ZEW NEWS

Research Results · Conferences & Workshops · Publications

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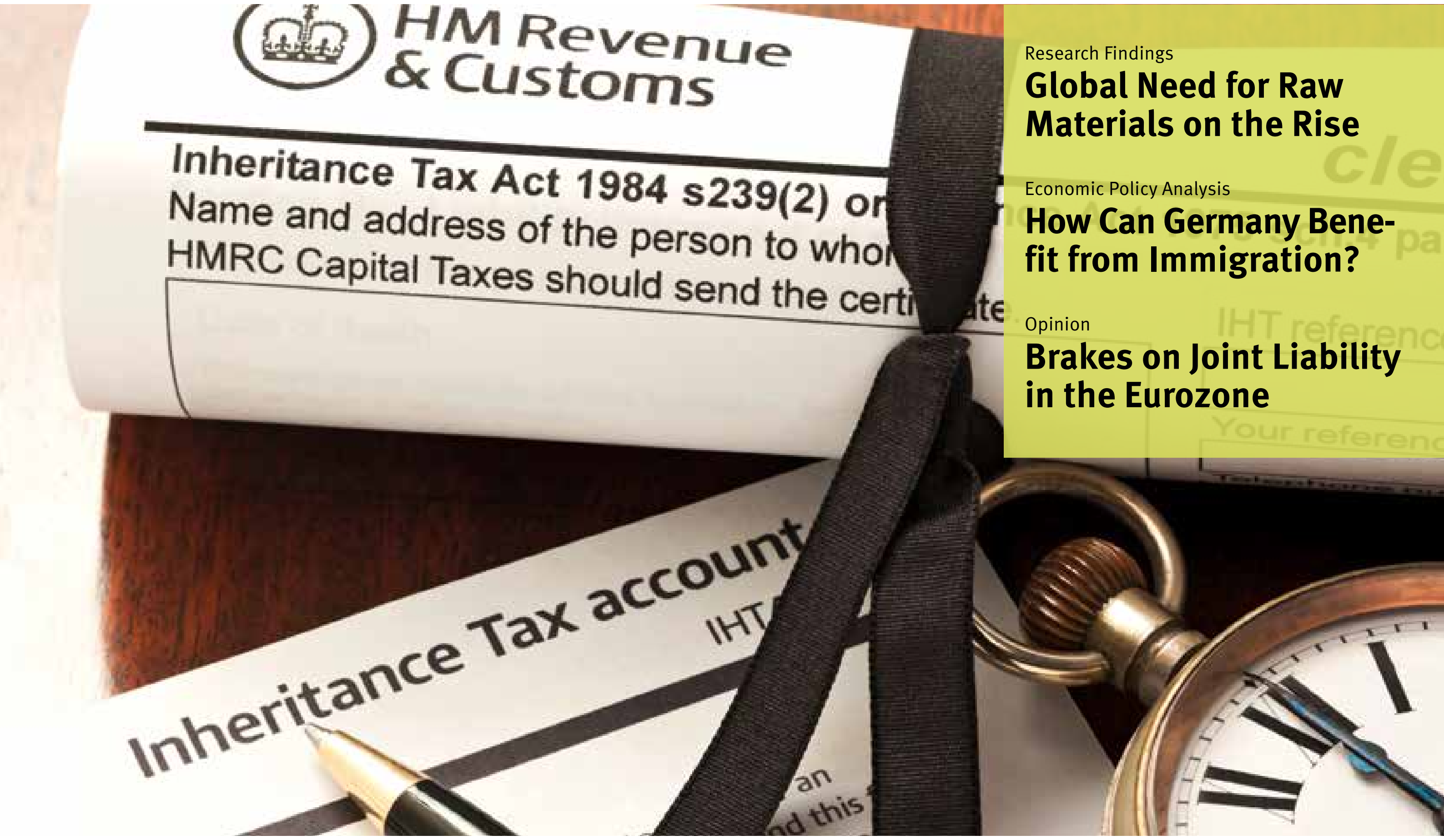

Research Findings
Global Need for Raw Materials on the Rise

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Inheritance Tax Reform Proposals Would Result in Cost Increases for Business Transfers

At regular intervals for some years, the Centre for European Economic Research has been estimating the inheritance tax burden that results when ownership of a medium-sized model firm is transferred to close family members, such as a spouse or child. This work is carried out on behalf of the Foundation for Family Businesses in Germany and Europe.

Model calculations by ZEW researchers that examine three proposals currently under consideration by the federal German government show significant inheritance tax burden increases for firm transfers. When transferring ownership of a model firm valued at around 103 million euros, the tax burden would grow by approximately 142 per cent, were the current cabinet proposal to pass. The respective tax burden would increase by 10.9 million euros to 18.6 million euros.

In response to a 2014 decision by the Federal Constitutional Court of Germany declaring the current provisions of inheritance law unconstitutional, the German federal government has developed three proposals to reform the inheritance tax system in Germany.

First, a cornerstone plan was outlined by the German Federal Ministry of Finance (BMF) in February 2015. This plan restricts the existing tax benefits for transferred company assets (which amount to 85 or 100 per cent) to a maximum of 20 million euros. This maximum amount is structured in the form of an exemption threshold, which means that for transfers of larger amounts of business assets, no further tax advantages would be offered unless the requirements for the planned needs test were met. On the basis of the model company considered by the ZEW researchers, Germany would fall back to rank 17 in an international comparison of inheritance tax burdens among 18 jurisdictions. The average tax burden would increase nearly fivefold, from 7.7 million to 34.6 million euros.

