D.

This shows that the benefits of internationalising R&D outweigh the costs, and that firms are on average more profitable if they also conduct R&D abroad. Calculations further indicate that the degree of internationalisation of R&D matters for company's profits. That is, medium-centralised firms that conducted R&D activities in two or three other countries showed the greatest increase in profitability (+3.5 percentage points). Compared to these firms, companies that reported R&D in four or more countries showed a smaller premium, but this was still 2.6 percentage points higher than the returns for companies with exclusively domestic R&D. Evidently, only those firms with a very small degree of internationalisation show no significant increases (as yet) in their profits.

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INSIDE ZEW

Delegation of Abu Dhabi Visits ZEW

In mid-May 2011, ZEW welcomed a three person delegation of Abu Dhabi Department of Economic Development from the United Arab Emirates. The delegation swapped ideas with Michael Schröder, Marcus Kappler, Friedrich Heinemann, Khaled Al Syed Desouki, Rashed Ali Al Zaabi, Stephan Reichert, Shorooq Abdulla Al Zaabi, Holger Bonin, Wolfgang Franz (see photograph from left to right). The meeting aimed at identifying joint research interests and exploring the possibilities for future cooperation.

Photo: ZEW

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Moderate Employment Growth in the Service Sector Due to IT Outsourcing

In public opinion, outsourcing is usually associated with job cuts. The findings of a current study conducted by ZEW in Mannheim, however, indicate that this is not generally the case.

Firms in the German service sector which were outsourcing IT services had a higher employment growth rate than competitors which were not outsourcing.

The ZEW study (Discussion Paper No. 10-108) analyses the outsourcing of information technologies (IT) and its effect on medium-term subsequent firm-level employment growth in Germany. IT outsourcing is a special case of outsourcing and it can be seen as the practice of turning over all or at least parts of an organisation's IT functions to external service providers. Representative results for Germany indicate that more than 78 percent of firms with five or more employees are involved in IT outsourcing.

In the analysed period, the overall employment growth rate for German firms was around three per cent per year. The study suggests that in the medium-term IT outsourcing firms in the service sector have a ten per cent higher employment growth rate per year than their non-IT outsourcing competitors. For IT outsourcing firms in the manufacturing industries, however, neither this positive employment growth nor a decreased number of employees in the long run due to IT outsourcing can be observed. The study's findings indicate that medium-term outsourcing, i.e. in a period of three years, does not necessarily lead to job cuts in firms which are outsourcing IT services.

Data on 1,154 German Companies

The ZEW study analysed a representative sample of 1,154 German firms in the manufacturing industries and the service sector between 2003 and 2006. In addition to firm-specific data such as economic sector, number of staff, turnover, firm age, and usage of computers, the sample also contained information on a variety of IT services firms require for their business activities. By definition, IT outsourcing firms are firms that transfer at least one of the following basic IT services to external service providers: installation of hard- and software, system administration and maintenance as well as user support. The calculations by ZEW indicate that between 2003 and 2006 IT outsourcing firms had a slightly higher employment growth rate than firms which were not outsourcing IT services. Throughout all economic sectors analysed in the study, the employment growth rate was around six per cent higher in outsourcing firms than in non-outsourcing firms.

Outsourcing Improves Efficieny

One explanation for the positive effects on employment, which is confirmed by the study, could be that firms become more efficient when outsourcing services. Outsourcing activities such as IT services, which usually do not belong to the core competencies of the firms, frees up resources that can be used to concentrate on the core products and services offered on the market. This strengthens the competitiveness and helps improve the outsourcing firm's market position. Consequently, the firms' number of employees will increase.

However, the results vary when analysing firms in the service sector and firms in the manufacturing industries separately. The employment growth rate of IT-outsourcing firms in the service sector is 10.5 per cent higher than in firms in the service sector using internal IT services. On the other hand, the positive effect of IT outsourcing on employment cannot be verified for firms in the manufacturing industries. However, medium-term job cuts due to the outsourcing of IT services cannot be confirmed either.

The different effects of IT outsourcing in these two economic sectors is most likely due to the fact that IT services do not play such a major role in the manufacturing industries as in the service sectors, and that there are considerably more PC workplaces in the service sector than in the manufacturing industries.

