

DIW Berlin

German Institute
for Economic Research

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2005 Annual Report

DIW Berlin

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for Economic Research

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2005
Annual Report

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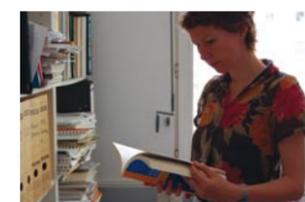
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President's Message

The German Institute for Economic Research (DIW Berlin) is Germany's leading economic research institute. Its strength is based on its active engagement in both research and policy advice and its independent status as a non-partisan and non-profit organization. The two main interacting tasks of equal weight are:

- (i) To scientifically examine economic processes in Germany and abroad.
- (ii) To provide timely policy-oriented contributions to the public.

According to this commitment, DIW Berlin has established work areas with a well elaborated focus and world-wide coverage. It contributes to the international awareness of Germany as an important location of policy relevant competitive academic research.

DIW Berlin's research findings are published in scientific journals, presented to the scientific community and disseminated to the broader public. One of the key functions served by the Institute is to supply decision-makers from the spheres of business and politics as well as the general public with up-to-date economic and structural data, forecasts, research reports, and services in the area of quantitative economics. The Institute's research findings are also very widely discussed in the media.

In the last decade, the Institute has continuously undertaken substantial efforts to respond to the changing demands of science, politics and society. The employees of the Institute have provided magnificent support for these efforts, particularly in terms of improving the joint production process of high quality applied economic research and policy-oriented output. After a substantial external evaluation of the Institute in 2004, DIW Berlin received very positive recognition for this process by the Senate Evaluation Committee of the German Leibniz Association in 2005 and by the general public.

DIW Berlin's ambition is to become an internationally leading and widely visible institute for applied economic research and policy advice. The keys to achieving this objective is further integration and professional exchange between these two areas and a strong international networking. Today more than ever, DIW Berlin plays an active role in scientific research and contributes to the further

development of economic models and concepts as well as to empirical research methods.

The research program of DIW Berlin focuses on three key areas:

- Identification of global economic trends
- Research on the conditions for prosperity and sustainable growth
- Elaboration of the role of the activating state

These areas are analyzed from different perspectives by the following seven research departments, each managed by its own departmental head who is jointly appointed with a university:

- Macroanalysis and Forecasting
- International Economics
- Public Economics
- Information Society and Competition
- Innovation, Manufacturing, Service
- Energy, Transportation, Environment
- "Socio-Economic Panel" Longitudinal Study (SOEP)

Research and advisory activities are carried out at DIW Berlin both within the individual research departments and by cross-departmental teams. These structures enable the Institute to react flexibly to the emergence of new and topical questions in economic and social policy. There is an intensive exchange of knowledge and information among the departments, the cross-departmental research groups, and the Institute's extensive network of external partners in German and foreign universities, research facilities, and enterprises.

With regard to the Institute's future development, DIW Berlin intends to build on the knowledge and experience it has accumulated in applied economic research on the German, European and the world economy. International policymakers addressing the challenges of globalization are stakeholders in the work of the Institute, including the German state and federal governments, many foreign national governments, the European Commission, the International Monetary Fund and the World Bank.

The aim of DIW Berlin is to further enhance the outstanding reputation of its policy-oriented work by improving the quality and quantity of its research output for the academic community. The high scientific reputation of DIW Berlin results from its close co-operation with universities (in-

tensified through joint appointments of its staff), its publications in top-ranking peer reviewed journals and presentations at prestigious conferences, and from competitively acquired international research assignments. Moreover, DIW Berlin is renowned worldwide for its provision of socio-economic panel data (SOEP). The international empirical research community increasingly relies on these data, as proven by the rising number of empirical papers based on the data provided by DIW Berlin.

DIW Berlin has met the challenge of combining original research and policy-oriented activities. The new priorities are to further intensify the Institute's international relations and to push forward the promotion of young researchers. The start of the DIW Berlin Doctoral Program 'Graduate Centre of Economic and Social Research' in 2006 is a core strategic task of the Institute to ensure the necessary provision of qualified young researchers. The Institute will not only consolidate and build on its past accomplishments, but will maintain and strengthen its efforts to become one of the most respected scientific think tanks for applied economic research and policy advice worldwide.

Klaus F. Zimmermann, President

DIW Berlin—A Brief Introduction

The German Institute for Economic Research (DIW Berlin) is Germany's largest economic research institute. As an independent and exclusively non-profit facility it carries out basic research and provides consultancy services on economic policy. It was founded in 1925 as the Institute for Business Cycle Research and received its current name some years later. The Institute has been located in Berlin since its foundation. In 2006, a branch in Washington D.C. will be established to strengthen the international visibility and to intensify the international relations of the Institute.

The overall administration of DIW Berlin is the responsibility of the President, Prof Dr Klaus F. Zimmermann, who is assisted in his duties by the Vice-President, Prof Dr Georg Meran, and the Managing Director, Dr Susanne Maria Schmidt. They together constitute the Executive Board.

Each of the seven Institute's research departments is chaired by a department head who is also actively involved in the design of DIW Berlin's research programs and in the scientific coordination of its research activities. The research topics in which the Institute's departments are specialized can be grouped under three main themes:

- Basic understanding of global economic trends
- Identification of the prerequisites for welfare and sustainable growth
- Specification of the role of the activating state.

Research and consultancy activities are carried out both within the individual research departments and by interdisciplinary research teams. The Institute's three service departments (Information and Organization, Information Technology, and Management Services) provide a range of services to internal and external users.

The legal status of DIW Berlin is that of registered association comprising in addition of the Board of Trustees (chairman: Prof Dr Dr h.c. Günter Stock), and the Advisory Board (chairman: Prof Daniel Hamermesh, PhD).

Approximately half of DIW Berlin's budget consists of public grants provided as research funding and paid in equal parts by the State of Berlin and the German government (Federal Ministry of Economics and Technology). These funds are supplemented by income earned from projects and commissioned work and by membership fees and donations.

DIW Berlin's staff numbered 190 in 2005, of whom approx. 100 were researchers. In addition to the permanent staff, many Research Professors and Research Affiliates contribute to the activities of the research departments. These researchers cooperate with the Institute for a fixed period of time, providing important fresh impetus to the Institute's research agenda.

DIW Berlin has assumed the task of conducting basic research of international renown and of providing research-based consultancy services to policymakers, economists, and the general public at national, European, and international level. Applied research and policy consultancy are the combined result of a superior academic culture at DIW Berlin. The Institute is internationally renowned for the quality of its economic policy analyses and is also well known on the basis of its published research findings.

The guiding principle behind all the activities carried out in DIW Berlin's departments and research areas is the Institute's vision to become an international renowned think tank in short term. The department's research programs are designed in pursuit of this vision.



A Week at DIW Berlin

Work at DIW Berlin tends to mirror the pace of official Berlin, with slower periods during the summer. That is the time for the researchers at DIW Berlin to work on their papers and discuss their work with colleagues. When the calendar flips to September this peace of a quiet scientific life is over. It was during the first week of September 2005. The five-day stretch provides a snapshot of DIW Berlin in action.

Monday, September 5

It's Monday morning, and it's Dr Stefan Kooths' first day at DIW Berlin. He reflects this day: It's the first day at the office, and it's D-day already. DIW Berlin's Department Macro Analysis and Forecasting hired me from Muenster University (where I was Managing Director of MICE, the Muenster Institute for Computational Economics) to rebuild their national accounting systems. The room is clean and has been tidied up very nicely. All drawers are empty. So are most of the physical files and the hard disk of my desktop computer! Virgin soil, so to speak. I interpret it as a sign to begin something new. Outsiders often regard national accounting as dull and boring stuff. Poor outsiders. They'll never know how fascinating this field of economics can be. And what a challenge it is to trace the various activities within an economy in a systematic and meaningful way. And to explore what stories the data can tell you (and what stories they can't tell you). My new colleagues, all of them very friendly and helpful, mention that in the past the whole national accounting thing has been done with Excel. A two-dimensional table for describing economic life that has so many facets? Okay, take a spreadsheet workbook and you get a three-dimensional view on your data, but that's it. Any increase in dimensions (and there are many more than just four) means to distribute your accounting system over a bunch of different files and folders with various (very vulnerable!) intra- and inter-file cell references which, in the end, only one person

will be able to read and administrate—the developer him- or herself. And even this person will become more and more reluctant to make fundamental changes once the whole thing works somehow (“Never change a running system ...”). A spreadsheet cell is nothing meaningful. It's just a piece of data with a row number and a column letter. Therefore, the cell itself cannot explain what it stands for; neither to the human reader nor to another machine that uses it for further processing (e.g., a forecasting software tool). That's not, what I want. However, the first telephone call with someone asking for some particular piece of national accounting data reminds me why Excel (or similar spreadsheet programs) became so popular: because it's so extremely easy to get fast first results. Mix this with the usual every day office rush and you get the sweet poison of quick-and-dirty solutions. But they do come at a very high price that you have to pay when the complexity of your projects increases. Therefore, the whole day I am working on the list of demands for a new piece of software that avoids all these problems but which, in turn, would involve much more development before we get our first results.

Late in the afternoon I feel ready for a first guess on how many months are needed until we get a fully functional and flexible system for national accounting at DIW Berlin. The development time overlaps with our next major forecasting event, so some manual work would remain during the development process in the first hardcore-test of the new software. Very late in the evening I discuss the proposal with the Head of the Department. After an hour or so the decision is taken: we'll break new ground and start the new software project. That was my first D-day at DIW Berlin. Or rather D-day and night, to be more correct ...

Tuesday, September 6

Portuguese Catholic University, Porto, Portugal. 140 participants from 23 countries and three continents have been meeting here since the day before yesterday. This is the 16th European Regional Conference of the International Telecommunications Society. It is organized by ITS Europe, an association that has its head office at DIW Berlin. Dr Brigitte Preissl, Department Information Society and Competition, and Chairman of the association is managing the conference and she is responsible for its organization as regards content and its implementation. “The ITS conferences are of great importance for the exchange between science, politics and the economy,” says Dr Brigitte Preissl. “Representatives from all three areas come together to discuss important questions of telecommunication development and exchange knowledge and explain their positions”.

The program includes all the important questions of the telecommunication markets such as broadband technology and infrastructure development, mobile phone markets, the internationalization of TC services and issues of regulation. Dr Brigitte Preissl will speak on the local loop problem. She will compare the various local loop unbundling solutions in Europe from the point of regulatory practices. “Examples from Denmark, Sweden, the Netherlands, UK, Italy and Germany illustrate the many different combinations that exist and developmental directions that have been taken by various competitors with regard to service and infrastructure,” Dr Preissl explains. “A simple comparison of local loop unbundling statistics only covers a very small section of the competitive local loop situation.”

9 p.m., ARD capital studio, Berlin-Mitte. “More enthusiasm for reform, please!” These are the words Prof Dr Klaus F. Zimmermann, President of DIW Berlin, uses to comment on the grand coalition that is beginning to emerge on a federal level. He is a guest of the live-program “Phoenix-Runde” to which Matthias Platzeck, the Prime Minister of the State of Brandenburg, and Matthias Geis from the *ZEIT* newspaper are also invited. “A grand coalition will bring about the necessary changes only to a limited extent,” says Prof Dr Zimmermann. “I do, however, expect fundamental progress that strengthens position, including a reform of federalism, a revision of national finances, a company tax reform and an approach to an ancillary wage cost reduction through labor market policy savings and counter financing measures that include an increase in value added tax.”