German Federal Ministry of Finance specifies requirements of the inheritance tax reform

In June 2015, the German Federal Ministry of Finance further specified the inheritance tax reform in a draft bill. In addition to the tax exemption threshold of 20 million euros, the bill provides a step-wise ablation model with regard to the relief for business assets (currently 85 or 100 per cent) applying to assets between 20 million and 110 million euros along with a standardised discount of 25 to 40 per cent for assets valued above 110 million euros.

For the ZEW model firm, this plan results in a 30 per cent relief rate for business assets. Although the average burden would decrease significantly from 34.6 million euros to 25.2 million euros, this would only raise Germany's position in the international ranking from 17th to 16th place.

Further modifications have been made in a cabinet draft issued on 6 July 2015. According to this third plan, the tax exemption threshold would increase from 20 million euros to 26 million euros, respectively to 52 million euros for family firms. But at the same time, tax relief for business assets with a value of more than 114 million euros would be reduced to 20 per cent, respectively to 35 per cent.

Cabinet proposal suggests a rise of the tax-free threshold

For the ZEW model firm, the cabinet draft only results in a larger relief rate of 34 per cent, respectively 51 per cent for family firms. As a result, the average tax burden would amount to 23.9 million euros or 18.6 million euros (for family firms). Neither scenario would result in any improvement in the international ranking.

The inheritance tax could become a significant tax-related disincentive to do business in Germany

If the cabinet proposal were implemented in its present form, the inheritance tax burden of the examined model family business would rise from its current level of 7.7 million euros to 18.6 million euros, an increase of 10.9 million euros, or by around 142 per cent. Compared to the 18 jurisdictions considered in the study, Germany would fall from twelfth to 16th position in the ranking. Therefore, the inheritance tax would constitute a significant tax-related disincentive to do business in Germany, in particular because only few neighbouring countries have such a tax.

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INHERITANCE TAX BUDENS IN GERMANY WHEN TRANSFERING A MID-SIZED COMPANY IN THE LEGAL FORM OF A CORPORATION OR PARTNERSHIP

Change in national ranking based on proposed reforms

	Average burden in EUR m	Ranking
Status Quo	7.7	12
Cornerstone Plan	34.6	17
Draft Bill	25.2	16
Cabinet Proposal	23.9	16
Cabinet Proposal (Family Firms)	18.6	16

CURRENT RANKING OF THE INHERITANCE TAX BUDENS IN 18 COUNTRIES WHEN TRANSFERING A MID-SIZED COMPANY IN THE LEGAL FORM OF A CORPORATION OR PARTNERSHIP

National ranking	Average burden in EUR m	Ranking
Austria	0.0	1
Switzerland (Zurich)	0.0	1
Czech Republic	0.0	1
Luxembourg	0.0	1
Poland	0.0	1
Sweden	0.0	1
Slovak Republic	0.0	1
Italy	2.3	8
United Kingdom	4.4	9

National ranking	Average burden in EUR m	Ranking
Ireland	5.8	10
Netherlands	6.1	11
Germany	7.7	12
France	8.7	13
Spain	8.8	14
Finland	9.8	15
Denmark	11.3	16
US	29.7	17
Belgium	39.3	18

The calculations of the inheritance tax burdens were based on the transfer of the ownership of an example company valued 103 million euros.

Source: ZEW

Knowledge Investment Particularly Benefits IT-Intensive Branches of the Economy

Investment in knowledge is playing an ever-more important role in economic growth. A new ZEW study shows that increasing digitalisation and knowledge-based investment have reciprocally beneficial effects that can lead to additional productivity growth.

In order to reap benefits from new technologies in their business activities, companies must do more than simply buy computers and software. They must also strive to enhance their internal processes and develop employee skills. The results of previous studies show that IT investment leads to particularly strong productivity growth when simultaneous efforts are made to enhance and further develop the company's human capital and organisation. Yet the use of IT does not just necessitate knowledge investment. It can also augment the positive effects of such investment on productivity, thus facilitating the development of new products and processes.

Against this background, a new ZEW study investigated whether branches that invest more in IT exhibit stronger productivity growth as a result of investment in knowledge, employee skills, and marketing. However, in order to assess the reciprocal effects with digitalisation, the macroeconomic scope of knowledge-based investment must be known. Prior to September 2014, only a small share of knowledge investment was accounted for in national GDP, according to the statistical methods used in the EU. However, statistical offices in EU member states must now track investments in research and development (R&D). Unlike production equipment, investment in "organisational capital" cannot be determined with a simple mathematical procedure. Estimates of the value of such investment must be developed.

In an EU project titled INDICSER, ZEW researchers helped to develop a dataset on the basis of the INTAN-Invest database that measures eight categories of knowledge-based investment (in addition to software) for eleven branches in ten EU countries. An empirical analysis of this data, which extends from 1995 to 2007, shows that the share of investment in intellectual property and employee skills is the highest in the manufacturing industry in most countries (due to R&D investment), followed by the business services and retail sectors. Overall, a one per cent increase in knowledge-based capital in the area of intellectual property and organisational competencies leads to an average increase in added value of 0.13 per cent. However, there is a considerable difference between IT-intensive and less IT-intensive branches. The described effect is smaller than 0.03 per cent among companies that rank in the bottom fourth for IT intensity.

Knowledge investments are just as important as investment in physical capital.