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RESEARCH FINDINGS

Venture Capital Investors Use Worldwide Cross-border Cooperation to Overcome Distances

The flow of venture capital (VC) across national boundaries continues to increase. In the past decade foreign investors have been involved in more than a third of VC transactions. A substantial proportion of these deals are conducted across great geographic and institutional distances.


Photo: iStockphoto

Cross-border syndication among VC donors may help to overcome geographical and institutional distances.

A new ZEW study (Discussion Paper No. 11-22) examines the internationalisation of VC investors. In recent years, VC investors have bet heavily on internationalisation. Indeed, some 30 per cent of the world's venture capital investors finance foreign companies. Participation in foreign ventures is by no means limited to large global VC investors. Typically, foreign venture capital providers either invest alone in a portfolio company (standalone investment), or they are invited to participate in a transaction by one or several local VC investors – this form of co-operation is referred to as a VC syndicate. The advantages for VC investors arising from internationalisation – including opportunities to invest in growing markets or improve risk diversification – are counterbalanced by some disadvantages. Noteworthy burdens include the high cost of procuring information, not only about the enterprise to be funded, but also about legal frameworks and cultural habits in the target country.

Little research has been conducted to date about the ways how VC providers overcome these burdens. The ZEW study makes a contribution to filling this gap by investigating how venture capitalists overcome the complexity of investing in geographically and institutionally distant regions.

Nearly 24,000 Transactions from the Zephyr Database Analysed

The study is based upon information from the Zephyr database, which is maintained by Bureau van Dijk. This dataset includes deals worldwide, thus offering the huge advantage of a very broad scope. Altogether, 23,826 local and international VC transactions conducted within the period 2000 and 2008 in a total of 48 countries were examined.

ZEW calculations show that the geographical and institutional distance between a potential foreign VC investor and the target firm decreases the chances of participation in a venture. This negative effect is significantly more marked for standalone investments than for syndicated ones. When VC investors cooperate across national borders, less general and country-specific experience is required on the part of the foreign investor than in standalone investments. Thus, syndication not only facilitates overcoming great geographical and institutional distances but also compensates for the lack of experience.

Syndication Offers Opportunities for Inexperienced VC Investors

Smaller, less experienced VC investors are also in a position to exploit the potential advantages associated with internationalisation. The findings show that experienced local VC investors primarily seek out experienced foreign partners. However, inexperienced local VC investors also form syndicates with less experienced foreign VC partners. Cross-border syndication among small VC investors may thus prove to be a promising pathway for overcoming geographical and institutional distances for these investors.

This finding is of particular interest for inexperienced VC investors who would like to start their activities in foreign countries. For these investors, it would make sense to conduct their international expansion through syndication with foreign VC investors who have similar levels of experience. Over the course of time – with increasing experience and the expansion of one's own contact network – an initially inexperienced VC investor can achieve independent access to transactions abroad and also be in a position to to invest in larger deals and to join cross-border syndicates led by more experienced venture capitalists.

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INTERVIEW

Questions & Answers: How Well Do Rating Agencies Perform?

A Government Agency Should be Formed as a Competitor to Private Credit Rating Agencies

Credit rating agencies are powerful. Their judgements determine the conditions under which a country can borrow money on international capital markets. Prof. Dr. Michael Schröder, head of the department of International Financial Markets and Financial Management at ZEW, explains how rating agencies work and how they can be better monitored.

If the creditworthiness of a country or firm is downgraded, a much higher price must be paid on capital markets to finance spending or roll over debt. Isn't it true that a downgraded rating can increase the likelihood of default, thus promoting the very outcome the rating is meant to warn against?

This is undoubtedly a problem. Rating agencies are caught in a dilemma between publicising new information about the default risk of a nation or firm too soon or too late. On the one hand, rating agencies should inform the public about changes in default risk in a timely manner. On the other hand, the downgrading of a rating leads capital market investors to demand higher risk premiums. As a result, financing costs increase and the debt burden on a country becomes even less sustainable, which can result to another round of lowered ratings and increased risk premiums. In the worst case scenario, a reduced rating can set off a downward spiral that leads directly to the insolvency of a nation or a company.

What information do rating agencies rely on to make their judgements?

Rating agencies conduct their risk assessments based on an analysis of publicly available information as well as data from their own research. The gathered information is processed using a variety of methods and then condensed into a rating. The activities of rating agencies are meant to reduce the transactional costs of information gathering, which can lead to a more efficient capital market. The ratings spare investors the need to conduct their own comprehensive analysis, but of course, investors must then have faith in the reliability of rating assessments.