Prof Dr Georg Meran, Vice-President of DIW Berlin, right, and graduate Katharina Wrohlich, Research Associate

Wednesday, September 7

In the morning, Prof Dr Georg Meran, Vice-President of DIW Berlin, will take one final look at the proof of the folder and the poster. He is sure that the students will like the design. It better be the case, because the advertising material is the starting signal for the first doctoral program of DIW Berlin, the Graduate Center for Economic and Social Research. “Seeking outstanding young scholars!” the poster reads. The best economics and social sciences students from all over the world are to come to Berlin. Here, they can learn how research and political consultation are combined in a very special way. “The goal of the Graduate Center’s activities is to provide the doctoral students with a research environment and an institutional training structure that will develop their talents in an accordingly exemplary manner. It leads them to a deep understanding of economic and social processes and offers them the opportunity to apply their knowledge within the professional research environment of the leading economic think tanks in Germany,” explains Prof Dr Georg Meran. The program follows a dual training approach. It offers high-level core and field courses, and on-the-job training within research projects of DIW Berlin.

6 p.m. A side-room of the huge atrium of the Berlin branch of Deutsche Bank in Berlin-Mitte. An opportunity for the participants of the 2nd Joint Debate of the Alfred-Herrhausen Society, *The Economist*, and DIW Berlin to gather one last time. Its ready to begin, more than 200 guests have already taken a seat outside. The topic of the evening: “The European welfare state—did it fail in Germany?” A little while later, John Peet, editor of *The Economist Europe*, opens the discussion. Alain Madelin, Member of the French Parliament, and Prof Dr Horst Siebert, Professor at the Johns Hopkins University, agree: the European welfare state model has failed. Lord David Lipsey from the Social Market Foundation, and Prof Dr Karl Wilhelm Lauterbach, Director of the Institute for Health Economy at the University Cologne, have a different opinion: “The welfare state is not dead—it is sick—in Germany in the area of health service in particular—but it must urgently be cured. This patient is too important, he must not be left to die.”

7 p.m., ‘Heute’ news on the ZDF television channel. “The price of oil will continue to rise in the long term”, is the forecast of Prof Dr Claudia Kemfert, Head of the Department Energy, Transportation, Environment, in her commentary on the high petrol prices. Today, the federal government has released a part of its oil reserves to slow the market price increase which is a consequence of hurricane Katrina. Prof Dr Claudia Kemfert has already had three radio interviews and one live appearance in the N24 television studio. The development and forecast of energy prices are published by DIW Berlin on a regular basis. A lot of research is carried out in this area, too. Since Prof Dr Claudia Kemfert’s assumption of office two years ago, press inquiries to her and her Department have quadrupled.

Thursday, September 8

9 a.m. Press office of DIW Berlin. The newspapers and clippings of the day’s press are looked through and the internal press review is being prepared. Today it will be particularly comprehensive. There is a lot of response from the press about the current week’s report (36/2005) on the Kirchhof concept, which was given to the press the previous day. “DIW: Kirchhof concept does not work out”, reads the headline of the *Handelsblatt*. Prof Dr Kirchhof, a former member of the German Federal Constitutional Court and shadow minister of Angela Merkel during the 2005 campaign, proposed a flat tax scheme for Germany. Yesterday, the ticker of press agency Reuters read: “DIW: Kirchhof reform not fundable and unjust”. Dr Stefan Bach, the author of the DIW Report, concludes that the low taxes proposed by Prof Dr Kirchhof would result in billion Euro public spending deficits. Even if all tax subsidies were cut. Constitutional law expert Prof Dr Paul Kirchhof was a member of the competence team of chancellor candidate Angela Merkel. He was supposed to be finance minister once the Union party won the election. He did not, however, manage to convince people of his radical tax concept during the Bundestag election campaign.

3.30 p.m., main building of DIW Berlin, office of the President. Prof Dr Klaus F. Zimmermann is collaborating on a research project with his supervisee Arne Uhlendorff. The project’s title is “Differences in unemployment between migrants and natives in Germany” which will initially be published at DIW Berlin as a discussion paper. The study will be conducted with data of the German Socio-Economic Panel Study (SOEP). A research discussion at DIW Berlin:

Prof Dr Zimmermann: “What is the status of our paper on the comparison of the duration of unemployment between migrants and Germans? Did your alternative estimates of the various hazard rate models lead to new insights?”

Uhlendorff: “No, our results seem to be stable and independent of the specification of the unobserved heterogeneity. On average,

Dirk Heckmann



Arne Uhlendorff, Research Associate

Dirk Heckmann

migrants are unemployed for longer than Germans. Once they find a job, however, it is as stable as the jobs of previously unemployed Germans.”

Prof Dr Zimmermann: “Good, that is a very interesting result and represents a significant addition to the current literature. In the next few days, I will begin with the results chapter of our paper. Yesterday, I revised your description of our econometric model and I would like to discuss this with you in detail. Have you had a look at my revised version?”

Uhlendorff: “Yes, I have, and I have a few questions about it. I suggest we sit down straight away at the computer and make the changes to our paper ...”

Friday, September 9

It is mostly postgraduate students who are coming to Upstate New York this morning, to Cornell at the head of Lake Cayuga. They have come here to familiarize themselves with the German Socio-Economic Panel Study (SOEP). The services offered by the SOEP within DIW Berlin include workshops that introduce users of the anonymized micro data of the SOEP to this complex set of data. “We have been offering this service since 1989 at DIW Berlin in the German language and since 1993 also in the English language in the U.S.A.,” explains Dr Joachim Frick, Deputy Head of the Department SOEP. “Our partner in the U.S., Prof Rich Burkhauser, was Professor at Syracuse University in 1993; since 1998, he has been at Cornell University, where we offer users training courses every two years. The course is limited to 20 participants and is always booked up very quickly.”

Workshop-participants travelling from the Americas, Asia and Australia represent the entire global SOEP user community. “It is good when young users of these data know each other and stay in contact. Because that way they can assist their colleagues,” Dr Joachim Frick explains. The user training course therefore includes a get-together at the beginning and a BBQ in Prof Rich Burkhauser’s garden at the end. As a rule, it takes a little while before young researchers are able to produce publishable results using SOEP data. They are often introduced two or four years after the training course at the International SOEP user conference, which also takes place every two years. “The user conference always takes place in Berlin. 2006 will be a highlight, because the seventh conference will take place during the Soccer World Cup,” says football fan Dr Joachim Frick.



SOEP Researcher
Dr. Silke Anger and
participant at a
SOEP conference



Prof Dr Alfred Steinherr, Head of Department
Macro Analysis and Forecasting

Macro Analysis and Forecasting

The year 2005 was a very special year for DIW Berlin and its Department Macro Analysis and Forecasting. It was the year of its 80th anniversary. DIW Berlin was established in 1925 as the “Institut für Konjunkturforschung” (Institute

for Business Cycle Research) and adopted its present name later. In November 2005 an international conference was organized by the Department Macro Analysis and Forecasting in Berlin to track the tremendous changes that had marked the evolution of forecasting. National income accounts only became available in the 1950s, forecasting models in the 1960s, easy access to international data in the 1980s. The last decades have benefited from a tremendous progress in technology, allowing forecasters to develop appropriate models for different purposes and to respond to the increasing information demand by government

and the private sector for data transformed for their needs.

One question often raised concerns the usefulness of forecasts as they often are off the mark. In May 2005 the German magazine *Der Spiegel* titled an article “Blindness of Forecasters” and the newspaper *Frankfurter Allgemeine Zeitung* titled an article “Away with Forecasters”. “Our forecast in January 2005 was indeed too optimistic as we had, like others, not incorporated the strengthening of the U.S. dollar and the steep increase in oil prices during 2005,” explains Prof Dr Alfred Steinherr of DIW Berlin. “However, our June forecasts were right on the mark,” he adds. But the question remains, are forecasts useful? Since decisions need to be taken on the basis of what is likely to happen in the future there is a need for forecasts. With the knowledge available today forecasters have to extract the relevant information to make the most reasonable forecast. Call this “rational” and “efficient”. They may in the end miss the mark because there is always uncertainty in the behavioral equations used and because surprise events may unfold. “In a study we produced 2004 we show that our forecasts fulfill indeed these two conditions of rationality and efficiency and that they are clearly superior to flipping a coin. Otherwise said, it is on average always better to act on the basis of forecasts than on some prophecies,” says Prof Dr Steinherr.

Each year, April and October are two important dates for the Department. Then the German Joint Forecasts Group makes its forecasts and evaluation of the economic situation for the Federal Government. The group consists of the six leading economic research institutes in Germany, among them DIW Berlin. “In the October report of 2005 we disagreed with the general policy recommendations in a minority view,” tells Dr Christian Dreger, Deputy Head of Department Macro Analysis and Forecasting. “We judged it preferable to relaunch the economy and reduce the budget deficit through the growth-induced higher fiscal revenues combined with savings on the expenditure side,” Dr Dreger adds. “We argued against the opposite strategy to reduce the fiscal deficit through tax increases. We also saw no need for the European Central Bank to increase interest

Business Cycle Forecasts: Art or Science?

There is a long and potentially never ending discussion about the accuracy, rationality and dispersion of forecasts for the evolution of the business cycle, very much of the same kind as the discussion whether monetary policy should be seen as an “art” or a “science”. For a forecast to realize it should not matter how it is produced. In fact, different techniques are available for this task. In any case, economists should apply standard evaluation criteria to the forecasting exercise and carefully check the quality of forecasts, as this is already standard in the analysis of economic policy.

Based on this proposition, Dr Ulrich Fritsche, Senior Researcher at Department Macro Analysis and Forecasting and since October 2005 Assistant Professor at the University of Hamburg, and Dr Joerg Doepke, Senior Researcher at Deutsche Bundesbank, made an attempt to analyze several aspects of accuracy, rationality and dispersion of publicly available forecasts about two of the main macroeconomic variables –real GDP growth and inflation – for Germany using the largest dataset ever build for such an exercise.

The study was based on data from many professional forecasters. This panel structure enables researchers to investigate the accuracy and efficiency of macroeconomic forecasts more efficiently than in previous studies. Forecasts are found to be, on average, unbiased and weakly efficient. However, the forecasts are not efficient in a strong sense. In fact, evidence from different econometric models suggests that other variables than the history of GDP growth and inflation could be utilized to lower the forecast errors. Hence, information from other variables has not been properly incorporated when the forecasts were made. In particular monetary factors could be used to reduce GDP growth and inflation forecast errors. Furthermore, the dispersion of individual forecasts is positively related to the volatility of macroeconomic variables, but less with the levels of these variables. This finding can be interpreted as evidence of the hypothesis that professional forecasters have different beliefs on the adequate model of the economy. Since the forecasts are found to be systematically better than flipping the coin or asking the oracle, it is advisable to take them into account in the own forecasting process.

Dr Fritsche and Dr Doepke use a standard aggregate demand and supply model to identify the nature of the shocks expected by the forecasters. This exercise reveals that forecasters have very divergent expectations regarding the nature of the shocks predicted to hit the economy in the year to come. The lion’s share of forecast errors can be attributed to unexpected demand shocks.

All-in-all, business cycle predictions from professional forecasters help us to define our position regarding future developments. However, these forecasts have their drawbacks as well. Future work is needed to improve our understanding about the dynamics of real world developments.

rates as the available data showed no increase in inflationary expectations.”

