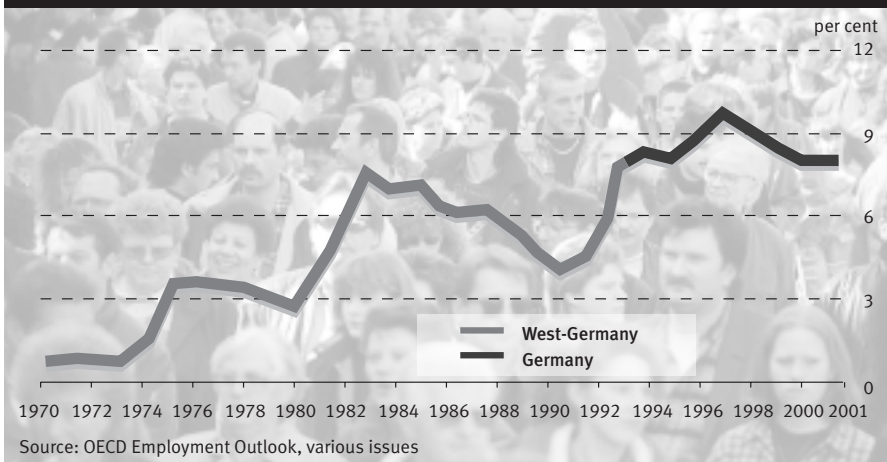


A Strategy for More Jobs

The German federal elections are over, but the problems remain, particularly on the job market, even though practically all candidates had promised to considerably reduce them. This primary goal corresponds with present requirements. Nevertheless, politicians should not assume the sole responsibility for finding a solution to the employment problem and should by no means succumb again to the temptation to be measured according to quantitative objectives. Other parties are also responsible and have to meet their obligations, this applies particularly to the wage bargaining parties. We need a set of measures with long-term effects.

Unemployment rate in Germany



■ Regarding the creation of competitive jobs, wage policy assumes a leading role. The fact that moderate union wage rate increases are able to contribute substantially to more employment should be uncontested, even among unions, otherwise their vehement pleading for the reduction of non-wage labour costs to improve the employment situation would hardly be comprehensible. But focusing solely on non-wage labour costs does not allow a clear view of the situation. For companies it does not make any difference whether they pay wages to their employees or transfer compensations to social insurance institutions. Labour costs are labour costs, it is their total amount that is decisive for the em-

ployment level, their division into freely available income and social security payments – which should be as effective as possible – is only the second, albeit important, step.

Labour costs: moderate increases and flexibility

Real gross wage costs can only develop according to the trend of the labour productivity growth rate if employment has reached a satisfactory level. We are far from such a situation, and this means that wage policy will have to make a deduction from this path of labour cost development for the next years to come. If they fail to do so, they should not com-

plain about employment losses and demand “Stop Job Losses” on May 1st.

Encouraging employee profit-sharing will probably prove to be particularly helpful. If union wage rate increases are deliberately determined at a low level and combined with agreed profit-sharing components, this will also allow for different profit situations of individual companies and in addition it will alleviate the unions’ concern that the agreed wage increase in the collective agreement was too low, in case there is a better economic recovery than originally assumed during collective bargaining.

More flexible institutional regulations on the labour market have to be part of a wage policy beneficial to employment. The usual factors creating obstacles are known and should be changed for the better: for instance, more company-

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related wage fixing, the extension of the so called advantage principle, and the abolition of the declaration of general application of a collective agreement.

Lower contribution rates for social security systems increase net compensations for employees and reduce labour costs. This, however, requires the willingness to further reform the pension insurance fund and to restructure both the health care system and the unemployment insurance system.

Pension system and health care reforms are necessary

However justified criticism of details may be, the pension system reform has been an important first step. In order to avoid a further increase of contribution rates the future federal government will have no other alternative but to increase the statutory age limit for pensioners by at least one or two years and to consistently reduce insurance coverage accordingly if employees withdraw prematurely from employment. Restructuring the health care system, which is long overdue requires more extreme measures, which include three reform elements. Firstly, the insured's option to switch from one health insurance to another at any time guarantees full competition between all health insurance schemes. To this end, individual old-age reserves made in private medical insurance companies will have to be transferable in future so that the interfund risk-adjust-

ment scheme preventing competition would eventually be no longer necessary. Secondly, there will be separate minimum benefits related to the obligation to insure and optional benefits where eligibility is based exclusively on a voluntary additional insurance, e.g. for free choice of doctors, hospitals, and cures. Thirdly, previous income-related premiums and free insurance of family members in statutory health insurance schemes will be replaced with personal risk equivalent premiums, and general taxation will solve any redistribution/allocation issues that might come up. The solidarity with persons earning low incomes and the promotion of families which is a principle enshrined in the current system is a responsibility to be assumed by the whole of society, and all tax payers should finance this idea.