In the debate concerning the optimal share of GDP that should be devoted to investment, it is important to realise that knowledge investments – which, statistically, have been insufficiently measured to date – are just as important as investment in physical capital. The ZEW study demonstrates that particularly robust growth is experienced from investment in intellectual property and organisational capital in IT-intensive branches such as transportation, telecommunications, business services, and financial services. Moreover, this finding applies to all branches of the economy which, when compared internationally, are intensive users of IT.

The study is available for download at:
www.zew.de/en/publications/7751

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IN THIS ISSUE

In 2008, the absolute demand for raw materials was greatest in China, rising significantly to 17 billion tonnes. Second place belonged to the USA with 9.9 billion tonnes.

Growth in Final Demand Is Driving up the Global Need for Raw Materials

Globally, raw materials extraction has increased steadily in recent decades. A new ZEW study shows how changing consumer and investor habits are affecting raw materials extraction. The principal reason for the increase in global demand turns out to be increased final demand.

Between 1995 and 2008, global production of biomass, fossil fuels and minerals rose from a total of 48 billion tonnes to 69 billion tonnes. Since raw material extraction contributes to many kinds of environmental harm, political decision-makers, especially in Europe, are making efforts toward the more efficient use of raw materials in production. However, their strategies are concentrated on reducing apparent raw materials use in a single nation. This approach ignores indirect raw materials flows, which are necessary for producing goods, but are not further documented once they are exported. These indirect raw materials flows have increased due to globalisation. It is also important to know which factors stimulate raw materials consumption in order to achieve a real reduction in the use of raw materials and not merely have it outsourced abroad.

The "material footprint" is an indicator that measures the use of materials. It quantifies all raw materials that are used – including indirect use – in production to meet the final demand of an economy. In a recent study, ZEW decomposed raw materials consumption into different influencing factors both globally and for 38 selected nations. These factors included increasing final demand, changing composition of goods, changes in the input-output structure of the economy and changes in the intensity of raw materials extraction. In their global analysis, they also examined shifts in final demand. The ZEW analysis was based upon regional data from the World Input Output Database (WIOD), which ZEW prepared together with ten European universities and research institutes.

In 1995, the United States was the largest supplier of raw materials in the world, with 8.4 billion tonnes, followed by the People's Republic of China with 7.9 billion tonnes. Australia had the largest per-capita extraction of 64.4 tonnes. In 2008, China's raw materials production had increased to 18.1 billion tonnes of raw materials. As before, Australia continued to have the greatest per-capita production of raw materials, now reaching 79.3 tonnes.

China's demand for raw material increased

In 1995, the United States exhibited the highest material footprint, at 8.9 billion tonnes. In terms of per-capita demand of raw materials, the United States, Australia and Finland were in the lead, each with over 30 tonnes – this quantity exceeded China's about five-fold. In 2008, the absolute demand for raw materials was greatest in China, rising significantly to 17 billion tonnes. Yet, the country still remained a net exporter of raw materials. Second place belonged to the United States with 9.9 billion tonnes. Only Germany, Japan, and Hungary reduced their raw materials consumption. In Australia, Austria and the United States, per-capita raw materials consumption was over 30 tonnes, and in Finland and Ireland, it actually exceeded 40 tonnes.

Progress could not compensate for increase in demand

The ZEW analysis shows that global consumption of raw materials increased by 44 per cent between 1995 and 2008. The most significant influencing factor was rising final demand, at 48 per cent. A second driver was the regional shift of final demand to nations that consume more materials-intensive goods; this raised the materials footprint by 25 per cent. This shift is particularly evident for building materials and investment – an indication of the impact of increasing infrastructure investment in emerging nations such as China and India. The dematerialisation of final demand and improved materials intensity in raw materials extraction curbed the rate of growth in the consumption of raw materials, but could not completely compensate for the increased demand.

The study is available for download at:
www.zew.de/en/publications/7920

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China: When Building a Career Comes at the Price of Bank Risk

Officials in China are in constant competition when it comes to career advancement. The primary yardstick for promotion is the economic success of the region they govern. In many cases, they seek to buy this success with bank loans. A recent ZEW study sought to answer the question whether career-advancement incentives for Chinese politicians lead to increased bank risk.

China has a special system of career advancement for local government officials: their chances for promotion increase when the economy of the region they govern shows strong economic development relative to other regions. In this competitive environment – local administrations receive growth targets to measure their performance – officials have incentive to take out bank loans via "financing platforms" to, say, carry out local infrastructure investments. These platforms finance almost half of government debt, mostly through bank loans. An estimated 70 per cent of the platforms are either under the direct control of municipal governments or strongly influenced by them. The others must submit reports to state agencies at the regional level.

For the period from 2005 to 2013 ZEW researchers investigated the extent to which the economic measures Chinese officials introduced to advance their careers increased bank risk, and the mechanisms involved.

Policies that encourage infrastructure financing with bank loans increase bank risk

Their study shows that politicians' efforts to build their careers contributed to increased bank lending. What is more, the quality of the loan portfolio sank and bank liquidity declined. These consequences can be traced back to the special way financing platforms work. Policies that encourage infrastructure financing with bank loans increase bank risk. The risk is particularly strong for local banks, where officials can make their influence better felt than at banks operating in multiple regions.

The study is available for download at:
www.zew.de/en/publications/7887

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Sustainable Investment Funds: Worthwhile Alternatives for Ethically Oriented Investors

In the world of investment, the watchword is return. But some individuals are unwilling to put their money just anywhere in search of the highest yield. For these ethically oriented investors, social responsibility plays an important role. A recent ZEW study investigated whether investment funds that label themselves as "sustainable" – that is, funds that are guided by ethical, social or environmental criteria – make different investments from conventional funds.