Other analysts were concerned about the build up of excess liquidity. A paper by Dr Christian Dreger and Prof Dr Jürgen Wolters, Research Director at DIW Berlin, “Investigating Money

Demand in the Euro Area. New Evidence Based on Standard Models”, published as DIW Berlin Discussion Paper 561, showed that the apparent monetary overhang in the Euro zone is in line with standard models of money demand behavior and is not ex-

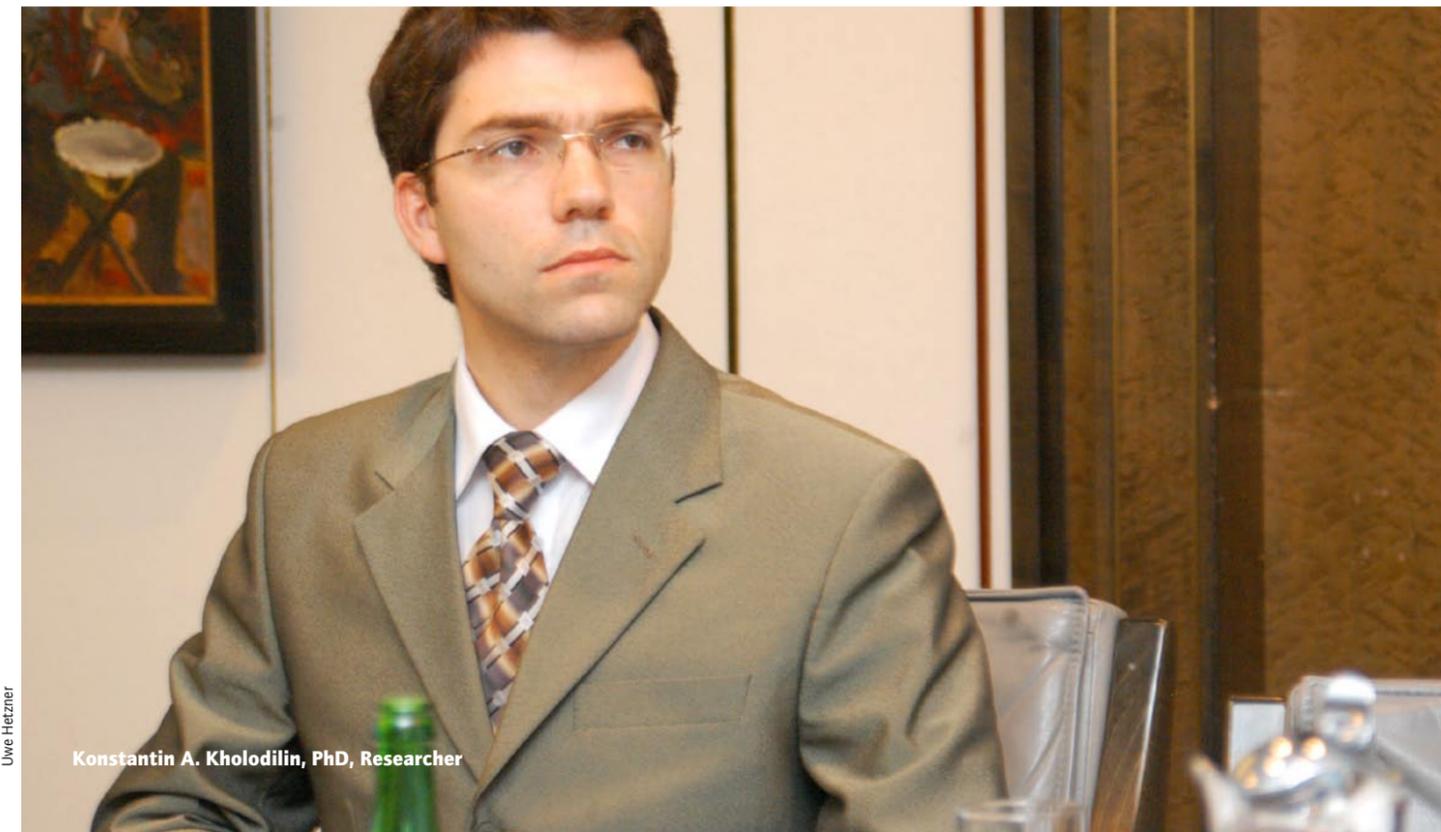
pected to lead to a rise in inflation. They achieved this robust result by not imposing a short run homogeneity restriction between money and prices.

Globalization

Whilst a generation ago most forecasting occurred in a national context, the increasing globalization trend has forced forecasters to operate with world models. This often exceeds the capacity of a single institution and makes international cooperation necessary. DIW Berlin is member of EURO-FRAME, a European group of forecasters operating a world model, which presents its forecasts twice a year. This cooperation combines detailed knowledge of national economies with modeled world-wide interdependencies. 2005 the Department has also established a cooperation agreement with Global Insight, a U.S. based company with global reach and the leading private provider of forecasting services. “For macroeconomic analyses and policy advisory services we also increasingly cooperate with international networks, such as FEMISE for studies on Mediterranean countries, FINPROP for studies on the financial integration of Europe, Human Dynamics for sector

evaluations,” says Prof Dr Alfred Steinherr.

2005 was also a very special year for the Department as a major staff turnover occurred. The Department has significantly lowered its average age and more than half of the team are non-Germans. In 2005 published research increased significantly as did the externally funded research. The list of research associates added Daniel Gros, PhD, Director of CEPS in Brussels and Prof Dr Peter Bofinger, Professor at the University of Würzburg and member of the German Council of Economic Advisers. Daniel Gros, PhD, published his study on the U.S. net foreign debt as two DIW Berlin Research Notes “Foreign Investment in the US: Disappearing in a Black Hole?” and “Foreign Investment in the US: Being Taken to the Cleaners?”. The results are a bombshell for the assessment of global imbalances. Daniel Gros, PhD, shows convincingly that the net capital income flows reported in the U.S. current account are vastly exaggerated in favor of the U.S. So the real net foreign debt of the United States is not, as officially reported, U.S. dollars 2,200 billion but over U.S. dollars 4,000 billion.



Konstantin A. Kholodilin, PhD, Researcher



Dr Tilman Brück, Head of Department International Economics

actively involved in all of these debates by conducting research and providing policy advice on such topics. As a leading European centre for applied economic research on international and regional integration, the Department has shaped many important policy debates in recent years. Recent contributions to such European and German policy debates include the effects of Eastern enlargement, of European regional policy, of the scale and the employment effects of migration as well as the necessity for reforms in the Stability and Growth Pact.

As a case study of European integration more generally, the department reviews the current state of debate on European financial market integration and offers a specific four-point plan on how to advance European integration in that field. Financial market integration is of central importance for the single European market and future

economic growth in the European Union. Dr Tilman Brück, Head of the Department International Economics, argues: “The key policy challenge is to integrate national financial markets while strengthening Europe as a global financial marketplace characterized by growth and stability.”

Research Findings

To address this policy challenge, the Department International Economics has conducted research on three related issues:

- the global and European characteristics of the banking sector,
 - the challenges facing financial service firms, and
 - current processes of convergence in the EU.
- Dr Mechthild Schrooten, Deputy Head of the

Department International Economics, explains: “The performance of the European financial sectors is crucial for the future role of Europe on the international playing field. However, it has to be considered as a part of the overall European integration process, and therefore is essential also for trade and migration, since migrants usually remit a remarkable amount to their home country.” Therefore the special issue of financial architecture is closely connected to the more general topic of European and international integration.

Dr Hella Engerer, Research Associate in the Department, shows in her research that there exists a convergence in structural indicators despite a persistent heterogeneity of ownership structures across the different countries. The experience of the new member states has shown that success is not a function of specific forms of ownership of banks. Dr Engerer hence argues: “It can not be

International Economics

European integration has become a piecemeal process in recent years. European financial market regulation, fiscal policy coordination, migration, security policy, utility deregulation, and even relations to our Eastern neighbours are all hotly debated and open-ended policy issues in Europe. The policy process on these issues is hence slow and much informed debate is required before decisions are made.

European Financial Architecture

The Department International Economics, and its European Integration group in particular, are

Dr Ayalneh Bogale (Alemaya University, Ethiopia), Dr Philip Verwimp (HiCN and ISS Den Haag), and Prof Robert Bates (Harvard University) at a HiCN workshop





Dr Mechthild Schrooten, Research Associate

said that private credit institutions work better than public banks. Furthermore, there is strong evidence that certain preconditions must be fulfilled before the success of privatization can ma-

terialize. In addition, it is important that all banks are operating under the same rules.”

Focusing on small and medium-sized enterprise [SME] finance, Prof Eva Terberger, Re-

search Professor of the Department, argues that “state intervention in favor of these enterprises does not always seem to be in line with the core principles put forward for financial sector development in general.” Although the promotion of SME finance is a political reality in most countries, this fact has largely been ignored by the macro debate on financial architecture. Casting fresh light on this topic, Prof Terberger shows that the adequate tools to foster financial development and growth might depend on the financial structure and the role of SMEs within a country. However, as Prof Terberger makes clear, many questions in this field are still waiting for satisfactory answers.

Current Policy Challenges

European financial markets are currently characterized by major changes. The introduction of the Euro has strengthened calls for the deregulation and liberalization of financial markets in individual and across member states. This affects especially the banking sector. The trend towards common European competition standards as well as the restructuring, consolidation and new positioning of business practices

will continue to affect national banking systems. Furthermore, international regulations like Basel II will play an increasing role in the future.

The intensity of competition differs significantly across European financial markets. Many sub-sectors continue to be characterized by high degrees of national fragmentation while other sub-sectors are much more uniform. Such differences have many impacts, last but not least on the financing of small and medium-sized enterprises.

Finally, the role of the state in financial market integration is still quite diverse across Europe. This is, incidentally, a key difference to the emergence of a strong national financial market framework in the United States, which never had to cope with unifying different legislative approaches and traditions in such an economically vital sector. In Europe, diversity concerning the role of the state implies that in some countries the state is both the regulator and the owner of significant financial intermediaries.

Four-Point Plan

These research findings have prompted Dr Schrooten and Dr Dorothea Schäfer, a Research Associate from the Department Innovation, Manufacturing, Service, to design a four-point plan for enhanced European financial market integration.

1 Enforce simple rules of the game

The existing heterogeneity of national financial market regulation creates high costs for business in Europe. Therefore, the rules of the game must become simpler. Some progress has been made in this field but future progress has to be accelerated.

2 Perceived diversity as an opportunity

The existing degree of diversity in the European financial market is beneficial for the European economy. It allows portfolio diversification and hence risk management for economic actors, which will

support growth. In addition, the existing diversity will create important synergies in future cross-border mergers in this sector.

3 Support financial sustainability

Financial market sustainability will be best supported by clear European rules and regulation. This should include a European agency for financial market stability, which can measure and control financial market activities across Europe.

4 Ensure financing of SME

With tighter national budgets due to the Stability and Growth Pact, it becomes more difficult for national governments to support small and medium-sized enterprises [SMEs] within their jurisdiction. European governments should thus adjust their support policies for SMEs. For example governments should standardize the accounting rules for SMEs, which otherwise cannot easily tap loans from other European banks. It is thus advisable to standardize accounting rules for SMEs to enable them to benefit from European-wide financial services countries.

Top Level Economic Policy Advice in Ukraine

It is not self-evident for a German economic think tank to provide economic advice to the head of a foreign government. Nonetheless in Ukraine, the continuous and research based advisory work of German economic experts received top level attention by Prime Minister Yuliya Tymoshenko. Since 1994 DIW Berlin has provided a great number of top policy makers and stakeholders in the Ukraine with a broad range of sound advice on economic reforms. German experts, assisted by the partnership institute IER in Kiev, were recruited and managed by DIW Berlin and financed by the Federal Government of Germany.



Ukrainian Prime Minister Yuliya Tymoshenko

The research work of both the German Advisory Group and the IER focused on the solution of practical day to day economic problems the political key players were faced with, and on the development of far reaching reform strategies. Over the years with more than 800 policy papers, 15 books and numerous reform programs the team shaped economic reforms in Ukraine.

During a meeting on 13 July 2005, the Prime Minister of the Ukraine stated at the end of the intensive, two-hour discussion that she wished to be properly briefed by the DIW Berlin team on individual topics on a weekly basis. Dr Tilman Brück, Head of the Department of International Economics and a member of the delegation on the day, said about the meeting: “It was amazing how openly Prime Minister Tymoshenko spoke about current matters of economic policy and how interested she was in our approach. Although some of the economic problems in the Ukraine have partly been caused by her government, she seemed willing to discuss the topics, to change track after a consideration of the arguments and thus to improve economic policy.”