A new way to support the unemployed

Social provisions in the event of unemployment also need to be revised. Here, the following model resting on three pillars seems to be expedient: The first pillar includes a compulsory insurance covering exclusively a loss of earnings. Its benefits will continuously decline in line with the duration of unemployment until they will have reached the level of welfare benefits which will then be paid out by the social welfare system. The second pillar consists of voluntary additional insurance funds, e.g. for la-

bour policy measures or more generous maintenance payments. The third pillar concerns the social welfare system as it is to date. Benefits will be significantly reduced for unemployed welfare recipients who are fit for work. In exchange, they will have more opportunities to earn money once they start to work and will be granted state subsidies, if appropriate. Thus, going to work is rewarded and not idleness, as is currently the case. Nevertheless, it is again the wage bargaining parties who have to support this change. They need to broaden the qualification-related wage structures even further in order to align wage costs with productivity in the area of low-qualified work and to render jobs more profitable.

Investments are the necessary precondition for new job creation. A tolerable and internationally competitive tax burden has a positive effect on the willingness to invest. The tax reform is better than its reputation, yet again the old rule applies: every reform requires another reform. The reason being that, according to ZEW calculations, important competitors still have a far lower effective average tax burden in international competition for locations. The main intention of the required impending reform of the tax system is to simplify the system, to further reduce income tax rates, and the abolition or at least fundamental revision of the local business tax. An extended income tax base may very well be part of these measures. ◀

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ZEW Economic Studies

Elke Wolf

What hampers part-time work? An empirical analysis of wages, hours restrictions and employment from a Dutch-German perspective

This book contributes to clarify the conditions of jobs with shorter working hours and reckons the potential for increasing part-time employment in Germany. Two crucial obstacles of part-time employment are addressed: Firstly, the wage structure and its implications for labor supply, and secondly, the lack of job offers for part-time employees. The Netherlands – known as the first part-time economy in the world – is used as a benchmark for the German case. The empirical analyses in this book are based on representative household data for Germany and the Netherlands.

Physica-Verlag, Vol. 18, Heidelberg/New York, 2002

You may also order this book online: www.springer.de/economics

Research Findings

Low Share Prices Dampen Consumption

For more than two years stock markets throughout the world have been on a downswing. This destruction of capital spoils consumers' willingness to consume to a certain extent and thus impairs the overall economic growth rate. In a study commissioned by the Federal Ministry for Economics and Technology the ZEW investigated to which extent retail sales in Germany decline when assets in shares diminish.

■ One of the points of departure in the ZEW study on the influence of share markets on economic development was the idea that a sustained decline of assets in shares diminishes today's and future earnings from the assets of private households and thus leads to a decline of private consumption expenditure. The study finds that real retail sales diminish on average by 0.5 percent when assets in shareholdings decline by ten percent. This, however, is an overall effect which sets in only gradually and brings its full influence to bear only after about two years. Based on the decline of the Dax by 55 percent since the beginning of the year 2000, real retail sales thus might dwindle by a total of approximately 2.8 percent. Since share prices have been continuously falling, it seems as if a part of these effects is already realised.

In the overall view, however, one should not overestimate the role that the stock market plays in private consumption. German households' assets in shares, for instance, are comparatively low and not broadly distributed. The decline in prices thus primarily affects more wealthy households which do not have to reduce their consumption immediately. In addition, it is by no means



certain that the great slump in stock market prices will last. It should have only minor effects on the consumption expenditure of investors with long-term investments.

Sagging share prices can also have a negative effect on corporate investments. This affects mainly small, innovative companies that have not been able to take up capital via the stock market in the past two years. Furthermore, listed stock corporations might experience difficulties with credit financing, since

falling share prices have diminished corporate goodwill, and the banks have to cope with their own stock market losses. On the other hand, from 1996 to 2000 only about 3.5 percent of German business investments were directly financed through equity issues. Thus the loss of assets in shares is likely to diminish the overall economic growth rate. But it will not be a major impediment to a coming upswing. ◀

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ZEW Economic Studies

Jens Köke

Corporate Governance in Germany – an Empirical Investigation

Corporate governance is an important issue on the research agenda of financial economists. Using a new and unique data set of German corporations, this book examines three topics that are crucial to a better understanding of corporate governance: (a) the frequency, causes, and consequences of control transfers, (b) the determinants of acquisition and failure, and (c) the role of corporate governance and market discipline for productivity growth. This book points out methodological drawbacks of previous empirical studies and provides suggestions how to avoid these problems in research practice.