To find out whether the strategies of alternative investment funds differ from those of conventional funds, the study's authors looked at German-licensed funds that place money in Europe or elsewhere abroad and rated the sustainability of their stocks. For their assessment, they used scores from three rating agencies (Oekom, Sustainalytics and Asset4). The researchers identified 60 funds in Europe and 119 funds outside Europe that claim to be sustainable and compared their portfolios with an equal number of conventional funds. They analysed the sustainability ratings of all the funds' individual stocks through 31 December 2013.

The study found that, on average, the funds that advertised themselves as sustainable put significantly more money into companies with high sustainability ratings and avoided investing in companies with poor sustainability ratings. By contrast, conventional funds invested around 60 to 70 per cent of their portfolios in stocks with below-average sustainability ratings. The figure for alternative funds was only 25 to 35 per cent, depending on which rating agency's scores were used.

A closer look at the investment strategy is important

In sum, the portfolio policies of sustainable investment funds differed significantly from those of funds that did not apply additional ethical, social and environmental criteria when selecting stocks. This suggests that such funds do indeed fulfil the expectations of ethically oriented investors. Nevertheless, investors seeking sustainable portfolios are well-advised to take a close look at a fund's particular policies and practices, as some investment services emphasizing social responsibility have worse ratings than some conventional funds.

The study is available for download at:
www.zew.de/en/publications/7888

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A recent ZEW study shows that the composition of groups in language courses for migrants plays a part in their improvement in language skills.

Language Learning: Fellow Students Affect Immigrants' Success

Learning the local language is of key importance for the social and occupation integration of immigrants. A new ZEW study examines whether the composition of groups in language courses for migrants plays a part in their improvement in language skills. The results show that the average age of the groups, the proportion of students from the same region of origin, and similarity in language skill levels at the start of the course all significantly foster participants' improvement in their language skills.

The study specifically investigates whether groups with more women, a greater proportion of college graduates, similar language skill levels or the same region of origin achieve better results in the language courses. The analysis was based on researchers' own survey of immigrants participating in adult language courses offered by the Federal Office for Migration and Refugees (BAMF). The "Programme for the Improvement of Job-Related Language Skills for Persons with a Migration Background" provided German language training to 132,000 migrants in Germany from 2009 to 2014. The programme was free of cost for participants and is remarkable in several ways: the high number of participants, the high number of hours (up to 730 hours) taught, and the duration of the language training provided (six months full-time or twelve months part-time).

All participants were first gerneration migrants who had been in Germany for an anverage of nine years

As part of an evaluation of the BAMF programme, 2,981 participants were repeatedly surveyed in 2010. All participants in the survey were first generation migrants who had been in Germany for an average of nine years, and most of them were advanced beginners in the German language. The average age of the programme participants was 39 years, and the majority were women. The most common regions of origin were Russia (36 per cent), Asia (21 per cent), Turkey (twelve per cent) and Eastern European countries (ten per cent). About a quarter of the participants were graduates from tertiary education in their home country.

The programme set no criteria for the composition of groups in the language courses. As a result, the groups who took the language courses were quite diverse with respect to their language skills at the beginning of the course as well as age, educational achievement, and region of origin.

Participants' average age affects their likelihood of improving their language skills

The results show that the participants' average age significantly affects their likelihood of improving their language skill levels. As from the age of 35, the probability to improve one's language skills decreases. On average, older participants and older groups made comparatively less progress. When over half of the participants began the course at the same language skill level, this had a positive effect on their language skill acquisition. Groups with greater diversity in region of origin were also likelier to achieve a higher language skill level. The participants in a more heterogenous group may have an advantage because they have to rely on German as their common language.

The proportion of women and college graduates in a group had no notable effect on language progress

By contrast, the proportion of women and college graduates had no notable effect on language progress. The findings suggest that better outcomes could be achieved in language instruction for migrants if participants were grouped by language skill level. Moreover, participants would increase their language skills more if the participants were mixed with regard to age and region of origin.

The study is available for download at:
www.zew.de/en/publications/7916

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Germany Emerges from the Crisis with New Debts but a Balanced Budget

The German experience of the crisis was very different compared to those of most other countries in Europe. Germany was hit by a very strong shock which was relatively concentrated in the exporting, manufacturing industries. In addition, the German labour market was very resilient during the crisis due to earlier labour market reforms and policy instruments facilitating labour hoarding. As a consequence, public finances were only moderately affected and not many policy reforms had to be enacted. A recent ZEW study presents the German experience of the crisis.

Prior to the onset of the financial and economic crisis in the autumn of 2008, Germany's economic situation was stable and its budgetary deficit was small. The German labour market in particular was becoming more dynamic as a result of the "Hartz reforms". The crisis reached Germany in 2009 with a drop in GDP of more than five per cent. This sharp cutback was primarily the result of a 14 per cent decrease in exports and a temporary reduction in industrial production. Because of the nearly balanced pre-crisis federal budget, automatic stabilisers, such as the unemployment insurance system, could function without restriction. Despite the fall in GDP, the unemployment rate rose slightly in 2009 and even began to decrease in the following years.

Expansive stimulus packages to counter the recession

The first crisis intervention package ("Economic Stability Plan 1"), which was passed in 2008, increased annual expenditure by approximately 0.2 per cent of GDP. Among other measures, the package reduced corporate and household taxation, improved the depreciation bases for small and mid-sized enterprises, and increased the maximum duration for short-term work from six to 18 months. In addition, the packet included stimulus measures, such as the introduction of a "cash for clunkers" programme and infrastructure investment.