The DIW Berlin team analyzed for Prime-Minister Tymoshenko the macroeconomic situation and main causes for rising inflation, fiscal risks and the current budget situation. This helped to prevent much demanded but wrongly argued interventions into the monetary policy of the National Bank of Ukraine. “We also put forward proposals for structural re-

forms aimed at increasing efficiency in health care provision. The core reform element is the fundamental change towards the remuneration of services provided, instead of the current practise of payments for existing infrastructure. This key reform step is now broadly accepted in Ukraine and should become part of future health care reforms,” says Dr Lars Handrich, coordinator of the advisory group.

The team developed a framework for reforming public utilities by introducing benchmark competition among the different local monopolies supervised by an independent regulator. “Our discussions also covered the difficult situation agricultural policy. Corning the hot potato issue—the populist debate about ‘re-privatisation’ in the aftermath of the ‘Orange Revolution’ we offered a face saving exit strategy to the government,” tells Dr Brück.

Dr Handrich, coordinator of the advisory group stated that “the close, personal provision of advice to Prime-minister Yuliya Tymoshenko was one of the absolute high lights in the 10-year long history of the project, and the involvement of the relevant decision makers represented a new level of quality”.

Despite the ouster of Yuliya Tymoshenko as head of government the reform arguments presented during the meetings shaped persistently Ukraine’s economic reform agenda.



Dr Lars Handrich

One Year at the Hitotsubashi University, Tokyo, Japan

Hitotsubashi is the Japanese expression for “first bridge” which means in the given context, first bridge at the palace in Tokyo—the palace of the Japanese emperor. Today the administration of the Hitotsubashi University and the business school can be found near the palace, while the faculties as well as the Institute of Economic Research (IER) are placed in Kunitachi, a green and wealthy suburb of the Japanese capitol which is considered as to be more safe concerning earthquakes. The Hitot-

subashi University is famous in economics. Just after entering the campus one feels the specific spirit which makes professors, students, the people working in the library and the administration teaching, learning, doing research and other necessary things in a very calm and totally efficient way. Interesting and famous people from all over the world are working here or come for visits.

The list of the seminars held on a regular basis is long.

The official time difference between Japan and Germany is eight hours. However, I often had the impression that the real time difference seems to be ten years. Japan is ten years ahead. Many of the German social phenomena are even more pronounced in Japan: the aging society, chronic budget problems, the low flexibility and shortcomings of the labour market, the redefinition of the role of the government. However, Japan started to address most of these problems several years ago and often in a very pragmatic way. Let us take the ageing society. The Japanese society is ageing fast. Any answer to this phenomenon is not simple, and has many aspects. However, to make the situation more comfortable, Japan uses one of its assets: the development of an adequate technical equipment for the elderly. In such an environment, ageing has a value, even a market value. Elder people themselves consider the new technologies as a specific help, technophobia is widely unknown.

Japan now is back on to economic growth. The way back was hard. Nearly every sector in the Japanese economy was confronted with a period of reconstruction. Tremendous efforts have been made on both levels, the individual and the society. However, the Japanese government is aware that many things still have to be done to make this development sustainable. Therefore, Japan is watching closely German politics and reforms—do they improve the conditions for sustainable growth? Several elements as the old-age care insurance are already adopted in Japan. Nowadays, Japan is also looking for ideas concerning the redefinition of the gender relationship. It seems to be clear that this issue is one of the most important ones. It has a considerable impact on the economic and social life. In this field both countries, Japan and Germany can learn a lot from other economies like the Nordic ones.

This holds also true for the academic life. During my time at the Institute of Economic Research at the Hitotsubashi University there were only two females working as professors—I was one of them. Consequently, I experienced the male dominated Japanese style of work. During my stay

I was working in the field of European and International Integration and could get into contact to many experts focusing on the question whether the European Union and its history is a blueprint for the Asian integration process. The European integration process, the development in the US and the transatlantic relationship were hot topics in many discussions. Much of what I have learned

on the island is now part of my personal and academic life. One of the important academic results of the stay in Japan was a strengthening of my international network, since the Hitotsubashi University is closely connected to many internationally high ranked economic research institutes and organisations. Back in Europe, my work at DIW Berlin is benefiting in many respects from the far reaching experiences I have made abroad.

Dr Mechthild Schrooten

Eric Okawa





Prof Dr Viktor Steiner, Head of Department Public Economics

Public Economics

Business start-up funding for the unemployed is gaining more and more significance as a labor market policy tool in Germany: while in 1994 there were less than 37,000 funded start-up businesses, by 2004, the figure had risen to more than 350,000. This development was further encouraged by the introduction of the business start-up grant (Me-Incorporated) on 01/01/2003 as part of the Hartz reforms. In addition to the bridging money transfer, which has been available for some time, there are now two more funding tools for those unemployed persons who ready to start a business. As part of a larger evaluation project for the Federal Ministry of Labour and Social Affairs, the Department Public Economics is looking into the effectiveness and efficiency of both programs. The interim report submitted in 2005 indicates that both programs are successful with regard to avoided falling back into unemployment. As far as the bridging funding is concerned, the report is based on a sufficient period of time after the end of the fund-

ing period, while some of the Me-Incorporated funding is still ongoing, thus allowing only a preliminary conclusion. Furthermore, Prof Dr Viktor Steiner of DIW Berlin explained to *Spiegel* magazine that the two tools address different target groups. Receivers of the bridging fund are on average better qualified than participants in the Me-Incorporated and were unemployed for a shorter period. Receivers of the bridging money are also more likely to recruit. At the beginning of 2005, 30% of men and 22% women in receipt of a bridging fund had already employed one or more persons. The majority of Me-Incorporated participants on the other hand continued to work in a classic one-person Me-Incorporated. The studies continue and will eventually produce a final report, which will be published in mid-2006.

“We investigate the various governmental policy tools—taxes, transfers, the provision of public services, and state regulations – which influence the allocation of resources and the influence of political reforms on these results”, Prof Dr Steiner explains. The analysis of decision-making on the different governmental levels constitutes another focus of the department’s research activities. The empirical micro-economic underpinning of the research activities in the area of state activities is the department’s trademark.

An important research goal is the development of the methodological bases with focus on micro-econometrics and micro-simulation. The department is thus heavily involved in current political and economic debates in Germany and on a European level.

The research focus financial policy, in collaboration with the Federal Finance Ministry, continues the wage and income tax micro-simulation model. The tax transfer micro simulation model [STSM] was also further developed. It represents behavioural adjustments to the offers on the labor market. “This allows the analysis of the distributional effects of tax reforms as well as their allocative effects”, Dr Stefan Bach, research associate in the department, explains. Another important activity in this area of research is the development of an integrated database for the micro simulation models, which collates the micro data of tax statistics, income and consumer surveys,

the micro census and the Socio-Economic Panel of DIW Berlin using statistical methods. “This allows us to analyse the allocation and distribution effects of tax reforms, which also affect income and consumer taxation,” Dr Bach explains. A new research focus in this area concerns the development of a new micro simulation model on business taxation. Taxes and public spending are also investigated with regard to their relationship to the various levels of the federal state.

STSM is also a central tool of scientific analysis in the area of social policy and in policy advice. The latest developments concern the dynamic modelling of the budgetary offer behaviour, the significance of child care costs, and the welfare analysis of political reforms. A further important methodological development concerns the dynamisation of the STSM, which allows the analysis of demographic change and, in simplified form, the effect of long-term financial and social policy reforms. Initially, effect analyses were carried out regarding health and pension reforms in Germany. Other fields of research in the area of social policy include empirical analyses on family policy and

basic social security.

Using microeconomic evaluation models and the STSM, the Department’s Research Area *Labour Market and Educational Policy* carried out impact analyses on the effectiveness of the active labor market policy and governmental educational policy. An on-going project investigates the labor market effects of the subsidisation of social contributions among low wage workers. Another current research field deals with the micro-econometric evaluation of active labor market policies in Germany. In a longer term third-party funded project, the department, on behalf of the Federal Ministry of Economics and Labour evaluates, as part of the Hartz evaluation, the funding of start-ups for the unemployed (bridging money and start-up funding, Me-Incorporated). In the area of educational policy, microeconomic analyses were carried out on the effects of the student funding *Bafög* on educational decisions. Initially, empirical analyses were obtained based on the STSM on the long-term distributional effects of the state educational financing reforms.



Hans J. Baumgartner, Research Associate

Simplification of the Tax System—Not a Simple Matter

During the German Federal Election campaign 2005, Angela Merkel caused a stir appointing Prof Dr Paul Kirchhof as Minister of Finance to her shadow cabinet. Kirchhof, well-noted Professor of Tax Law and former Judge at the Federal Constitutional Court, stands for a flat rate income tax of 25% from whose tax base, in return, all tax concessions and exemptions would be dropped. This proposal, which was initially backed by Angela Merkel, caused an intensive public debate and provoked strong opposition from the former red-green coalition government. In particular, the claim that the suggested reform would be revenue-neutral and leave the income distribution more or less unaffected was challenged by its opponents. The claim was that, due to vast loopholes in the tax system, rich people or firms were effectively paying very little income tax and that, therefore, by broadening the tax base rates could be cut without much loss in tax revenues. However, this claim was not backed by any empirical evidence.

“Using our microsimulation model based on a broad sample from income tax files we analyzed the potential effects of the flat-rate income tax as well as other proposed tax reforms,” says Dr Stefan Bach of DIW Berlin. “We found that such a clear drop in the tax rates, particularly in the upper incomes range, would cause considerable loss of revenue, and that this would not be compensated by broadening

the tax base or stimulating growth. During the election campaign we published an report—the Wochenbericht—high-lighting the potential for broadening tax base.”

Against popular claims that rich people mostly evade income tax one has to observe that the tax liability as charged is considerably progressive. The ten percent of tax payers in the highest income groups account for more than 51% of tax revenue; the 1% richest people about 20%, and the 0.1% at the very top—29,000 tax payers—provide 8.3% of revenue. There is clear tax progression, too, that is, the tax paid rises as income rises. However, the effective average tax paid is clearly below the top tax rate of 42%, even for tax payers earning very high incomes.

Potential tax concessions or scope for broadening the tax base can be identified using our microsimulation model adjusted to 2005 data. The relevant figures were related to taxable income. As a matter of fact, many tax payers, particularly those in the upper ten percent percentile, declare losses on renting and leasing or commercial shareholdings, and this could be deemed as a clear indication of tax saving activities. However, even in the top income groups these losses amount to less than 10% of the considerable taxable income of these households. The saver’s free allowance and the half-income procedure on dividends are taken into account in calculating tax-free income from capital assets—the latter, however, balances the advance payment on the final corporation tax payable. Bonuses paid for Sunday, public holiday and night shift work have not so far been taxed, and taxing them is being discussed by all sides. They are not included in the data in the income tax statistics, appropriate information from DIW Berlin’s German Socio-Economic Panel Study [SOEP] was integrated in the tax data set via imputation procedures. In addition, higher allowable expenses above the general employees’ allowance were taken into account in income from employment. These include the commuter’s allowance and special expenses (except insurance contributions) and extraordinary charges.

In addition to these expenses, some of the reform proposals also aim at restricting the scope for building up hidden reserves and limiting lump sums for a part of the operating expenditure and the calculation of income. Since there is no information on these relations in the tax statistics, as profits are only shown on balance, it is difficult to estimate the effects of these measures on tax receipts. However, many of these measures involve higher tax payments in the short term with lower tax payments later (depreciation regulations, provisions), and to that extent the effect on the level of actual tax liability and on tax revenue is rather low in cash terms. In addition, the relevant provisions have been tightened over the last years, and reactions by tax payers to the new rules would have to be taken into account. As there is hardly any empirical evidence on this, for our empirical analysis we assumed that taxable profits (without capital gains) would at most rise by 15%.