Physica-Verlag, Vol. 17, Heidelberg/New York, 2002

You may also order this book online: www.springer.de/economics

Research Findings

Educational Prospects in Poland

According to the PISA study the family background assumes a vital role for children's success at school not only in Germany but also in Poland. A ZEW study conducted on Polish children's educational attainment during transition reveals that the parents' educational level and regional factors such as the place of residence have a greater influence than the financial situation of the family.

■ In the course of the transition from a centralised to a market economy inequality in Poland has increased. Not only income differentials between private households have widened but also inequalities in terms of socio-economic status such as the parents' occupational status or the children's educational level. In view of the rise in disparities in society it is all the more important to answer the question whether social inequality is passed on, or even inherited from one generation to the next. The relationship between the educational attainment of Polish children and their family background as well as the extent to which parental poverty is transmitted to the children are part of the project Intergenerational Poverty Dynamics which the ZEW carried out in cooperation with scientists of the Polish foundation CASE. Panel data of the Polish Labour Force Survey on more than 4,000 young men and women and their parents were the basis for this study financed by the Volkswagen Foundation. The data cover the transformation period from 1992 to 2000.

Educational level has increased during the transformation process

The study shows that the educational level of the young generation has overall increased during the transformation period, particularly from 1997 onwards. Similar to Western European countries, Polish children's educational attainment is closely related to their parents' educational level. The higher the degree held



by the parents, the higher the probability that the daughter or son will also strive to obtain a higher educational level. For instance, more than two thirds of the children with parents holding a university degree enrol in university, while this share is less than ten percent for children whose parents have attended primary school at most.

When using personal characteristics such as sex, number of siblings, health status, and the parents' human capital endowment as control variables the data reveal a weak, but nevertheless significant correlation between parental income, the labour market situation of father and mother and the educational attainment of children. Likewise, children from farming families seem to be

educationally disadvantaged, however less so for financial reasons than due to the fact that they are living in rural areas with fewer educational institutions.

City size matters

The multivariate analysis shows that the South Eastern provinces of Poland (particularly Slaskie) offer the best educational prospects while Western provinces from Zachodniopomorskie to Dolnoslaskie provide the worst educational opportunities. The city size seems to matter even more than the region for the level of educational attainment. The rule of thumb is: the larger the city the better the educational

prospects. One explanation might lie in a better access to educational institutions in large cities. Furthermore, it is also worth noting that young women experience more educational success than young men.

Poverty transmission between generations in Poland seems to be caused primarily by parents passing on their human capital to their children and by access to secondary school and universities than by purely financial aspects. Interestingly enough this correlation seems to have remained unchanged even during the transformation process.

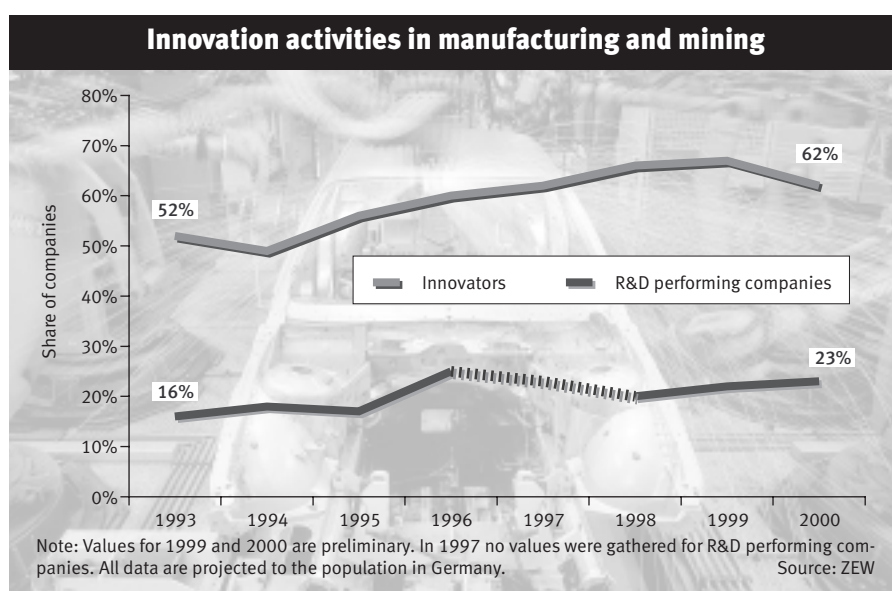
For more information see ZEW Discussion Paper No. 02-35. ◀