In 2009, "Economic Stability Plan 2" was passed. Besides extending the first package, it included further expansionary fiscal measures, such as a 170-euro increase in the base tax-free allowance and a decrease in the minimum tax rate from 15 to 14 per cent. In addition, the government subsidized short-term work during the crisis and expanded the investment programme in infrastructure and education in 2009 and 2010. Lastly, health insurance contributions were reduced and tax relief for parents were realised through a one-time children's supplement and a permanent increase in the child allowance. The annual fiscal burden resulting from the second stimulus package amounted to approximately 0.41 per cent of GDP.

In addition, starting in 2010, the "Growth Acceleration Law" improved the business environment for firms by modifying corporate taxation and introducing tax decreases. Moreover, the Act raised the child allowance and lowered the inheritance tax. Overall, the two stimulus packages and the "Economic Growth Acceleration Law" increased public expenditures and lowered revenues, which resulted in an annual added burden on the federal budget of about one per cent (2009) and 1.5 per cent (2010) as a share of GDP. From 2011 onward, the additonal fiscal burden is approximately 0.9 percent of GDP. Despite this rather small added burden to the budget, government debt rose substantially in 2008 – 2010 from 65 per cent to more than 80 per cent due to the poor economic situation. This increase in government debt was particularly attributable to the cost of rescuing the crisis-shaken financial sector. These measures required government contributions of 240 billion euros – or 9.5 per cent of GDP. The ultimate debt impact of the support measures will depend on the extent to which losses on the financial-sector stakes taken by the government prove preventable.

Spending cuts and rapid economic recovery

In 2010, to counteract the growing government debt, the federal government decided to pass a new measure, called the "Future Package". In addition to tax rises and reduction of subsidies and changes to ecological taxes (reduced energy tax allowances; flight taxes) and tax compensation from nuclear energy industry, public expenditures on social benefits, defence, and public administration were cut back. Between 2011 and 2014 this led to savings amounting to around 80 billion euros. As a result of these fiscal responses to the crisis, expenditures rose in relation to GDP up to 2011, while revenue rates fell. As of 2012, the expansionist measures were counterbalanced by the contractive Future Package. As a result of economic recovery after 2009 and the effects of the Future Package, expenditure as a percentage of GDP fell starting in 2011, and consequently, the budget was close to being balanced from 2012 onward.

Compared to other European countries, Germany's government finances were only moderately affected; fundamental tax and spending reforms were not necessary. Due to the pre-crisis reforms and the full efficacy of the automatic stabilisers, the unemployment rate also remained constant, and later, it even fell. By adjusting social benefits to inflation and increasing the tax-free allowance, available income rose by 1.8 per cent for the poorest ten per cent of households. Due to the withholding tax, the richest ten per cent of households saw an 0.6 per cent increase in after-tax income. Those who benefited the most from the reforms were single parents and single persons.

The study is available for download at:
www.zew.de/en/publications/7952

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Q&A: How Can Germany Benefit from Immigration?

“Germany Must Find a Way to Handle Low-Skilled Labour Migrants”

The massive wave of refugees entering the EU has led to an increasingly intense debate in Germany on how to sensibly manage economic and humanitarian immigration. Calls for an immigration law have been made with increasing frequency. In this interview, labour economist Holger Bonin explains that Germany has good regulations for the management of labour migration in place. Still, the country faces tough challenges when it comes to agents with low qualification levels who enter Germany.

Judged by the net intake of immigrants, Germany seems to have overtaken traditional immigration countries. Does the country need better governance of labour migration?

It seems that the immense challenge of the massive intake of asylum seekers has diverted attention away from the issue of economic migration. However, after some rather tacit amendments in recent years, Germany’s labour migration policy ranks among the most liberal in the world. In regard to immigration into the labour market from EU member states, regulation is no longer possible due to the principle of free movement of workers. The high employment rates of EU migrants suggest that market forces do quite well in governing labour migration. When it comes to the selection of labour migrants from non-EU countries, Germany has established a demand-based management system. This means that obtaining a resident permit is fairly easy, provided that you are qualified and can show an adequate job offer. Giving proof of employment weight in tight labour markets is a reasonable system, for it helps avoiding unemployment or under-qualified employment upon entry into the country.

Many say that Germany will require immigration in order to compensate for the loss of human capital due to demographic ageing. Do you see threatening labour shortages ahead?

I am not too much concerned, since I believe that labour markets are flexible in the longer run. Of course, the size of the labour force in Germany will decline substantially with no immigration. Yet this decline is a highly predictable and gradual process. This gives agents good chances to respond, e.g., through investment in physical or human capital. Future labour demand could thus adapt to shrinking labour supply, and domestic workers may even benefit from this in terms of higher wages. Therefore, labour migration is just one possible, but not an inevitable way to cope with demographic change. In my view, the economic benefits of immigration mostly stem from making the human capital pool in a country more diverse, rather than just making it larger.

What specific benefits are you thinking of?

Migrants carry novel skills and ideas. This may move the economy of the receiving country towards a higher growth path. Besides, immigrants who become well-integrated into the labour market may help improve upon the sustainability of government finances. The results of a recent ZEW study, for instance, show that future immigrants to Germany could reduce the long-term tax burden on the entire population if their average employment and income levels reach those of the incumbent workers with completed apprenticeship training. Indeed, the fact that Germany is running a budget surplus is partly a result of employment growth fuelled by the intake of EU labour migrants.