How can we objectively measure the quality of a rating?

At first glance, measuring the predictive value of ratings seems simple enough: We can compare historical ratings with outcomes. However, what precisely are the outcomes? And what does the rating specifically tell us? Ratings provide an implicit statement of probability – for example, about the chances that interest payments will no longer be serviced for a bond. However, ratings do not tell us when such a payment default might occur. In hindsight, it is possible to calculate how frequently payment defaults have occurred for specific ratings. However, it is not possible to gather precise data about correct or false predictions. Rather, we can only conduct a plausibility test: Higher ratings should be associated with fewer defaults than lower ratings. Furthermore, one must also consider the issue described earlier: In extreme cases, ratings may bring about the very results that they predict. In such cases, the prediction of an event and its occurrence are no longer independent from one another, thus making a measurement of predictive value fundamentally impossible.

Who monitors whether rating agencies are working reliably and accurately?

EU Directive 1060/2009, which deals with the regulation of rating agencies in the European Union, has been in force since the end of 2009. In Germany, the Federal Financial Supervisory Authority (BaFin) is responsible for oversight. The new EU directive primarily seeks to ensure that rating agencies active in the EU are not dependent upon their clients and have no incentives to falsify their ratings on behalf of clients. To achieve this goal, rating agencies have been required to make public their methods, models, and assumptions. This makes it possible for their competitors and for independent experts to critically examine their procedures, and gives investors a chance to form a better picture of the reliability of ratings.

Are these provisions sufficient?

These are useful first steps. Alongside their economic function in credit markets, rating agencies fulfil a quasi-public mission. With regard to minimum capital requirements for banks, for example, ratings serve as the basis for the determination of capital requirements for credit

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Photo: ZEW

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risks. Life insurance companies are only permitted to invest in "investment-grade" securities. Moreover, numerous contracts, including credit default swaps, are directly linked to credit ratings. Nevertheless, in these areas there is hardly any form of monitoring to ensure that rating decisions are sound.

What should be done to make ratings more transparent?

Effective economic monitoring could begin with an independent public rating agency, potentially financed by the EU. Such a government-funded rating agency would have different incentives than private agencies in preparing ratings. Thus, the spectrum of available ratings would be expanded by a new variant. Furthermore, over time, a government rating agency could have a benchmark function for comparing the ratings and rating methods of private agencies.

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"Super E10": An Economic Assessment

E10, or gasoline containing ten per cent bioethanol, was recently introduced in Germany with the goal of improving the climate balance in the German transport sector, promoting independence from crude oil production, and meeting the requirements of the EU, which has made an increased admixture of ethanol in standard petrol mandatory by 2020.

Photo: digitalstock

A failure to adequately inform the public about Super E10 prior to its indroduction has been cited as a key reason for poor consumer acceptance in Germany.

Reducing greenhouse gases in the transport sector is an important goal of environmental policy, as this sector accounts for more than 30 per cent of current energy demand and almost a fifth of all greenhouse gases in Europe. However, is the mandatory admixture of ethanol the right policy measure for reducing transport-sector CO_2 emissions that result from fossil fuels? In responding to this question, we will apply the following criteria: objective fulfilment (i.e. will the desired environmental goal actually be accomplished?); cost efficiency (i.e. will the desired environmental goal be accomplished in a cost-effective way?); acceptance by consumers; and social acceptability. The objective of the legally mandated introduction of E10 is controversial. Reduction of CO_2 emissions in the transport sector depends in large part upon consumer acceptance, as well as technical implementation. In the course of manufacturing bioethanol, CO_2 is released during production, processing, and transportation. Environmentally harmful fertilizers are often used and additional tracts of land are made arable by clearing rain forests. This has the consequence that the "lifecycle emissions" for ethanol may turn out to be even greater than emissions from ordinary fossil fuels. For the European E10 standard, however, bioethanol will only be acceptable if it generates at least 35 per cent less greenhouse gases than fossil fuels. According to current estimates, the use of German-manufactured bioethanol will reduce associated CO_2 emissions by half. New technological developments could serve to further improve this equation in the future. However, arable land is scarce in Europe, so there is a fear that any large expansion in bioethanol production could not be accomplished without damaging biodiversity and Europe's land and water resources.