Altogether, the result shows a potential for broadening the tax base of just under 12%. If higher taxable profits are included, the figure would be 14.5%. Although this would finance a remarkable reduction in tax rates, it would definitely not be enough to cover the loss of tax revenue if the top income tax rate was reduced to 25%. There would be considerable loss of tax revenue, and the distribution of net incomes would become more unequal.

The DIW Berlin study was well appreciated in the media as a substantive empirical contribution to the heated debate during the 2005 election campaign. It contributed to the general impression that the proponents of the flat-tax rate and other related reforms held a too optimistic view about the self-financing potential of these reforms. Although tax-base broadening and further reductions of marginal tax rates might be an important aim and improve the efficiency of the tax system, in DIW Berlin’s view it should be based on sound empirical analysis.



Dr Stefan Bach, right, and Peter Haan, Research Associates

Information Society and Competition

The EU Heads of State and Government agreed in March 2000 to make the EU “the most competitive and dynamic knowledge-driven economy by 2010.” To achieve this ambitious target, the regulatory framework for electronic communications which became applicable on July 25, 2003, established a series of legal acts and associated measures to encourage competition in the electronic communications markets, to improve the functioning of the internal market and to guarantee basic user interests which would not be guaranteed by market forces. Prof Dr Christian Wey, Head of Department Information Society and Competition of DIW Berlin explains: “While the general aim of the framework is to arrive at competition based on different infrastructures and to maintain sector-specific regulation only for monopolistic bottlenecks, current market structures and developments in most EU countries show that the conflict between regulation designed to stimulate new infrastructures and regulatory measures which enable fast market entry of service providers is hard to overcome.” Furthermore, he adds, technological develop-

ments like the creation of next generation networks and investments in new infrastructures like fiber-to-the-home indicate that dynamic aspects are of utmost importance for an efficient regulatory framework.

In a study involving five EU countries, namely Denmark, the Netherlands, Italy, Sweden and the UK, the Department Information Society and Competition explored how these countries have implemented the actual EU framework and whether or not they focused on infrastructure or service-based competition. “While the countries’ policies differ with respect to the speed of imple-

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**Prof Dr Christian Wey,
Head of Department
Information Society
and Competition**

mentation and the actual measures taken, different pricing policies turned out to have only a limited impact on the development of either infrastructure or service-based competition,” explains Prof Dr Christian Wey. “Investments in new infrastructures mainly focused on urban areas and did not depend very strongly on the access and pricing policies taken by national regulators,” he adds.

The regulatory approach to be taken towards new infrastructures and networks was analyzed in two projects focusing on the different regulatory mechanisms and new technological developments in next generation networks, respectively. Both

projects underline the impact of uncertainty about relevant costs, efficient market structures and possible negative impacts of regulatory interventions based on actual market structures instead of long-term perspectives on future entry.

E-Business Market W@tch monitors the adoption, development and impact of electronic business practices in different sectors of the economy in the enlarged European Union. Based on unique data from representative enterprise surveys and a large collection of case studies from individual companies, e-Business Market W@tch has matured into an internation-

ally recognized resource for sound information on the uptake and impact of Information and Communication Technology (ICT). Its studies support policy-makers to understand the different dynamics and implications of ICT usage and thus helps them to take more informed decisions.

Dr Brigitte Preißl, Dr Philipp Köllinger and Daniel Nepelski, all research associates of the department, contributed to e-Business Market Watch in 2005 with sectoral studies which ana-

lyzed recent ICT trends and impacts in the machinery and equipment industry, the automotive industry, and the aeronautics industry. Also, they used data from e-Business Market Watch for a series of econometric analyses which focused on diffusion dynamics and the economic implications of ICT usage. "Maybe our most important result of these studies is that there is no direct link between ICT usage and enterprise performance," says Dr Köllinger. "The old mantra 'more ICT equals more success' is hence not necessarily true. How ICT is used turns out to be even more important than if ICT is used and innovations play a key role in this process. If ICT adoption does not result in an innovation, the money could be better spent elsewhere."

This result has stimulated a new debate about the strategic relevance of ICT and the potential role of government to support the technological development of firms. As a consequence, European policy makers have shifted their focus from simply promoting ICT uptake to a more qualified approach which tries to identify potential market failures and which supports auxiliary factors which help firms to use new ICT tools for innovative purposes, such as education and R&D.

The team frequently presents the results of the project and the academic articles which are based on it at various international conferences.



Pio Baake, Research Associate

An Efficiency Defence of Buyer Power in Retailing

In many industries suppliers are confronted with increasingly powerful buyers. A prominent example is retailing, in particular for fast-moving consumer goods. According to studies of the European Commission and the OECD, the grocery retail market in several states of the European Union is now dominated by a small number of large retailers, which are also increasingly active across borders. Retailers' buyer power has also played a major role in some recent antitrust cases in Europe (Tuko and Carrefour/Promodes), while in the U.K. antitrust authorities have gone as far as introducing a Code of Practice to protect suppliers from the supposedly opportunistic behavior of dominant retailers. Though market concentration in retailing is generally lower in the U.S., concern about buyer power has also been on the rise. While antitrust authorities are typically sceptical about those concentration trends, joint research with Professor Roman Inderst, who became Research Professor of the Department Information Society and Competition in 2005, has identified new efficiency reasons for buyer power in the retailing industry. Their main message is that any purely static view of how market structure affects welfare is likely to be misleading. Antitrust authorities are thus well advised to take a more dynamic perspective, as they increasingly do, thereby incorporating firms' incentives to invest and innovate. Traditionally, the focus has been squarely on how horizontal market power affects investment incentives. Lately, however, antitrust authorities around the world have become increasingly concerned about the exercise of power in vertical relations.

By explicitly analyzing the likely effects of buyer power in retailing on upstream firms' innovation incentives the research uncovers several new channels which tend to enhance suppliers' incentives. In their DIW Berlin Discussion Paper 464 "Buyer Power and Suppliers' Incentives" (forthcoming European Economic Review 2006) Inderst and Prof Dr Wey show under which circumstances large buyers indeed obtain more favorable terms from their supplier; however, larger buyers need not stifle a supplier's incentives. While reducing a supplier's overall level of profits, it is shown that a supplier obtains a larger share from the innovation rents when buyers are large which in turn increases suppliers' incentives to invest in both product and process innovation. In another joint research project on "Countervailing Power and Upstream Innovation", published as DIW Berlin Discussion Paper 524/2005, another argument has been developed which, again, challenges the view that the presence of powerful buyers will stifle suppliers' incentives to innovate. Following the seminal paper by Katz (1987, American Economic Review), countervailing (or buyer) power was interpreted as the ability of, in particular, large buyers to substitute away from a given supplier. Given this kind of "outside-option" setting, competition between retailers in local markets tends to increase suppliers' investment incentives as the supplier's enhanced competitiveness reduces the value of a large buyer's outside option, which in turn provides further incentives for the supplier. Overall, this research casts doubts on recent concerns about the alleged anticompetitive effects of buyer power; rather to the contrary, there are strong pro-competitive effects associated with the emergence of powerful retail chains which should ultimately benefit consumers.

Innovation, Manufacturing, Service

Innovation, that is new products and services or new ways of organizing production, is of prominent importance for growth and prosperity in highly developed industrial countries. Innovations are relied upon to give their companies the competitive advantage and to create the high-wage jobs needed to maintain and even improve their high standard of living. Germany is no exception. After a long period of sluggish growth, the current German government has put innovation policy high on its agenda. But where does Germany stand with regard to its innovative capacity?

To answer this question, a team of researchers from the Department Innovation, Manufacturing, Service developed and constructed a composite indicator of national innovative capacity. The team of DIW Berlin has prepared the *Innovation Indicator for Germany* on commission of Deutsche Telekom Stiftung and Bundesverband der Deutschen Industrie (BDI, Federation of German Industries). While its name highlights that the *Innovation Indicator for Germany* aims at describing and understanding Germany's innovative performance, it does so by comparing Germany with 12 other leading industrial countries (Aus-

tria, Belgium, Denmark, Spain, Finland, France, Great Britain, Italy, the Netherlands, Sweden as well as the United States and Japan). Constructing a cross-country ranking of innovative capacity posed two main challenges for the DIW Berlin team: Firstly, an economy's capacity to innovate cannot be directly observed and assessed and secondly, Germany and its rival countries among the World's core innovators share a lot of important traits (well developed infrastructure and education systems, commitment to free trade and property rights, etc.) and are thus difficult to rank. Prof Axel Werwatz, PhD, Head of Department and project coordinator says: "Both challenges required a broad approach. No single indicator or small set of indicators can adequately capture innovative capacity or discriminate among these highly developed countries." Hence, in order to assess a country's innovative capacity, the researchers of DIW Berlin constructed a multi-faceted, multilevel indicator system, culminating in a single overall composite indicator build in a step-wise fashion from more than 150 original indicators. The overall indicator rests on two pillars: (1) the innovative capacity of the key innovation actors (companies, citizens, government) and (2) the societal framework conditions they are facing and creating. That is, while innovations are aimed at the market and are ultimately created by enterprises, companies operate within a complex set of framework conditions shaped, for instance, by university research, government

regulations and consumer preferences. The team of DIW Berlin thus identified seven important areas (education, research and development, financing innovations, networking of innovation actors, implementation of innovations in production, regulations that promote innovations and competition, and innovation-friendly demand) which define the framework conditions in a national innovation system. The quality of these conditions determines the innovative capacity of companies, which, acting together with the state and the citizens, configure this innovation system themselves. The overall indicator thus summarizes seven components of innovative capacity on the system side and three on the actor side.

By narrowing down this broad approach, a composite score results for Germany's innovative capacity as compared internationally the *Innovation Indicator for Germany*. Germany's overall innovative capacity was given an 'average' ranking in the middle of the field. Taken by itself, 6th place for the innovation indicator, following the United States as leader, three Scandinavian countries and Japan is not yet cause for worry. However, the relatively low score of 4.66 (on a scale of 1 to 7) indicates, held against that obtained by the United States (7), but also Finland (6.01) and Sweden (5.83), that Germany suffers from considerable disadvantages in innovative capacity when compared to these front-runners. "A country



Prof Axel Werwatz, PhD,
Head of Department Innovation,
Manufacturing, Service

Innovation, Manufacturing, Service

such as Germany, whose growth and prosperity are based on innovations to a substantial degree, must strive to achieve a top position in the world, not necessarily in the ranking, but definitely with an indicator score that is close to the maximum,” says Prof Werwatz.

Due to the stepwise, modular construction of the overall indicator, the contributions which the individual areas of the innovation system and the key actors made towards the overall 6th place finish can be identified. In this manner, an ‘innovation profile’ for Germany was derived. Accordingly, particular advantages are given on the systems side in the areas of implementation of innovations (documented by the success innovative German manufacturers enjoy on global markets) and net-

working; serious disadvantages were pinpointed in the education sector and where the financing of innovations is concerned. Surprisingly, Germany’s worst ranking was on the actors side, in the innovation-relevant behavioral patterns and attitudes of the population. The German deficits are grave also due to the fact that the countries making up the front-runner group are ahead not in a few but in many areas. But they also serve as ‘role models’. As Dr Heike Belitz, Senior Researcher in the project, puts it: “Substantial improvements require persistent efforts, both in terms of excellence as well as breadth. The northern European countries, positioned in front of Germany, have proven that this is possible even in difficult times.”