But what about low-qualified immigrants who also seek to come to Germany?

We need to draw a clear distinction between refugees and economic migrants. Immigrants who are accepted via the humanitarian immigration channel require rapid support and qualification in order to make the labour market integration process as smooth and quick as possible. In fact, Germany’s Federal Employment Agency has developed a promising concept for such early intervention.

The huge challenge will be to make it work with high numbers of refugees. Active integration programmes will cost much at the beginning, yet the long-term costs of non-action for society and government would be much higher. With regard to low-qualified labour migrants from non-EU countries, decision-makers face a tough choice. As these economic migrants do not have a legal right to live and work in Germany, one could try to immediately repatriate those who make an attempt, or prevent them from entering the country altogether. In view of the strong push factors operating in the countries of origin, however, it may well turn out that this will not release enough pressure from the immigration system. The alternative, which certainly is unpopular, would be to open up Germany for low-skilled labour migrants a bit, to condition resident permits on gainful employment under non-exploiting conditions, and to maintain control through a quota system.

Prof. Dr. Holger Bonin
is head of the ZEW Research Departement “Labour Markets, Human Resources and Social Policy” and professor of economics at the University of Kassel specialising in labour markets and social policy. His research interests include the evaluation of labour market and family policies, labour shortages and demographic change, as well as the behavioural microsimulation of the labour supply.

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ZEW Lunch Debate in Brussels – Experts Discuss Effectiveness of Fiscal Rules in Eurozone

Albert Solé-Ollé, Friedrich Heinemann and Nicolas Carnot discuss fiscal policy in the eurozone.

ZEW once again held one of its regular Lunch Debates at the Representation of the State of Baden-Württemberg in Brussels in September 2015. The event focused on Europe's new fiscal governance. The central question concerned Europe's new set of fiscal rules: Do they constitute a quantum leap, or are they not worth the paper they're written on?

Professor Friedrich Heinemann from ZEW gave an introduction to the subject of debate and presented his co-panellists: Professor Albert Solé-Ollé from the University of Barcelona and Nicolas Carnot from the European Commission, a former employee of the French Treasury and the International Monetary Fund. In his presentation, Heinemann pointed out that the financial crisis, which broke out five years ago, has brought about numerous changes and additions to the eurozone's fiscal governance. Instruments such as the Stability and Growth Pact, he noted, have undergone substantial reforms, and many other innovations, such as the European Fiscal Compact, have been set up. In his opinion, however, the question must be asked as to whether these fiscal governance innovations actually work.

Albert Solé-Ollé emphasised that the origins of many problems which manifested themselves during the crisis are to be found in periods of strong economic growth. According to Solé-Ollé, the crisis showed that the eurozone's fiscal governance needs to place greater focus on ensuring that all levels of government prepare for difficult times whilst the economy is thriving. Nicolas Carnot stressed that fiscal governance should incentivise sustainable budgeting, even in good economic times – a largely undisputed notion. However, he explained, the difficulty lies in identifying such "good times".

The Lunch Debate concluded with a discussion session, during which participants had the opportunity to ask questions and share their thoughts. Discussion considered, for example, how confidence in the stability of the eurozone should be restored and to what extent countries affected by crises, such as Spain, have so far managed to implement reforms.

ZEW to Make a Good Impression at the 2015 EEA Congress in Mannheim

Well-attended welcome reception at ZEW for participants of the 2015 EEA.

ZEW made a good impression at the Annual Congress of the European Economic Association (EEA) , which was held at the University of Mannheim from 24–27 August 2015. Researchers of the Mannheim-based institute provided numerous presentations and participated in poster sessions, for instance at the ZEW Welcome Reception with more than 100 guests, including invited representatives from international research institutions and universities. After a welcome speech by ZEW President Professor Clemens Fuest, the guests had the opportunity to exchange ideas. In a poster presentation, ZEW researchers presented and discussed their latest findings with their colleagues from other institutions.

Economists from all of ZEW's research units, as well as ZEW research associates, provided a total of 15 presentations at this year's EEA Congress. The presentations addressed issues such as whether firms are more likely to avoid taxes in case of high local tax rates, how vote-buying affects monetary aggregates, and what a common unemployment insurance system for the euro area could look like in practice. In addition, ZEW hosted an information stand at the University of Mannheim during the whole congress, where EEA participants had the opportunity to catch up on career and collaboration possibilities at ZEW.

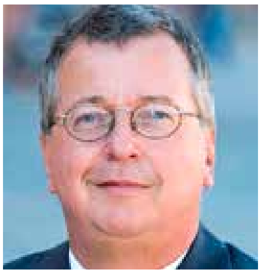
The list of more than 1,000 participants who attended the 2015 EEA included leading international researchers and members of the Executive Board of the ECB. French Nobel laureate and former EEA president Jean Tirole and his US colleague Eric S. Maskin of Princeton University, as well as Vítor Constâncio,Vice President of the ECB, also attended the congress. The EEA currently has more than 3,100 members and the annual congress provides a platform for discussion and exchange of ideas in the field of economics.

Dr. Klaus Rennings Deceased

On Wednesday, 16 September 2015, Dr. Klaus Rennings, head of ZEW's "Environmental and Resource Economics, Environmental Management" Research Department, died unexpectedly. It was with deep regret and great sadness that the Board of Directors, the works council and all ZEW employees learned of the passing away of Klaus Rennings.