Tax Subsidies Required

There are significant doubts regarding the cost efficiency of E10. Since manufacture of biofuels in Europe is expensive and ethanol-containing fuels are not price-competitive with petrol or diesel fuel, bioethanol production requires tax subsidies. These subsidies inflate the costs of CO_2 avoidance: According to a study commissioned by the The Federation of German Industries (BDI), the use of sustainably produced ethanol in 2020 will result in avoidance costs of between 132 euro per tonne CO_2e and 322 euro per tonne CO_2e. The lower price estimate would only apply if second-generation biofuels could be used, which use cellulose-containing raw materials such as green wastes, straw

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In Europe bioethanol is gained primarily from sugar beets (in the picture) and grains.

or wood to generate energy. Compared to these figures, the current price of an emission certificate on the EU emissions exchange – in other words, the avoidance costs for one marginal tonne of CO_2 – is approximately 17 euro per tonne of CO_2 and is expected to rise to between euro 20 and 40 euro per tonne by 2020. This shows that CO_2 reductions can be achieved in other sectors at significantly lower cost. If one expanded the emissions trading system in an economically meaningful way to include the transport sector, then measures or technological innovations would also be subsidised in the transport sector that could lead to emissions reduction at a lower cost than the current certificate price. However, this might well not include the use of ethanol-containing fuels, at least not under current technical conditions.

Inadequate Public Information

One cannot truly speak of consumer acceptance of biofuels today in Germany. Alongside consumer worry about the technical compatibility of the new fuel that has resulted due to inadequate public information efforts, there is a growing negative attitude grounded in ethical considerations. This fact is demonstrated by the findings of a ZEW consumer study that was undertaken as part of the ECO-CARS project.

In the study, 600 persons in Germany were surveyed about their preferences when purchasing an automobile. Along with conventional technologies (diesel and petrol), the subjects were also offered a selection of modern and future technologies (hybrid, propane, hydrogen, electric and biofuel) in fictional purchasing situations. The analysis of the survey showed that automobiles fuelled by bioenergy were very rarely selected in comparison to other types of engines. Even when presented with identical equipment, cost, and driving characteristics, only ten per cent of those surveyed decided in favour of an engine powered by biofuels. By contrast, hydrogen powered vehicles have a much better public image and were selected by significantly more consumers.

Effects on Food Prices

The social acceptability of E10, both nationally and globally, depends critically upon the effect that bioethanol production will have upon food prices. Even if current bioethanol production for E10 sold in Germany does not have a major impact upon world market prices, increasing demand for bioethanol could result in intensifying competition for acreage between food cultivation and crops to meet bioethanol demand. Therefore, a way must be found – perhaps through a selective certification process – to assure that meeting the demand for foodstuffs has priority and that nobody goes hungry on account of biofuel use. Other socio-economic effects also speak against increasing bioethanol use in Europe. As part of a simulation study, we explored the effects of rising biofuel shares in total fuel consumption upon employment in Europe. A number of different scenarios were calculated for 2020; these scenarios differed in terms of biofuel usage shares (0 to 15.2 per cent), available production technology (first or second generation), and import prices for biofuels. The results of the simulation showed that increasing the share of biofuel use would lead jobs to migrate from the refining, energy, and transport sectors to bioenergy production and agriculture.

However, in all of the scenarios considered, the changes in total employment were relatively minor. The order of magnitude was small – plus or minus 300,000 jobs, depending upon the scenario – when placed in relation to the 200 million jobs in the EU.

CO_2 Avoidance in the Transport Sector "at any Price" is not Advisable

Was the introduction of E10 truly a disaster, as claimed by the German media? Consumer acceptance has clearly been weak. Yet from an economic point of view as well, the mandatory introduction of E10 as an instrument of climate policy must be critically questioned: both its stated objective and its cost effectiveness are far from assured, and its social acceptability is hardly guaranteed. It would make more sense to expand the existing EU emissions trading system to include the transport sector. Should this prove politically unfeasible, existing policy measures should be further expanded and improved, including the eco-tax for reducing of the number of kilometres driven; efficiency standards for automobiles to reduce energy use per kilometre; and CO_2 emissions norms and taxes for reducing CO_2 emissions per energy unit or per kilometre. These policy measures should be linked to appropriate infrastructure measures and targeted subsidies for new technologies as well. Yet all of these policy actions must be compared to the costs of reduction efforts in other areas. It would not be very advisable to seek CO_2 avoidance in the transport sector "at any price".