Uwe Hetzner

Industrial Conference

On May 12 and 13, 2005, DIW Berlin’s Industrial Conference was held for the first time in a conference center located in the heart of Berlin. Around 60 experts from businesses and associations participated in this event. DIW Berlin presented its economic forecasts for the time ahead until 2006 with respect to the situation of the global and the German economy on the one hand, and looked into the development of the industrial sector as a whole and its various branches on the other hand. After that, business associations’ experts reported on the current state of affairs in their respective areas of trade and provided forecasts of how they think the production in their industries will fare until 2006. Estimates of the two sides did not differ substantially for 2005; DIW Berlin reckons with a 1.9 per cent hike in production against business experts’ 1.7 per cent predictions. However, business experts are somewhat more pessimistic when looking at 2006—they only predict a 1.4 per cent hike—than DIW Berlin with 1.9 per cent. This spring conference’s special focus was on the “working hours debate”. The business experts reported how their member companies deal with the factor working hours. Towards the end of the conference, this topic attracted once again the participants’ attention. In his inspiring contribution, Prof Axel Werwatz of DIW Berlin put the working hours factor into a broader economic perspective. Katharina Heuer, Head of the Personnel and Training Strategy of the German public railroad company Deutsche Bahn AG, gave examples practiced in her company of how working hours can be managed in a more efficient way.

Fostering the dialog between the business and science communities is the aim of the Industrial Conference. As an established and distinguished forum for experts who are interested in estimations of current economic trends at global, regional, and sectoral level, as well as the consequences for the German economy, the conference has been held twice yearly in Berlin since 1960. The scientific coordination of the event by DIW Berlin and the active participation of the business community constitute the event’s seal of quality and also its unique selling point. The conference provides a comprehensive and detailed picture of the current economic situation, while in the future greater emphasis will be placed on illustrating the structural challenges facing sectors and enterprises.



Axel Arendt, Chairman Rolls-Royce Deutschland, at the Industrial Conference

Uwe Hetzner

German Minister of Education and Research, Edelgard Bulmahn, left, and Prof Dr Claudia Kemfert, Head of Department Energy, Transportation, Environment



Energy, Transportation, Environment

One of the most important challenges of the 21st century is to minimize impacts of climate change

by the mitigation of greenhouse gas emissions and adaptation of most vulnerable regions of the world. Such climate change can cause serious natural disasters as hurricanes, floods and droughts. Climate change is determined by the increasing greenhouse gas emissions mostly coming from burning fossil fuels (coal, oil and gas) which together are scarce resources. Therefore, a drastic mitigation of greenhouse gas emissions can be reached by increasing the share of sustainable energy resources. The department's purpose

is to assess economic consequences of climate change, to find economically feasible solutions to improve energy efficiency and to substitute fossil energy, and to evaluate energy, transportation and environmental policy options to reach these goals.

In 2005 climate policy was high on the political agenda, both on national and international levels: A new National Climate Change Programme was passed, The European Emissions Trading Scheme came into operation, the Kyoto Protocol agreed in 1997 came into force, and the Climate Change Conference in Montreal served as a kick-off for the further development of the international climate regime beyond the Kyoto period (2008–2012).

Such steps are necessary in the light of threatening climate change impacts. The department evaluates the economic costs of climate change using global integrated assessment models. One major outcome was that economic climate impacts could increase by factor 10 up to 200 trillion U.S. dollars within the next 50 years.

“Solving the climate problem means also solving the energy problem,” Prof Dr Claudia Kemfert, Head of Department, said. “It is unlikely that humankind will be able to stabilize emissions at current level in order not to exceed a dangerous level of 2° C by the year 2100. This is economically unfeasible as most of the world's nations are not prepared to substitute fossil energy by sustainable energies as renewable energies in such a short time

horizon”. Climate change cannot be avoided, but it must be abated, he adds.

The Kyoto protocol ratified by Europe, Japan, Russia, Canada, and many other countries was the first international binding agreement to reduce the concentration of greenhouse gases in the atmosphere. It is an important first step to protect the global climate by national targets and by new instruments such as International Emissions Trading, Joint Implementation, and Clean Development Mechanism.

The European Union is a pioneer in climate change policy. The European emissions trading system constitutes the key element of a common strategy which could serve as a blueprint, given

that it works effectively. For that, ambitious emission targets and appropriate distributions of emission allowances defined in national allocation plans [NAP] are essential. For the first trading phase national allocations were rather generous and free of charge for (nearly) all installations. Nevertheless, CO₂-prices increased sharply and contributed to rising electricity prices. The passing through of opportunity costs generated high windfall profits in the electricity sector and a high burden for energy intensive industries, in particular. “In future phases we need more effective emission reduction targets and an increasing auctioning of emission allowances,” Dr Jochen Diekmann, deputy Head of Department, confirms



Dr Jochen Diekmann and Dr Barbara Praetorius, Research Associates

in a joint report for the Ministry of Environment. In Germany greenhouse gas emissions decreased slightly in 2005, primarily due to high energy prices. However, the national target of reducing CO₂ emissions in the period 1990 to 2005 by 25% has been failed considerably.

A major challenge is to strive for a future energy mix which must be climate-friendly, economically feasible and competitive. Especially in Germany the restructuring of power supply is urgent in order to avoid stranding investments. “Energy savings, energy efficiency as well as climate-friendly technologies will play a major role in the future,” wrote Prof Kemfert and Dr Diekmann in their latest policy briefing on energy policy. The promotion of renewable energy is crucial. Germany successfully promotes renewable electricity by a feed-in fee system, according to the renewable energy law amended 2004. A comparison to other promotion systems shows that a feed-in fee system is most efficient and effective.

“But not only renewable energy plays an important role for electricity production, but also clean coal technologies [carbon capture and storage, CCS] as well as combined heat and power technologies [CHP],” wrote Dr Barbara Praetorius and Katja Schumacher, both research as-

sociates of the department, in a first assessment interim report.

As transportation causes 20% of total CO₂ emissions, it also plays an important role in climate change policy. “Therefore, it is crucial to increase alternative fuels and technologies as hydro or fuel cells,” Dr Uwe Kunert and Dominika Kalinowska, both research associates of the department, point out. “We assess policy options—especially road pricing and congestion pricing—to find out alternative ways for a sustainable transportation system,” Dr Heike Link, research associate, confirms.

“We need more climate policy to reduce greenhouse gas emissions, not only to meet the Kyoto targets, but—most importantly—to trigger a sustainable energy system in the long run,” Prof Dr Claudia Kemfert commented the recent development. Innovative energy technologies have to play a key role in this process.

The economic research on strategies and consequences of climate change policy demands for sound methodological approaches and models. DIW Berlin develops and applies integrated assessment models [IAM] and computable general equilibrium [CGE] to analyze economic costs and benefits of climate change policy. Works as published discussion papers in 2005 include modeling of induced technological change which is also a challenge for further research. Some of this research is carried out in co-operation with the department’s Research Professor Dr Truong Truong and other researchers.

Prof Dr Claudia Kemfert



The Challenge: Understanding the Dynamics of Electricity System Transformation

In modern societies, a complex system of electricity generation, distribution, and consumption is responsible for transforming physical energy sources for energy services. An electricity system constitutes more than just technical infrastructure: Economic and technical structures, institutions, belief systems, and energy and substance flows are closely integrated within the system. Any transformation of the electricity system has important impacts on some of the system’s components, its development over time and on its social and ecological environment—and vice versa. It seems unlikely that the system can reach a path of sustainability by itself.

The TIPS project, a 5-year research project funded by the Federal Ministry of Education and Research (BMBF), investigates the dynamics and impacts of transformation in the German electricity system with a special view to developing strategies for shaping the path for a sustainable future (<http://www.tips-project.de>).

Such a multi-faceted problem requires an interdisciplinary approach. In July 2002, a team of seven young researchers from different disciplines, led by DIW Berlin, started the TIPS program in form of individual and cooperative research projects. All modules of the TIPS program are interlinked by a common set of concepts and research questions, condensing to one focal point: can innovation processes be shaped in such a way that they provide for a transformation of the electricity system towards a sustainable path?

“The objective is to provide a new analytical and empirical understanding of the complex interaction of nature, technology, economy, individual behavior and governance in the electricity system,” explains Dr Barbara Praetorius of DIW Berlin and leader of the research team. “On that basis, we aim at identifying practical strategies for inducing innovation and for transforming the electricity system into a sustainable direction.”

The project emphasizes detailed empirical analyses of case studies, representing currently debated issues: distributed generation, emissions trading, and behavior of actors in liberalized European energy markets. Current case studies focus on micro-cogeneration and on carbon capture and storage.

Micro-cogeneration—the simultaneous production of heat and power in an individual building based on small energy conversion units—is of increasing political and public interest, as it promises higher efficiencies and lower greenhouse gas emissions. Micro-cogeneration turns consumers into power producers and could thus substantially change the electricity system. TIPS investigated the diverse consequences of a widespread introduction for the energy market, the customers, the environment and the economy and concluded that under current economic and technological conditions in Germany, only a small share of future electricity will be supplied via micro-cogeneration.

“Clean” coal power stations form the antipode to such distributed generation. As Germany possesses large coal and lignite reserves, coal is much of a focus in the public energy and climate protection debate. In their discussion paper “Carbon Capture and Storage: Breaking the German Coal Deadlock?”, TIPS researchers discuss the state of the art and the system of actors involved in implementing CCS. “CCS could be economically viable at a CO₂ price in the range of 30 to about 50 €/t. An upfront integration of CCS into coal based IGCC would be most economical,” says Katja Schumacher of DIW Berlin who estimated cost and generation shares of CCS with an energy economy model, the Second Generation Model (SGM). The study concludes that CCS and the resulting movement in the actor constellation may open up space for the concept of fossil fuels—including coal—as transitional fuels. However, uncertainty about institutional and legal issues creates a major barrier to its deployment.



Prof Dr Gert G. Wagner,
Head of Department SOEP and
Research Director of DIW Berlin

Academy of Natural Scientists and the “acatech” Academy of Technology. “The SOEP has made it possible to gather data about society for various social and economic science disciplines for more than 20 years. It is roughly comparable to the network of weather stations which exists in Germany for the making of the familiar short-term weather forecasts and the simulation of long-term climate change,” says Prof Dr Wagner. “Like the daily weather forecasts, the researching of social change tends not to be quite so spectacular. As is the case with long-term models of climate change, detailed conclusions which are of relevance for policy can only be drawn after many years of observation and analysis. Thus, the data of the SOEP have been used to undertake an intensive study of the lack of childcare and the employment of mothers since the middle of the 90s, and the results played a part in the Federal Republic’s passing of the Daycare Expansion Act and the new Federal Government’s desire to bring about a radical improvement in the conditions for bringing up children and gaining employment by introducing ‘money for parents’,” explains C. Katharina Spieß, research associate of the department, who has played a very important role in incorporating the results into policy. C. Katharina Spieß was, for example, appointed as a member of the Committee which produced the Federal Government’s 7th Family Report, which represents an important basis for the determination of family policy. “What is all the more gratifying is that C.

German Socio-Economic Panel Study (SOEP)

The German Socio-Economic Panel longitudinal Study (SOEP) is an infra-structural socio-economic research tool which is used throughout the world. “Consequently, the SOEP Department not only conducts research, but is also primarily concerned with the gathering of first-class multidisciplinary data about persons and private households in Germany as well as the provision of a good service to the almost 900 registered data users”, says the Head of the Socio-Economic Panel, Prof Dr Gert G. Wagner, who is able to look back on a long interdisciplinary research career as a Professor of Economics. Prof Dr Wagner currently is, for example, a member of the “Opportunities and Problems of an Ageing Society” Working Party at the Leopoldina German

Katharina Spieß has been offered a chair at the University of Frankfurt/Main. DIW Berlin offers high-achieving and committed young scientists unique opportunities,” says Prof Dr Gert G. Wagner enthusiastically.