Klaus Rennings had been working at ZEW since November 1994. He counted among those researchers who actively contributed to ZEW's development from the very beginning and who greatly identified with the institute and its work. ZEW has lost an extraordinary person and an outstanding researcher, who made a decisive contribution to the high reputation of the "Environmental Economics" Research Department. The Board of Directors and the ZEW staff have also lost an experienced, sympathetic and dear colleague, who could always be turned to for advice. Our heartfelt sympathies go to his partner, his children and his family.

Professor Martin Weber Becomes New Research Associate at ZEW



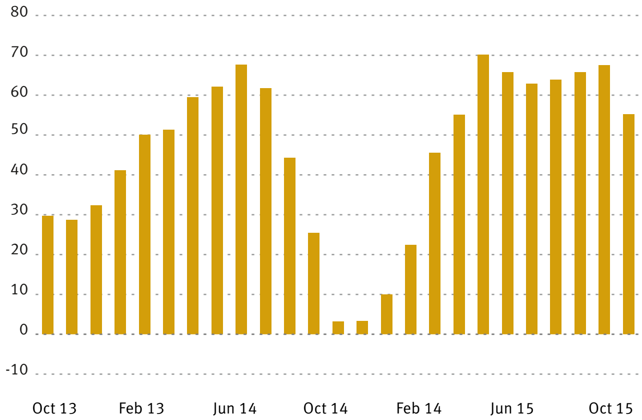
The Research Department "International Finance and Financial Management" ZEW welcomes a new Research Associate: Professor Martin Weber. Professor Weber holds the Chair of Business Administration and Finance, especially Banking, at the University of Mannheim. At ZEW, he will primarily address research related to investment, investors, and regulation. In addition to banking management, his research also focuses on behavioural economics. Martin Weber has been professor of business administration at the University of Mannheim since 1993. His earlier positions include professorships at the Universities of Kiel and Cologne. Weber obtained his doctoral degree at RWTH Aachen in 1981, where he studied mathematics and mathematical economics. He completed his habilitation thesis at RWTH in 1988. In June 2007, he was awarded an honorary doctoral degree from the University of Münster. He has also gained experience on the international scientific stage. Weber completed research stays as a visiting lecturer at Stanford University, Wharton School at the University of Pennsylvania, and the University of California, Los Angeles, in the United States. He publishes frequently in renowned academic journals, including "Review of Financial Studies", "Management Science", and "Review of Finance".

Beyond his scientific activities, Professor Weber was the director (1997-2002) and deputy director (2003-2008) of the Collaborative Research Centre 504, "Rationality Concepts, Decision Behaviour and Economic Modelling", funded by the German Research Foundation (DFG). Martin Weber ranks third in the "lifetime achievement" category of the current "Handelsblatt" business administration ranking.

Professor Sascha Steffen Takes Office as New Head of the ZEW Research Department "International Finance and Financial Management"

Professor Sascha Steffen (37) takes office as new head of the "International Finance and Financial Management" Research Department at ZEW. His primary research interests lie in the areas of European banking regulation and financial market stability, credit risk, as well as financial intermediation. Sascha Steffen currently holds an associate professorship of finance at ESMT European School of Management and Technology in Berlin. The position as ZEW research unit head also includes a professorship at the University of Mannheim Business School, which he will assume as of January 1, 2016.

The research areas at ZEW and the University of Mannheim are familiar territory for Professor Steffen. After two years as an assistant professor of banking and finance at the University of Mannheim (2009-2011), he was appointed to ESMT in 2012. Steffen completed research stays at the Stern School of Business at New York University, United States, from 2008 to 2009, and again in 2013. He has published his research results in distinguished academic journals, including the "Journal of Finance", "Journal of Financial Economics", and "Review of Financial Studies". Sascha Steffen studied business administration at Goethe University in Frankfurt from 2000 to 2004, where he also obtained his doctoral degree with a "summa cum laude" work in the area of finance. As a student he spent some time at Wharton School at the University of Pennsylvania in the United States.



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

ZEW FINANCIAL MARKET TEST GERMANY

Further Setback for Economic Sentiment

The ZEW Indicator of Economic Sentiment for Germany has further declined in October 2015. Decreasing by 10.2 points compared to the previous month, the index now stands at a level of 1.9 points. The exhaust gas scandal of Volkswagen and the weak growth of emerging markets has dampened economic outlook. However, the performance of the domestic economy is still good and the euro area economy continues to recover. This makes it rather unlikely that the German economy will slide into recession. The assessment of the current situation in Germany has declined by 12.3 points, the index now stands at 55.2 points.

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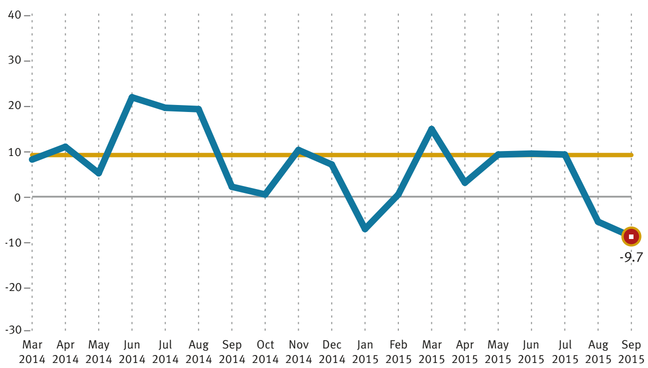
CHINA ECONOMIC PANEL (CEP) INDICATOR

Outlook for Further Economic Development in China Remains Negative

The outlook for further economic development in China remains negative in September 2015. The CEP Indicator, which reflects the expectations of international financial market experts regarding China's macroeconomic development over the coming twelve months, has deteriorated significantly in the current survey period (14–28 September 2015), falling from minus 6.0 to minus 9.7 points. The GDP forecasts for 2015 total 6.8 per cent, whilst these fall to 6.6 per cent for 2016. Forecasts show great variation



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

across individual economic sectors. According to the experts surveyed, developments in the private banking sector, in the automotive industry and, above all, in the information technology and services sector will be significantly worse than has as yet been the case. There is, however, a glimmer of hope; expectations for the consumer/trade sectors, for chemical/pharmaceutical industries, as well as providers/energy providers, are significantly more positive than they were in the previous month.