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INSIDE ZEW

ZEW Researcher Wins Klaus Liebscher Award of the OeNB


Photo: ZEW

The paper “Can Regional Transfers Buy Public Support? Evidence from EU Structural Policy”, written at ZEW, won the Klaus Liebscher Award of the Oesterreichische Nationalbank (OeNB), the central bank of the Republic of Austria. The award was presented to the author Steffen Osterloh by the OeNB President, Claus J. Raidl, at the 39th Economics Conference of the OeNB in Vienna.

The Klaus Liebscher Award is the highest award presented by the OeNB to young economists and is offered every year for two scientific papers on European integration issues and the Economic and Monetary Union. The award grants 10,000 euro per paper. In his paper, Steffen Osterloh investigates the influence of regional transfers taking place under the cohesion policies of the European Union on the citizens’ approval of the EU. The author shows that the regional transfers have a positive impact on the public opinion. However, the awareness of being a beneficiary of transfers is conditional on the citizens’ education and, depending on the source of information, affects their opinion to varying degrees.

Prof. Dr. Heiderose Kilper Elected New Spokesperson of Section B of the Leibniz Association – Prof. Dr. Glauben elected Deputy

At the conference of Section B of the Leibniz Association, held at ZEW in Mannheim at the end of May, the new spokesperson and the deputy spokesperson of the section were duly elected. The current spokesperson, ZEW President Prof. Dr. Dr. h.c. mult. Wolfgang Franz, will be leaving the position as scheduled after two years. Prof. Dr. Heiderose Kilper, Director of the Leibniz Institute for Regional Development and Structural Planning in Erkner, will take office as spokesperson in the middle of this year. Prof. Dr. Thomas Glauben, Executive Director of the Leibniz Institute of Agricultural Development in Central and Eastern Europe, Halle (Saale), will assume the office of deputy spokesperson.

Photo: ZEW

Prof. Dr. Thomas Glauben, Prof. Dr. Karl Ulrich Mayer (President of the Leibniz Association), Prof. Dr. Heiderose Kilper, Prof. Dr. Dr. h.c. mult. Wolfgang Franz (from left to right).

ZEW Annual Report 2010

In the business year 2010, the Centre for European Economic Research (ZEW) Mannheim improved its results by half a million euros to 15.6 million euros. In particular, third-party funding strongly increased. ZEW received 6.3 million euros third-party funds that were raised in national and international competition, thus exceeding the previous year’s funding of 5.8 million euros. In 2010, 15 doctoral degrees and one habilitation were successfully completed at ZEW. A number of dissertations were awarded the highest possible grade of „summa cum laude“. At the end of 2010, a total of 172 persons were employed at ZEW, two thirds of which were researchers. The ZEW Annual Report 2010 contains many other interesting facts.

Its new design makes it more accessible for readers, and emphasises the highlights of 2010.

The 2010 Annual Report is available at www.zew.eu/annualreport

DISCUSSION PAPERS

No. 11-036, Sascha Rexhäuser, Christian Rammer: Unmasking the Porter Hypothesis: Environmental Innovations and Firm-Profitability.

No. 11-035, Nina Leheyda, Patrick Beschorner, Kai Hüschelrath: Ex-post Assessment of Merger Effects: The Case of Pfizer and Pharmacia (2003).

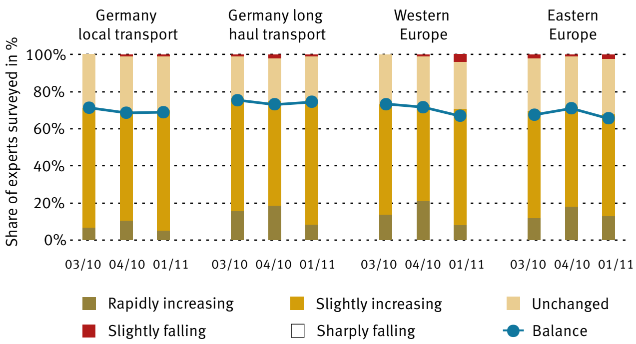
No. 11-034, Nina Leheyda, Patrick Beschorner, Kai Hüschelrath: The Effects of the Block Exemption Regulation Reform on the Swiss Car Market.