“As SOEP data is not only used in Germany, but also evaluated in 35 countries throughout the world—just as data about weather are incorporated into worldwide weather forecasts and climate models—research and development in the area of data processing are also important in the SOEP Department,” Prof Dr Wagner continues. “The highly efficient IT Department is the most important service department at DIW Berlin as far as the infrastructural tool of the SOEP is concerned,

as we would otherwise be unable to ensure that the data which we gather every year from about 12,000 private households and the 22,000 adults questioned in these households are reasonably prepared, analyzed and forwarded,” explain Dr Peter Krause, Ingo Sieber and Jan Goebel, all research associates, who are responsible for the database and the forwarding of SOEP data.

A particular challenge was the development of new computer software called SOEPremote in 2005. The aim was to ensure that data which were sensitive in terms of data protection legislation and which could not be forwarded to other scientists were made available on the Internet in a controlled way, so that abuse of data protection



PD Dr C. Katharina Spieß



Prof Bruce Heady, Melbourne, and Dr Peter Krause at a SOEP conference

legislation could be prevented and complicated scientific analyses could be made possible. “We took as our example the Luxembourg Income Study [LIS] of one of our international collaborators, and adopted the software [LISSY] of LIS colleagues and adapted it to our environment,” says Jan Goebel.

“Specially registered users of the Socio-Economic Panel study send us the evaluation program which is to be used to analyze the SOEP microdata,” says Ingo Sieber. “The program is automatically checked to make sure that it does not copy individual examples, which would constitute an attempt at deanonymization. If everything is satisfactory, the user will receive his results by e-mail over the Internet. In this way, it will be ensured that everything continues to be completely anony-

mous.” It has taken over a year to develop and fully test the SOEPremote system to ensure that it is foolproof.

Financing Research in a Unified Europe

Which effect does the European Market have on small, local businesses? Why are some immigrants successful and others are not? Why are more children born in France than in Germany and Italy? Regardless of whether it is a matter of European integration, migration or demographic change, issues relating to the arts and social and economic sciences have long had a European dimension as well. Up until now, the financing of these research projects has essentially been a national matter. This has to change in future. In its report of May 19, 2006, the German Scientific Council for the first time recommended the systematic planning of a research infrastructure for the arts and social and economic sciences. The previously used concept of ‘large’ scientific ‘apparatus’ for the research of the principles of the natural sciences is to be replaced with the wider concept of ‘research infrastructure’. The natural sciences have always been particularly well funded. Large apparatus such as particle accelerators, telescopes or weather stations receive quite generous finance—even at a European level. A particularly noticeable example is the CERN nuclear research facility.

There has so far not been anything like this for the arts and social and economic sciences. Long-term social and economic science studies can sometimes be just as complex and expensive as large apparatus for the natural sciences. Lastly, representative, high-quality data has constantly to be gathered over a long period of time and processed for scientific use. This is expensive. However, only good data can deliver reliable results at the end of the day. And such data is most powerfully used to provide valuable advice to politics. Even the establishment and maintenance of valuable scientific archives and collections is not only to be a matter for the States in future. The new concept of a research infrastructure includes:

- large apparatus which is ‘traditionally’ used for research purposes (e.g. telescopes, etc.);
- scientific research resources such as collections, archives (including biological archives), structured information (e.g. collections of data relating to the social sciences) or databases (e.g. in the field of genomics);
- infrastructures of information and communications technology (e.g. GRID and high-performance computers).

At a European level, ESFRI (European Strategy Forum for Research Infrastructure) develops concepts for an effective European science policy. Among other things, ESFRI is currently elaborating a European road map of new research infrastructures of Pan-European interest which are to be created in the next 10-20 years. The first draft should be available in the autumn of 2006. The European Commission will ultimately decide which projects are to receive what money.

Academic Relations

Collaboration with individual scientists as well as universities and research establishments is a key element of the strategy of DIW Berlin to expand academic research,” says Prof Dr Klaus F. Zimmermann, President of DIW Berlin, with regard to the academic relations of the Institute. “A cornerstone of this strategy is to gain scientists to act as Research Directors, Research Professors, Research Affiliates and Visiting Fellows for specific research and training tasks for DIW Berlin for a while and to involve them with close collaboration with the scientists at the Institute,” he adds. Three interdepartmental research groups are being led by Research Directors who perform a cross-section of tasks, for example the co-ordination of research and the production of publications. In close collaboration with the Research Departments, they co-ordinate research work and develop new topics and/or methods which DIW Berlin presents through its various products. Other tasks include the training and guidance of post-doctoral and post-graduate scientists. In 2005, 52 research pro-

fessors and 17 research affiliates were affiliated with DIW Berlin.

On the basis of collaboration agreements with the three Berlin universities, the University of Potsdam and the Viadrina European University in Frankfurt/Oder, DIW Berlin is working with its partners on the further expansion of the research platform in the Berlin-Brandenburg region. In 2005, the close personal links with universities in the region were able to be further strengthened by the joint appointment of a Departmental Head by DIW Berlin in conjunction with the Humboldt University of Berlin. Prof Dr Georg Meran, Vice-President of DIW Berlin, refers to the fact that the Faculties of Economic and Social Science at the Berlin/Brandenburg universities are also involved with the doctoral programme of DIW Berlin. “We are happy that we have been able to gain such excellent and internationally renowned scientists as Prof Dr Stephen Jenkins, Prof Irwin Collier and Dr Badi Baltagi for the Faculty,” says Prof Dr Meran. “With Prof Dr Truong P. Truong, Professor of Economics at the University of New South Wales, Sydney, we have been able to gain a well-known expert in the field of microeconomics, energy and climate change and CGE modelling.”

Outside the region, there is contact with many research establishments in Germany and abroad. A constantly growing number of projects are conducted by employees of the Institute together with scientists from universities and other research institutes. DIW Berlin belongs to several European research networks, including the European Network of Economic Policy Research Institutes [ENEPRI] and the European Forecasting Research Association for the Macroeconomy [EUROFRAME], to which the most important economic research institutes of the European Union and acceding countries belong.

In addition to its scientific networks with individuals and institutions, the Institute regularly organizes a research seminar to support the knowledge transfer within the institute and with other academic institutions. DIW Berlin places also strong emphasis on organizing and participating in conferences and staged the international experts conference ‘Bank Relationships, Credit Extension, and the Macro Economy’ in collaboration



Mark Darching

strated by the presence of the Institute’s members at scientific conferences. In 2005 the number of papers presented at the most important national conferences (German Economic

Association) as well as international conferences (European Economic Association and European Meeting of the Econometric Society) showed a significant increase to 41 compared to 35 the year before, which can be taken as an evidence for future publications. Both examples indicate that much was achieved over the last years to expand the position of DIW Berlin in the scientific community.

with the Journal of Financial Intermediation and the Federal Reserve Bank of Philadelphia in 2005. The success of these activities was reflected in a particularly impressive increase in the scientific output. Publications in refereed journals listed in the Social Science Citation Index by DIW Berlin employees increased to 35 in 2005, starting from 6 in 2000. The visibility of DIW Berlin’s research work in the academic community is also demon-

strated by the presence of the Institute’s members at scientific conferences. In 2005 the number of papers presented at the most important national conferences (German Economic Association) as well as international conferences (European Economic Association and European Meeting of the Econometric Society) showed a significant increase to 41 compared to 35 the year before, which can be taken as an evidence for future publications. Both examples indicate that much was achieved over the last years to expand the position of DIW Berlin in the scientific community.

About the Graduate Center

The Graduate Center of Economic and Social Research is the doctoral program of the German Institute for Economic Research (DIW Berlin). The Graduate Center of DIW Berlin is intended to provide young, outstanding doctoral students from all over the world with a research environment and an institutional training structure that will develop their talents in an accordingly exemplary manner. It will lead them to a deep understanding of economic and social processes and offer them the opportunity to apply their knowledge within the professional research environment of one of the leading economic think tanks in Germany. The program follows a dual training approach. It offers high-level core and field courses, and on-the-job training within research projects of DIW Berlin.

The location of the Graduate Center of DIW Berlin is a unique vantage point for young prospective economic and social researchers with a devoted policy focus. DIW Berlin deliberately offers many opportunities to communicate with policy makers in order to sharpen the doctoral students’ proficiency in contributing to the public debate and exposing their scientific results to discussion with highly experienced practitioners.

Graduates of the Center will be distinctly qualified to analyze economic and social policy issues. They will possess excellent methodological skills, experience in handling empirical data, a detailed institutional knowledge of the economic and societal structure of many countries and of international organizations, the crucial ability to disseminate their own research results.

The Graduate Center of DIW Berlin offers a three year training program for economics and social scientists. Beginning in October 2006, the program will accept approximately 20 PhD students per year. The Graduate Center aims to promote the individual career advancement of the participants and to ensure their future employability in both the international research area and policy advisory institutions. Longstanding contacts to these institutions’ top staff members, and their recruitment and placement officers, will facilitate the job search process during the final year of the program.

Government Relations

According to its articles, DIW Berlin must devote equal amounts of effort to research, political consultation and service.”

Prof Dr Klaus F. Zimmermann, President of DIW Berlin, describes the tasks of the Institute in Berlin. “The key element thereby is the professional combination of research activities and political consultation. The high quality of DIW Berlin’s consultation is guaranteed through scientific excellence”, says the President of the most influential economic think tank in Germany.

The Institute’s researchers engage in various ways of policy advice ranging from speeches and workshops for the parties represented in the federal and state parliaments to intimate discussions with the chancellor on specific topics. Classic political consultation in the form of expert reports for politics, companies, governments and associations is not only of financial significance to DIW Berlin. By dominating the traditional market for economic surveys, the DIW Berlin researchers have a privileged access to ministry officials and inside information of the legislation process. “Among the institutes DIW Berlin is leading with

respect to the revenues generated from policy advise activities in Germany. With a lead of 20% to the next economic think tank active in the political arena, DIW Berlin is present in most of the offices of the high-ranking government representatives”, explains Dr Susanne Maria Schmidt, Managing Director of DIW Berlin and member of the Executive Board. Further, this strong national basis is the ideal stepping stone to improve the already significant influence in Brussels.

In Germany, DIW Berlin conducts regular research for Federal ministries. Since 1950 the joint business cycle diagnosis, which is drawn up bi-annually on behalf of the Federal Ministry of Finance, is conducted in close collaboration with the other five leading economic research institutes. Also on a regular basis, the Federal Ministry for Family Affairs, Senior Citizens, Women and Youth is advised on parental money (an allowance for parents who take time off to look after their newborns). An area of major and long-term impact results from the tax simulation models build at DIW Berlin. Financial changes resulting from tax law modifications are estimated and the results are used for the formulation of Federal tax legislation. The regular adaptation of the model guarantees the significance of the model results. Besides this contractual work, several scientists are usually invited by the German Bundestag to elicit the research results of DIW Berlin on specific topics in front of committees, and commissions.

The regular German-French summits are usually accompanied by a high-ranking delegation of economists of both countries. Since 2003 DIW Berlin together with its French counterpart CEPII (Centre d’Etudes Prospectives et d’Informations Internationales) arrange for the economic experts to meet and handover recommendations for the common policy. Topics of discussion in 2005 were economic growth, competitiveness and innovation policies in France, Germany and in Europe at large. In light of these upcoming economic challenges, the Group recommends a stronger coordination and harmonization of the national approaches at the European level.

Additional in 2005 the evaluation of labor market reforms (so called Hartz-reform) received high political attention and will be used to revise

the labor market reform—a central goal of the big coalition.

During the election campaign in 2005, DIW Berlin conducted an independent economic analysis of the party platforms and the impact on the development of the German growth in general. As the major political parties received rather moder-

ate ratings, the attention in the political arena as well as in the media was significant.