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Research Findings

Innovative Power of German Manufacturing Industry Slows Down

Innovative activities of German manufacturing and mining industry continued to show a high level in an international comparison in the year 2000. Compared with 1999, the share of innovative firms has declined, although innovation expenditure remained stable and even reached a new all-time high in 2001. In 2000, companies delayed application-related innovations due to high capacity utilization rates and critical shortage of qualified personnel. On the other hand, they expanded fundamental research and development activities.



■ The German innovation survey, which the ZEW conducted with infas in 2001 on behalf of the Federal Ministry for Education and Research confirms these findings. Since 1993 the ZEW has been reporting regularly on the innovation behaviour of the German economy and has been analysing data of approximately 4,500 companies on an annual basis. According to the Oslo Manual of Eurostat and the OECD a company is regarded as innovative if, in the past three years, it has either introduced a new or significantly improved product or has implemented a new or significantly improved process in the company. Such an innovation does not necessarily have to be new to the market.

Compared to the previous year, the share of innovative companies in German manufacturing and mining industry fell from 67 to 62 percent in 2000. Simultaneously, innovation expenditure remained stable at approximately 58 billion

Euros and reached a new all-time high with 60 billion Euros in the year 2001.

As reported by the ifo Institute the high capacity utilization rate attained 87 percent in West Germany and in some manufacturing sectors even more than 90 percent. This development and the shortage of qualified personnel prevented companies from further expanding their innovative activities. The reason for this is that, particularly in the case of small and medium-sized companies where innovative activities are not institutionalized, innovations are in direct competition with manufacturing and distribution in terms of staff capacities. In order to secure market shares and to avoid customer losses, qualified personnel which is necessary for the successful implementation of innovation projects is urgently required to handle day-to-day operations.

Accordingly, in nearly all industrial sectors under review, shortage of quali-

fied staff ranks second as a factor hampering innovation in the year 2000, right after high innovation costs and risks. It has thus become more important than the shortage of financial resources. Until the mid-nineties, lack of finance was regarded as the prominent factor hampering innovations.

More research and development

In the year 2000, manufacturing enterprises delayed principally application-related innovation activities, namely the transformation of research results into marketable products and efficient manufacturing processes. By no means, however, did firms neglect fundamental research activities. On the contrary: since 1998 the share of German companies conducting research and development activities has steadily increased. In the year 2000 nearly one out of four manufacturing enterprises (23 percent) continuously pursued research activities.

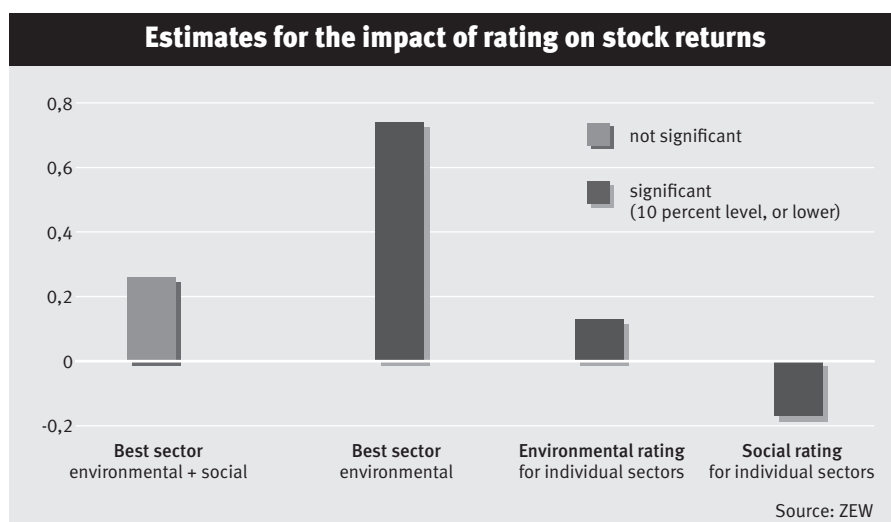
Nevertheless, R&D activities were intensified only in West Germany. In East Germany the share of companies continuously engaged in R&D declined from 31 percent in 1999 to 26 percent in 2000. Here the introduction of more rigid criteria for government support in order to increase the efficiency of R&D activities in East Germany seems to have made itself felt. Yet the share of companies continuously performing R&D is considerably higher in the East than in the West. For this reason this development should be regarded more as an adjustment to the West German level and thus as a change towards normal conditions. ◀