No. 11-033, Friedhelm Pfeiffer, Karsten Reuß: Human Capital Investment Strategies in Europe.

No. 11-032, Irene Bertschek, Daniel Cerquera, Gordon Jochem Klein: More Bits – More Bucks? Measuring the Impact of Broadband Internet on Firm Performance.

FACTS AND FIGURES

Slight Weakening in the Pace of Freight Traffic Growth



Source: ZEW

Findings from the current ProgTrans/ZEW Transport Market Barometer indicate that the rebound experienced in the wake of the economic crisis is slowing down. Estimates for growth in freight volumes for the coming half-year are somewhat lower compared to the previous quarter, even though they still predict positive growth. In terms of road transport volumes, the surveyed experts forecast continued growth in truck-borne transport. However, the percentage of experts who anticipate strong growth has declined somewhat.

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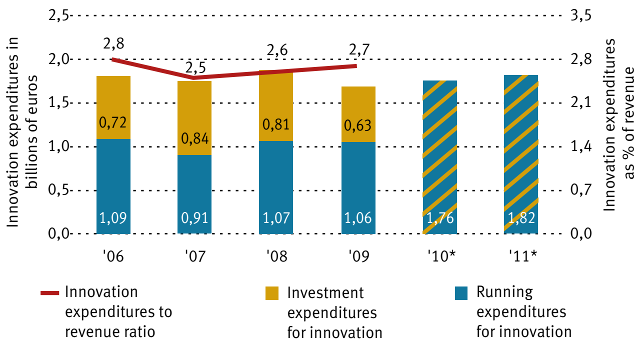
Rising Innovation Expenditures in the Rubber and Plastic Processing Industries



* Target figures from spring/summer 2010 Source: ZEW, Mannheim Innovation Panel

In the economic crisis year of 2009, the German rubber and plastic processing industry decreased its innovation expenditures by around ten per cent to 1.69 billion euros. Budgets were cut by firms for investment in new processes as well as in facilities for product and process innovations. Running expenditures for research and development and for marketing new products remained unaffected. For 2010 and 2011, innovation expenditures are anticipated to increase by four per cent in each year. Thus, by 2011, they will have returned to their 2008 levels.

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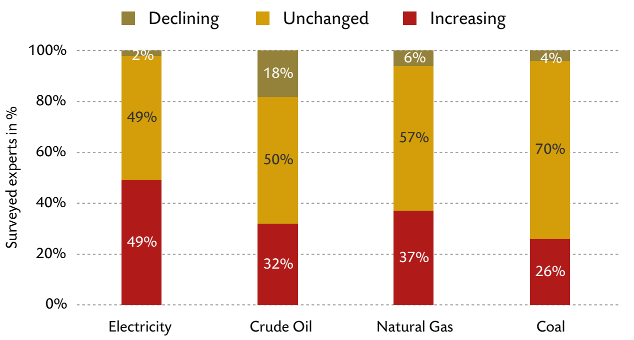
Stable Energy Prices Anticipated over the Short Term



Source: ZEW

According to the experts surveyed for the ZEW Energy Market Barometer, wholesale energy prices will remain largely stable over the next six months. 70 per cent of the experts indicated coal prices will remain steady in the period ahead. With regard to natural gas, 57 per cent believe prices will remain stagnant. In the case of electricity and crude oil, however, the experts were less optimistic. 49 percent and 50 percent,respectively, foresee stable prices. The ZEW Energy Market Barometer is a biannual survey of some 200 energy market experts.

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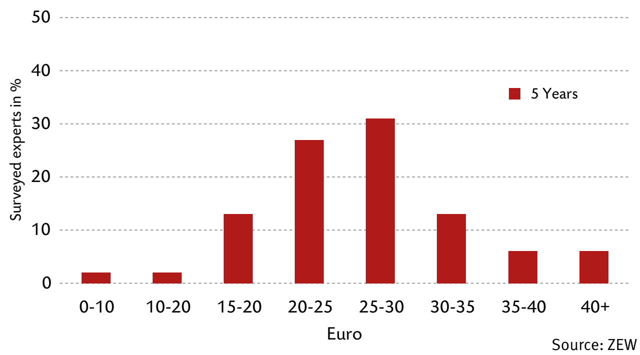
Emission Prices of 20 to 30 Euros per Tonne CO_2 Anticipated