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ZEW-PWC CHINA ECONOMIC BAROMETER

German Businesses See Themselves as Ahead of Chinese Competitors

German businesses are well-positioned in comparison to their Chinese competitors. This is the finding of the ZEW-PwC China Economic Barometer for the third quarter of 2015, which surveyed executives from German companies working in China. The ZEW-PwC China Economic Barometer is a quarterly survey by ZEW in cooperation with the auditing firm PricewaterhouseCoopers (PwC). Three quarters of those surveyed believe they are ahead of their Chinese competitors. Just eight per cent reported on Chinese companies that were ahead of them. Company executives believe their advantages lie particularly in the manufacture of complex products, innovation or brand strength. German companies are overall more critical of the regulatory environment in China than they were just two years ago. This applies in particular to copyright and intellectual property. The only areas where a majority of those surveyed expect to see an improvement in operating conditions are financing conditions and new business approvals.

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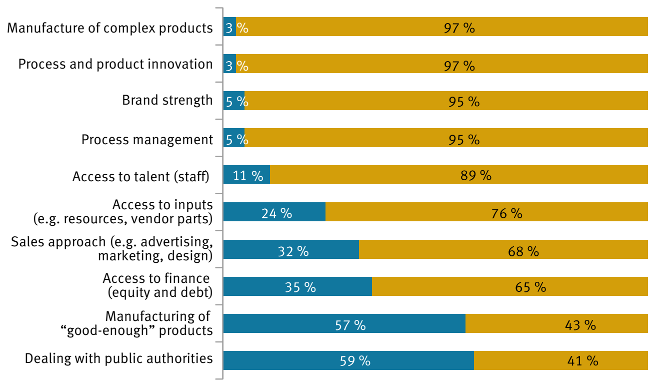

Source: ZEW-PwC China Economic Barometer

Putting the Brakes on Joint Liability in the Eurozone

Since the announcement of the ECB's Outright Monetary Transactions Programme (OMT), the interest rates of highly indebted countries in the eurozone have been far below the level that is justified by their economic fundamentals. The decline in interest rates is a welcome relief for many eurozone countries struggling with high debt levels and low economic growth. But the destruction of capital market discipline bears considerable risks. In particular, it rewards countries which build up excessive debt, and punishes those that make efforts to improve their economic performance and ensure that public finances are sustainable. Moreover, conflicts about fiscal policy arise within the eurozone. Countries like Germany become increasingly concerned that they may have to bear the costs of fiscal laxity in other countries. Individual member states of the euro area are no longer assessed according to their fiscal policies; they are neither punished nor rewarded by the capital markets. The lack of market sanctions was a key reason for the public and private sector debt buildup that caused the eurozone debt crisis.

What can Europe do to avoid making the same mistakes again? Together with Friedrich Heinemann, I have proposed the introduction of a new form of junior government bonds, to which I refer as "accountability bonds". The aim of this concept is to restore a situation in which the governments of individual euro countries are held accountable for their own fiscal and economic policy decisions.

Accountability bonds differ from "normal" bonds in the following respects: First, they would be excluded from government bond purchases made by the ECB. Second, accountability bonds would cease to be serviced if either the issuing country were to enter an ESM programme, or if this country's debt-to-GDP ratio were to exceed a pre-defined level, say, 120% of GDP. Temporary exceptions to this debt-level rule could be granted to countries whose current debt levels are higher. Each national government in the eurozone would be obliged to issue a share of its debt in the form of junior bonds. The value of this share would depend on the extent to which the country complies with the fiscal rules of the Stability and Growth Pact (SGP).

Countries with levels of debt below 60% of GDP would not be required to issue junior bonds at all. Countries with higher levels of debt would be expected to close the gap to the 60% threshold, as required by the SGP, by reducing their current deficits by 1/20 each year. The allowed deficits are determined in the framework of EU fiscal policy coordination, where a medium-term fiscal objective is determined for each country. If a country exceeds the deficit level agreed at the European level, it would be required to issue the excess debt in the form of junior bonds. This would imply that these countries would lose at least some of the implicit financial support which is currently provided in the case of over-borrowing as a result of the current implicit debt mutualisation in the eurozone.

Investors in accountability bonds would demand substantial risk premia for their investments. Excessive deficits would be sanctioned through higher interest rates.

Introducing accountability bonds would have three advantages. First, it would make sure that countries bear at least part of the costs of excessive deficits, rather than relying on other countries to step in. Second, fiscal policy coordination at the EU level would be more effective – violations of deficit limits would be costly and would attract more public attention. Third, accountability bonds would restore appropriate incentives for the implementation of sustainable fiscal and economic policies without destabilising the market for government bonds as a whole.

Clemens Fuest

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