Jan Hillmütter

Prof Dr Klaus F. Zimmermann with French Finance Minister Nicolas Sarkozy and Wolfgang Clement, German Minister of Economics and Labour

Media Relations

More than 1,200 national and international journalists rely on sound information of DIW Berlin and ensure that the research results of the Institute are made available to decision makers as well as to the general public. DIW Berlin provides constantly up-to-date information about the research of the largest German economic research institute through multiple channels. There are usually two press releases per week that added up to 97 in 2005 alone. All the major media—national and international, daily and weekly media—are clients of the press office. Ludwig Siegele, the Berlin correspondent for *The Economist*, relies on the active press policy: “DIW Berlin is one of the most important contacts for *The Economist* in Germany. From them, we are able to obtain up-to-date information about economic facts and situations. The press office is exemplarily accessible and its committed staff promptly provides further help and refers us to extremely competent contacts.”

The result of the press work of the Institute is impressive: DIW Berlin appeared almost 10,000 times in the printed media during 2005, whereas the scientists of the Institute made about 400 appearances on television and radio.

Especially the economic forecasts of DIW Berlin are highly visible in the press several times a year. In 2005, special attention was paid to the research of DIW Berlin concerning the disputed labour reforms in Germany, named Hartz I-IV after the head of a government commission. The *International Herald Tribune* quoted the President of DIW Berlin, Prof Dr Klaus F. Zimmermann: “Hartz IV is not a send-off for the whole system, but is the biggest reform we’ve ever had. Its most drastic effects for people are to be seen in terms of its consequences ... Our society is still ready to help people in distress, but we are expecting them to work.”

Besides quotes on current economic issues and contributions to talk shows and other formats, DIW Berlin’s scientists provided almost 90 editorials in 2005 to the printed media. Many of them authored by the Head of Department of the Socio economic Panel (SOEP), Prof Dr Gert G. Wagner who also contributes regularly a comment in *Frankfurter Rundschau*, a daily newspaper.

The name and face of Prof Dr Claudia Kemfert, Head of Department of Energy, Transport and Environment, is by now well known in the German media. Since she came into office in May 2004, she has quadrupled the media appearances of

her Department. Resulting from a consistent press strategy, the journalists turn to DIW Berlin first when they are looking for an expert in the field of energy, environment or transport. Of special success was the dissemination of criteria for a future energy policy through a well-regarded editorial in the *Süddeutsche Zeitung* in July 2005: “As a result of binding climate protection objectives and the promotion of renewable energy sources, it is now possible to give the right signals to avoid wrong investment and thus achieve greater independence from international energy imports and energy prices.”



MODERNIZING INFRASTRUCTURE IN TRANSFORMATION ECONOMIES

CHRISTIAN VO

Uwe Kunert u. a. · Abgaben auf Kraftfahrzeuge

Sonderheft 174/200

Publications of DIW Berlin



Verkehr in Zahlen

As a leading economic research institution, DIW's primary objective is to provide decision-makers in politics and industry, scientists, and the general public with up-to-date information on economic affairs. The underlying research results are published in

Wochenbericht: Presents weekly condensed information on current economic policy issues resulting from the research of DIW Berlin. Being available to policy-makers, academics, the business community and ministry officials as to the public at large it offers latest research results of DIW Berlin. The range of topics by the Wochenbericht reflects the work of all departments of the Institute. The first Wochenbericht was launched in 1928.

Weekly Report: Contains selected articles of the Wochenbericht that are of special interest to an international community published in English.

Quarterly Journal for Economic Research: In each issue the Quarterly Journal focuses on a current economic policy topic and provides related background information as well as controversial research issues. The articles are from reknown national and international scientists who have specialised into the respective topic. The Quarterlies have been published by DIW Berlin since 1926 and are an ideal source of information for decision makers in business, politics, and administration as the authors relate their contributions to practical experience.

Discussion Papers: Each Discussion Paper deals with a specific economic problem on a scientific basis. A distinguishing feature of these papers is that they present research findings prior to their subsequent publication in national and international scientific journals. The series has been introduced in October 1989 and is available electronically via internet.

Applied Economics Quarterly (Konjunkturpolitik): As an international journal Applied Economics is presented in English and provides empirical research with relevance for economic policy from national and international scientists. All areas of economics are considered, including social policy, labour and population issues, trade, international finance, stabilization and general growth. The journal's goal is to contribute to current policy debates and enhance economic policy-making by providing a forum for innovative and rigorous empirical research. While the journal is global in scope, it is particularly interested in publishing work on European policy issues.

DIW Berlin: Policy Advice Compact: In this series the research reports of DIW Berlin are published. They are the results of projects conducted for Ministries, the European Commission and other institutions. Additionally, descriptive empirical reports like market analyses or reports on the economical structure are offered.

Data Documentation: Through the basic research of DIW Berlin, data, metadata and databases are compiled in all areas of social and economic sciences. Those are presented and accessible to national and international scientists.

Event Documentation: The events of DIW Berlin including presentations, lectures and speeches of external and internal participants are documented in the Event Documentation for further availability and are available online.

schland - Forschungsprojekt (Bach/Bartholmai)

186: Aktuelle steuerliche Rahmenbedingungen für den privaten Mietwohnungsbau – Wirkungen und Alternativen

Society of Friends of DIW Berlin

Since 1951, the Society of Friends of DIW Berlin (VdF) consists of high-ranking national and international companies, supporting the non-commercial research of the Institute financially and intellectually. Those 55 years of activities was excelled in 2005 by the 80th birthday of DIW Berlin itself. In July 1925, Ernst Wagemann established the Institute for Business Cycle Research at Lützowufer in Berlin which was renamed into Institute for Economic Research (DIW—Deutsches Institut für Wirtschaftsforschung) some years later.

At the end of November, VdF invited prominent guests to a gala dinner to celebrate the decision of Ernst Wagemann 80 years ago. Dr Alexander von Tippelskirch, not only Chairman of VdF but also of Industriekreditbank AG, and Prof Dr Klaus F. Zimmermann, President of DIW Berlin, welcomed the guests in the „Great Ballroom” in the Ritz-Carlton in Berlin. The formal address was given by Edzard Reuter, former Chairman of the Board of Directors of Daimler Benz AG, and the Chairman of VdF for many years. Berlin’s

governing mayor, Klaus Wowereit, expressed the congratulations of the government of the state of Berlin: “There are several institutes in Germany; however, there is only one institute in our capital”. Wowereit emphasized that in 1925, Berlin was “the most significant location of industry on the continent”. The World Economic Crisis, the time of Nazism, the War and above all the division of Berlin prevented the city from maintaining its economic significance. However, the German Institute for Economic Research remained loyal to Berlin. It held its ground on the market despite the sharp competition with other research institutes and today “it is the largest and one of the most successful” German institutes for economic research, the governing mayor emphasized. The President of DIW Berlin, Prof Dr Klaus F. Zimmermann, endorsed this statement: “Today, DIW Berlin has healthy organisational structures and follows a unique and successful scientific course. At the same time, we enhance our role as a leading consulting institute for economic issues.” In order to maintain this position, DIW Berlin must continue to invest in the future. This also includes the establishment of a program for graduates using the well-established network of DIW Berlin with national and international universities.

As early as May, the members of VdF held their annual meeting in Berlin. For the first time, the President of the Institute held an economic keynote address that will be an inherent part of the yearly gathering in the future. His talk on “Demographic change requires educational reforms and lifelong learning” was published as

Wochenbericht and Weekly Report focusing on two tendencies. Due to the demographic development, the labor participation today is increasingly concentrated on the middle-aged age groups. “Furthermore, we must consider that Germany is in danger of losing ground in the educational comparison by OECD,” Prof Dr Zimmermann said. “It is mandatory for Germany to make better use of its labor potential and also to enhance its education level in order to maintain its position as a high wage paying country in international competition.” In practical terms, this means shortening the time until career entry. This objective can be reached, e.g. by reducing the duration of study times as well as by implementing the Abitur (Ger-

man university entrance qualification) after only 12 years. When coping with demographic change, the concept of lifelong learning plays a key role. In addition, the process of early retirement must be stopped. Older employees must continue to be available for the labor market, supported by corresponding further education measures.

After reflecting on the success of DIW Berlin that was achieved with the support of VdF and its members, Dr Susanne Maria Schmidt, Managing Director of VdF and DIW Berlin, presented the substantial improvements not only on the corporate design of VdF but also on the benefits available to its members. Newly developed high-ranking events and information formats were suc-



Berlin Governing Mayor Klaus Wowereit and Prof Dr Klaus F. Zimmermann at the VdF Dinner

cessfully implemented and fostered the relation to the individual member. VdF's Chairman, Dr. Alexander von Tippelskirch, emphasized that the development of the Institute and of the Society was fully endorsed.

The intimate "President's Dinner" consisting of members of the VdF and the President of the institute was considered an inspiring discussion round by the participants, which will also lead to common activities between DIW Berlin and VdF members.

The 2nd Friedensburg Discussion was another opportunity for the members of VdF to dis-

cuss general economic topics, this time with a British perspective, in an intimate roundtable with the British ambassador in Berlin, Sir Peter Torry. This forum allows for a risk-free discussion on sensible topics as all participants agree on confidentiality. The Friedensburg Discussions take place once a year, exclusively for VdF members with a maximum of six participants.

The Benefits of VdF Membership

DIW Berlin Wochenbericht or Weekly Report The Wochenbericht presents weekly condensed information on current economic policy issues resulting from the research of DIW Berlin. Being available to policy-makers, academics, the business community and ministry officials as to the public at large it offers latest research results of DIW Berlin.

The Weekly Report contains selected articles of the Wochenbericht that are of special interest to an international community published in English.

VdF Newsletter The VdF Newsletter is published on a quarterly basis and informs about publications, research results as well as of events and organizational changes at DIW Berlin.

Economic Flashlight Once a week the Economic Flashlight is sent exclusively to members of VdF. It contains information on current economic topics based on the research of DIW Berlin.

Events The Industrial Conference, aims at promoting the communication between business community and science. The conference is a recognized forum for experts who are interested in the assessment of the current development of the global economy, the corresponding regions and sectors as well as in the consequences for the German economy resulting therefrom.

VdF members receive invitations to the monthly Berlin Lunchtime Meetings, where scientists present new research results to an exclusive circle commented by a specialized journalist. At the Annual Meeting of VdF, the President of DIW Berlin comments on a current economic topic in his keynote address. Only after the meeting it will be published in a Wochenbericht and Weekly Report of DIW Berlin and made accessible to the media.

Since 2004, the Friedensburg Discussion has been arranged yearly to provide VdF members the opportunity to meet well-known contemporary personalities in a private circle.

The regular President's Dinner offers VdF members the opportunity of a first-class private evening with the President of DIW Berlin and maximum four more VdF members.

Data Members of VdF have preferred access to current figures concerning the general economic development as well as industry-specific information.

VdF Hotline The VdF Hotline supports VdF members on any request and especially assists VdF members in finding the appropriate speaker for specific economic topics.

Uwe Hetzner



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|---|-----------|
| No. of refereed articles (SSCI, SCI, AHCI) | 35 |
| No. of Discussion Papers | 83 |
| No. of articles in Wochenbericht | 73 |
| No. of conference contributions/presentations | 144 |
| No. of completed doctorates | 4 |
| No. of completed habilitations/new professorships | 1 |
| No. of conferences/workshops | 47 |
| No. of published books | 22 |
| No. of published book chapters | 49 |
| No. of mission oriented research projects | 124 |
| No. of project support(ers) | 61 |
| Volume of mission orientred research projects (in thousand €) | 3,394 |
| Volume of project support(ers) (in thousand €) | 1,524 |
| No. of published guest editorials | 88 |
| No. of published guest editorials | 97 |
| No. of press conferences | 7 |
| No. of journalists in press distribution list | 1,399 |
| No. of responses to press queries | 2,215 |
| No. of mentions in printed media | 9,893 |
| No. of TV and radio interviews | 367 |
| No. of „hits“ on internet home page | 1,555,804 |
| No. of subscribers of DIW-Newsletter | 1,470 |
| No. of events | 97 |