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Research Findings

Environmental Performance and its Effect on Shareholder Value

Do stock companies with a high degree of sustainability performance have a systematically higher shareholder value? This question is at the centre of a study which the ZEW carried out in collaboration with the Bank Sarasin. On average, stock prices of stock companies in sectors with particularly high ratings regarding environmental performance increase more than those of companies in sectors with lower environmental ratings. Conversely, a good social rating has the opposite effect.



■ The study (ZEW Discussion Paper No. 02-32) is part of the project “Corporate environmental and sustainability transparency for the stock markets” which the European Business School is carrying out on behalf of the Federal Ministry for Education and Research. It analyses 214 European stock companies for a period from January 1996 to August 2001.

The Fama-French approach – an extended Capital Asset Pricing Model (CAPM) – is used as basis to explain average stock yields. As with the CAPM model, cross-section regressions are carried out where the average stock return is the variable to be explained. While the CAPM model only uses the beta coefficient, namely the sensitivity of the stock price in relation to the market index, Fama and French complement this regression with two other influencing factors: market capitalization and the ratio of book value to market value.

In addition to these three factors the ZEW study uses the Sarasin ratings for environmental and social performance of individual companies and sectors. En-

vironmental ratings are used to evaluate companies and sectors on a 5-point scale according to environmental criteria such as harmful emissions released during the manufacturing process and the environmental impact of their products. For example, the water supply, software, insurance and telecommunications sectors received high ratings, whereas the chemicals, automotive and power generation industries received the lowest ratings. The criteria used for social ratings were for example working conditions, violation of ethical standards, and the manufacture of specific products, such as arms. Company ratings are based on the position of a company relative to the sector average.

Good environmental rating has positive effects

The study shows that environmental ratings of the sectors have a significantly positive and social ratings a negative impact on the average stock return of the

respective sectors. By contrast, the ratings of individual companies are not significantly related to stock returns. The diagram illustrates the most important results of the sector ratings: it shows the coefficient for environmental and social ratings for individual sectors as well as estimates for the two highest environmental ratings (“best sectors”) and condensed environmental and social ratings. The coefficient for the best sector ratings is relatively high and significant, while the coefficient for the condensed rating is positive but not significant.

A careful interpretation is required regarding the general effects of the results. It can be assumed that environmental performance causes higher stock returns, but the reverse effect also makes sense in economic terms: Companies with high profit and consequently high stock returns can afford environment-friendly production methods. Another interesting finding is that only the sector ratings and not the company-related ratings show significant coefficients. One explanation might be that the financial performance of ecologically “clean” sectors such as financial service providers, telecommunications and software companies was better than that of traditionally less “clean” industrial sectors such as the chemical, automotive, or energy supply industries. Therefore, these sector presumably also reflect the general structural change towards a service and information society which generates higher returns for these sectors. Further studies are aimed at analysing particularly the cause-and-effect relationships between ratings and the average stock return in more detail. ◀

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ZEW Financial Market Test

Results of the Survey in November 2002

■ The Financial Market Test conducted by the ZEW is a monthly business survey of German financial market experts which started in December 1991. The survey asks for the predominant expectations about the development in six international financial markets.

As a whole around 350 experts take part in the survey. 280 of them work in banks, 50 in insurance companies and investment companies and 20 in other industries. Participants in the survey are

financial experts of the finance departments, the research departments and the economic departments as well as the investment and securities departments of the firms. In detail, the financial experts are questioned on their medium term expectations about the development of important international financial markets with respect to the business cycle, the inflation rate, short term and long term interest rates, the exchange rate and share prices.