Source: ZEW

More than half of the experts surveyed for the ZEW Energy Market Barometer are predicting medium-term (five year-time horizon) prices of between 20 to 30 euros per tonne CO_2 on the European emission markets. The current price is about 14 euros per tonne. Among the survey participants, some 13 per cent forecast a price between 15 to 20 euros. Another 13 per cent anticipate that over the medium-term, the price of a tonne CO_2 will range from 30 to 35 euros. The ZEW Energy Market Barometer is a biannual survey of some 200 energy market experts.

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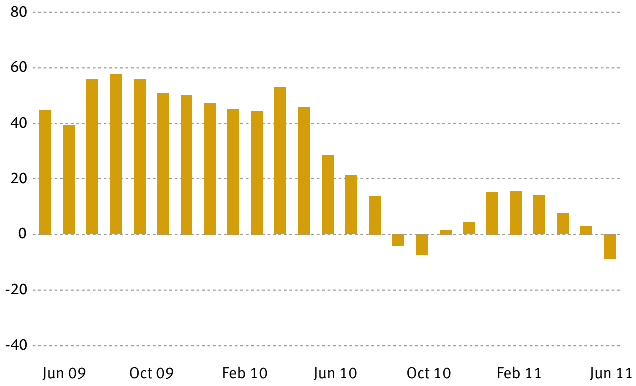
FACTS AND FIGURES

ZEW Financial Market Test June 2011



Balance of positive and negative assessments concerning economic development in Germany. Source: ZEW

Germany: Expectations Considerably Weaker

The ZEW Indicator of Economic Sentiment for Germany has dropped by 12.1 points in June. The indicator now stands at minus 9.0 points. This value is below the indicator's historical average of 26.3 points. To the decline of the indicator may have contributed that the Greek refinancing requirements have directed once again the attention of the financial markets to the debt crisis in some countries of the euro zone. Furthermore, unfavourable economic data from the US seem to have a negative impact on the assessment of the financial market experts with respect to the current situation and the perspectives of the economy of the United States. Troubles in the euro zone as well as the feared economic downturn in the US seem to weigh heavily on the mind of the financial market experts.

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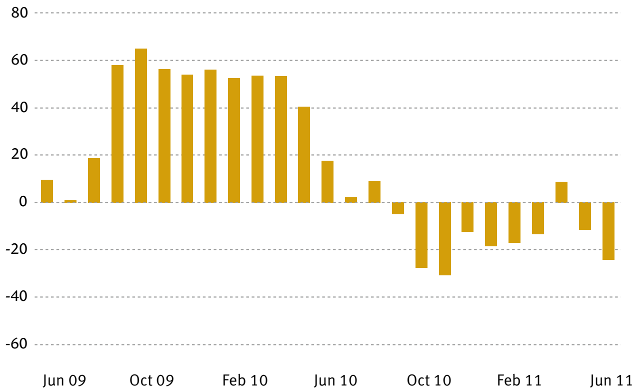

Balance of positive and negative assessments concerning economic development in Switzerland. Source: ZEW, Credit Suisse

Switzerland: Economic Outlook Diminishes

In June economic expectations for Switzerland have diminished for the second month in a row. The ZEW-CS Indicator has dropped by 12.8 points to the minus 24.3 mark reaching the lowest level recorded since November 2010. The ZEW-CS Indicator is calculated monthly by the Centre for European Economic Research (ZEW) in cooperation with Credit Suisse (CS). With 59.5 per cent of the surveyed experts, the majority of respondents still anticipates that the current favourable economic momentum will continue to prevail in the coming six months as well. However, merely 8.1 per cent of the experts foresee further improvement in the economy ahead, in contrast to 32.4 per cent of the analysts who in the interim see a cooldown in economic momentum.

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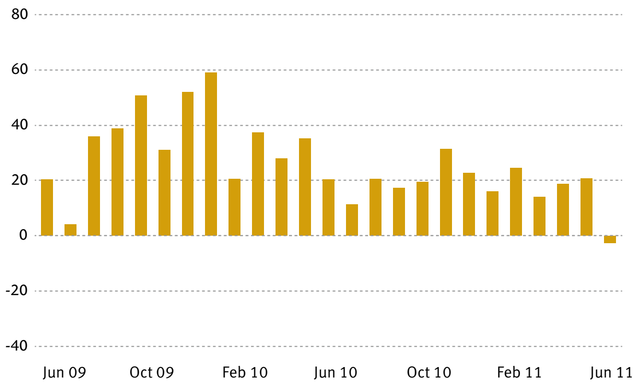

Balance of positive and negative assessments concerning economic development in the CEE region. Source: ZEW

CEE Region: Plunge of Economic Expectations

The ZEW-Erste Group Bank Economic Sentiment Indicator for Central and Eastern Europe including Turkey (CEE) has decreased by 23.4 points to minus 2.5 points in June 2011. The indicator reflecting the current economic condition in the CEE region has dropped by 16.5 points to 4.7 points. Nevertheless a majority of 76.7 per cent of the experts still assess the current economic situation as normal. The economic sentiment indicator for the CEE region and further financial market data have been surveyed monthly by the Centre for European Economic Research (ZEW) with the support of Erste Group Bank since 2007. The CEE region surveyed consists of Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania, Serbia, Slovakia, Slovenia and since October 2010 of Turkey.

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OPINION

Promises to Pay

Particularly on the international stage, Germany has been accused of weariness with the European project. At times, it is hard to avoid the impression that other European nations measure Germany's enthusiasm for Europe by the extent to which we are willing to instantly shoulder the burden of various financial rescue packages.

Those harbouring such feelings toward Germany point on the one hand to low growth in German unit labour costs, which is said to be unfair to other European countries, and, on the other hand, to our high trade surpluses, which are touted as proof of how much we have benefited from the euro. We should thus be happy to show a measure of gratitude, the logic goes. Yet both of these perceptions are flawed.

The unit labour cost theory falls under the category of "lies, damned lies, and statistics". The proponents of this argument typically select somewhere around 2005 as their point of departure in order to show that manufacturing unit labour costs in Germany – in other words, the ratio of the nominal wage to labour productivity – has indeed grown at a slower rate than the European average. At first glance, this reproach might appear justified, but it does not stand up to closer inspection. Viewed from a longer term perspective, what actually happened was that during the 1990s and into the early 2000s, Germany simply corrected its earlier wage policy sins, which had been committed at a time when domestic wage costs were appreciably higher than those in the eurozone as a whole. By 2005 we had simply returned to a unit labour cost level comparable to1990. And don't forget: we are speaking about unit labour costs, which take worker productivity into account.

The criticism levied by supporters of the labour unit cost thesis – namely, that the calculations are based on the manufacturing industries, and that for the economy as a whole, things would look quite different – represents a rearguard action. The high level of international competitiveness for which Germany is reproched finds its expression in strong exports, and Germany primarily exports manufactured goods. Thus, the unit labour cost comparison should be based on this sector.

The argument that Germany's large trade surpluses should justify an equally large willingness to pay for bailouts is of a similar pedigree. We in Germany are not entirely blameless for perpetuating this fallacy. Before Germany was replaced last year by China as the world's largest exporter of goods, talk was all too frequent in the media of our status as "world export champion", as if we were discussing the World Cup. No question about it: an export surplus means we are exporting more goods than we import. But the other side of the coin is the balance of payment deficits run by foreign nations. When we export more than we import, this means nothing other than an extension of credit abroad. A country may have good reasons to do so – for example, in response to demographic changes – as occurs when retirement provisions take the form of capital investments, some of which go abroad and will later be repatriated. But in recent years, our extension of credit to foreigners has occasionally gone awry. In return for supplying high-quality machinery to the United States, for example, we were given scrap paper from Lehman Brothers. It would have been better if we had instead made greater domestic investment.

This raises another important interrelationship. By definition in national accounting, the current account balance represents the difference between savings and investment. If domestic savings were completely transformed into domestic investment, the balance of payments would be in equilibrium. This understanding illuminates one important downside of Germany's trade surplus, namely, that there has been insufficient domestic investment activity in Germany. Indeed, Germany's domestic investment rate and resultant growth path ranks toward the bottom in a comparison of European nations. Seen in this way, we are actually harming ourselves with our massive trade surplus. The notion that this surplus should provide a greater willingness to pay is thus unjustified.

Wolfgang Franz

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