To construct forecasted figures, the qualitative response categories (increasing, unchanged, declining) are transformed into quantitative figures by the Carlson/Parkin procedure. Additional information to the applied procedure is available as an abridged version published by the ZEW. The present survey was conducted between October 28 and November 12, 2002 and all calculations are termed to November 15, 2002. ◀

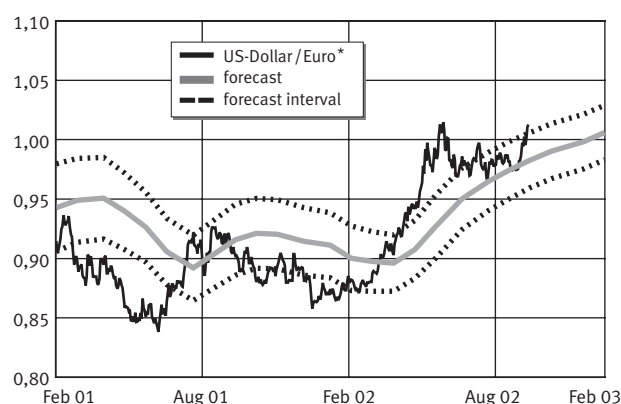
Felix Hüfner, huefner@zew.de

Euro area: The German economy continues to be paralysed

■ Economic sentiment for Germany declines in November sharper than for the whole euro area. In the balance the number of optimists surpasses the number of pessimists only slightly by four percentage points. Negative results have in the past been associated with recessionary tendencies. Therefore the risks of a recession have increased. For the euro area the balance is still clearly in the positive with 24 per cent. On financial markets two reasons are given for the weak performance of Germany. On the one hand the European Central Bank necessarily needs to focus on the developments in the whole euro area. As a second burden on the German economy the increasing uncertainty about the future course of the German economic policies is cited.

Surprisingly, stock markets remain relatively stable despite the negative press. Also the stock market expectations of the analysts are positive: Until February 2003 the surveyed analysts see the DAX at a level of about 3,350 points. A positive factor in these stock market expectations is the anticipated decrease of the inflation rate in the euro area. This could soon

Euro: development and forecast



Source: * Thomson Financial Datastream; ZEW

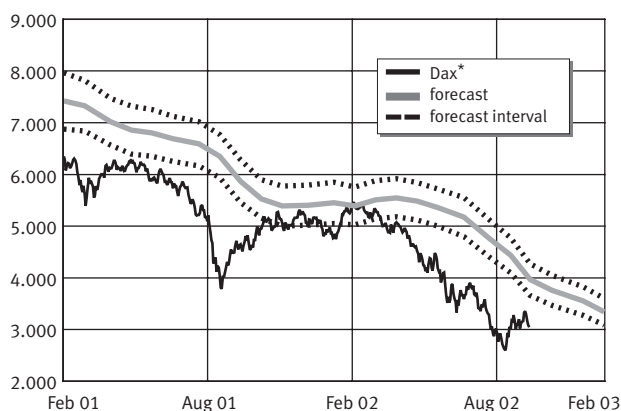
trigger a decrease of the short term interest rate by the European Central Bank, which analysts have already been forecasting for some time. Currently, they are expecting a decrease by 25 basis points until February.

A look at the evaluation of the development of single sectors in the German economy is very interesting. For example, the analysts are very sceptical about the developments in the German construction industry, which will remain in the low according to their evaluation. Investors should therefore focus on defensive stocks, such as utilities. Also chemicals and pharmaceuticals are expected to improve their earnings within the coming six months.

In the foreign exchange market the euro is believed to remain above parity to the US-Dollar for the first time in months. According to the analysts the difference between the US and the European interest rates plays an important role in this: Investors redistribute their portfolios into the euro area in order to profit from the higher interest rates in the short run. ◀

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Dax: development and forecast



Source: * Thomson Financial Datastream; ZEW

ZEW Conference

March 14/15, 2003 in Mannheim

ZEW-Conference: Empirical Economics of Innovation and Patenting

The Centre for European Economic Research (ZEW) in Mannheim announces a workshop on the empirical economics of innovation and patenting. The aim of the workshop is to intensify empirical, international comparative work on innovation and patenting. It will bring together international researchers working empirically either on innovation survey data (esp. CIS-type innovation surveys based on the Oslo-manual) or patent data (esp. patent office data).

Papers from all fields of empirical research on innovation and patenting are invited.

Invited speakers: **Bronwyn H. Hall**, University of California at Berkeley
Dietmar Harhoff, University of Munich
Alfred Kleinknecht, Delft University of Technology
Jacques Mairesse, INSEE-CREST Paris
Pierre Mohnen, University of Maastricht
Mark Schankerman, London School of Economics
Frederic M. Scherer, Princeton University

Submission deadline for an extended three-page abstract is December 15, 2002.

For further information please see www.zew.de/innovation-patenting or contact Dr. Norbert Janz, Phone +49/621/1235-171, Fax -170, Email janz@zew.de

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■ Discussion Papers

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Lammersen, Lothar: *Investment Decisions and Tax Revenues Under an Allowance for Corporate Equity*, No. 02-47.

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