

Dresden Branch



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The Dresden Branch, created by the Ifo Institute in 1993, conducts empirical economic research that is particularly oriented to the special conditions in the new Länder, especially in the Free State of Saxony. Ifo Dresden prepares economic analyses that deal with the business cycle and adjustment to systemic change in eastern Germany, especially in Saxony, and in the EU enlargement countries. It also offers economic-policy advice and provides a meeting place for academics, politicians and entrepreneurs. The branch is supported by the Free State of Saxony and draws on the experience and research resources of the parent institute in Munich to carry out its diverse tasks.

The Dresden branch currently works in the following areas of research:

- Business-cycle and growth in Saxony and the new Länder;
- Human capital, structural change and the position of Saxony and the new Länder in the competition of attracting new businesses,
- Labour market and social policy in Saxony and the new Länder;
- EU eastern enlargement and transformation,
- Public finance and the promotion of economic development in Saxony.

Under the leadership of the management team, Prof. Marcel Thum and Dr. Michael Berlemann, ten economists conduct research on current economic issues in the new Länder and the CEE countries.

In addition to the research projects, the Dresden branch offers **extensive services**. Dresden Ifo publishes economic-policy analyses in the journal *ifo Dresden berichtet* and in the book series, *ifo dresden studien*. Ifo Dresden supports policy-makers, businesses and federations with information and advice on current economic-policy question issues and organises workshops.

The journal **ifo Dresden berichtet** has been published by the Ifo Dresden branch since 1994 and appears every two months. Here Ifo Dresden researchers and external authors publish their current research results on the economic situation in the new Länder for a

broad readership in politics, business and research. The results of the more comprehensive research projects are published in the series, *ifo dresden studien*. In 2004 a study of the effects of EU eastern enlargement on the Saxon economy (vol. 35) and the results of demographic change on the labour market in Saxony (vol. 36) were published.

Economic conferences and workshops, such as the working group for the monitoring of economic activity, regularly take place at Ifo Dresden's facilities. In the series, **Dresdner Vorträgen zur Wirtschaftspolitik**, prominent economic and finance experts present their latest findings to a broad public.

Economic Activity and Growth in Saxony and the New Länder

Ifo Dresden also focuses on the business-cycle observation and forecasts for Saxony and the new Länder as a whole. Here, Ifo Dresden prepares a quarterly business-cycle and employment forecast for Saxony and the new Länder. These forecasts use the econometric forecasting models that were developed in 2004. In addition, preliminary work on the construction of a supplementary forecasting system for experimental stock markets was finished.

The forecasts for eastern Germany and Saxony in June and December are presented for discussion to the working group for the monitoring of business activity and then at a public press conference. A summary article appears in *ifo Dresden berichtet* in the first of fourth volumes of the year. In the spring and autumn, the forecast is based on the Joint Economic Analysis of the Economic Research Institutes.

The Ifo Business Climate indicator for Saxony and eastern Germany is an important leading indicator of the economic situation and development. The current status of the indicator is documented, with commentary, in the newspaper *Sächsische Zeitung* and in *Wirtschaftstelegramm*, a bulletin of the Ministry of Economics and Labour in Saxony.

The Dresden branch also supplies detailed analyses of the current economic situation of individual industry

[Ifo economic and labour-market forecasts for Saxony](#)

branches. These include reports on the business situation in Saxony's and eastern Germany's manufacturing industry and in construction. The industry branch analyses are also integral components of the forecast for Saxony and eastern Germany.

Human Capital, Structural Change and the Position of Saxony and the New Länder in the Competition to Attract New Companies to the Region

This research monitors and analyses the competitiveness of industry in eastern Germany. Numerous studies point to the central importance of innovation activities for the improvement of a company's competitiveness. These activities are analysed at Ifo Dresden annually on the basis of Ifo surveys, the results of which also provide information on the innovation behaviour of industry in Saxony. Despite unfavourable general conditions, the innovation activity of Saxon industrial firms was maintained at a still relatively high level in 2004. However, unfavourable market prospects, profit and financing problems are preventing many enterprises from further expanding their available innovation potential.

In a study for the Oberlausitz-Niederschlesien region, it was confirmed that to an ever-increasing extent the competitiveness of regional economic systems is determined by the ability of enterprises to develop and market new products and production procedures with the available **human capital**. A possibility to compensate for the disadvantages of a small- and mid-sized enterprise structure is the increasing use of networks for R&D projects, which, by combining strengths, offer businesses implementation opportunities and thus growth potential.

Saxon industry was also on a growth course in 2004. The sales of Saxon enterprises increased at an above-average pace in a comparison for Germany. This development is based not least on successful **structural change** in manufacturing towards technology and human-capital-intensive industries.

Labour Market and Social Policy in Saxony and the New Länder

A further concentration of the Dresdner branch is on the labour market and social policy in Saxony and the

new Länder. The observation and analysis of the Saxon and eastern German labour market is an ongoing task.

Ifo Dresden also closely examines the issue of demographic change. Saxony is particularly affected by demographic change. The population decline that began in 1990 will continue in future with a strong drop especially in the working age population. In order to avoid negative effects on the growth potential of the Saxon economy, policy options have been presented to help prevent a deficiency of skilled workers. The results of this research were published as *Ifo dresden studien* 36. In addition a preliminary study on the effects of demographic change at the local level was conducted for capital city of Saxony, Dresden.

Labour market reform is a further, current research area. The Hartz IV reforms were a step in the direction of reducing transfer payments, but the disincentives for welfare recipients to take on a job have hardly been reduced. How incentives to work can be increased using fiscally and socially compatible measures was presented by the Ifo Institute in 2002 with its welfare-to-work proposal. Among other things, the Ifo proposal calls for a reduction of basic services for all transfer recipients fit to work. In compensation a low-wage subsidy is granted to support employment in the first labour market. Welfare-to-work is designed such that the sum of labour income and government support even for part-time workers would lead to a household income that would amount of that of previous transfer income (ALG II – second phase of unemployment compensation).

The Dresdner branch deals with a possible implementation of the proposal for Saxony and advises municipalities that have opted for the independent provision of the long-term unemployed within the framework of the experimentation options of Hartz IV.

EU Eastern Enlargement and Transformation

The creation of the Single Market is an important pillar of the European Union. With the accession of ten countries on 1 May 2004, the cross-border activities between old and new member states will be further facilitated, by which the integration of the European

Saxony's high-level
of industrial innovation
activity

economy will also be advanced. For the trade in merchandise, the major barriers have already been removed as the so-called European treaties have taken effect. In contrast, the free movement of labour has not been completely liberalized. With a transition period of up to seven years, both the old and the new members have been given the opportunity to adjust to the new situation. Against the background of the recent enlargement round, Ifo Dresden has estimated for Saxony the migration and commuter potential from the eight central and eastern European countries (CEE) and published the results in *ifo Dresden berichtet*.

With the accession of the new member states, the population of the European Union increased by some 74 million to approximately 455 million people. It is well-known that the old EU member states are bracing themselves for demographic change. But also in the new EU member states, low birth rates, a negative migration balance as well as increased longevity will mean an even more serious problem from demographic change than in the old EU states. In light of this population development, some CEE countries reformed their pension systems fundamentally at the end of the 1990s. To be sure, the increase in pension costs has been stopped and the trend to early retirement has been slowed down. However, pension reforms in these countries have not yet been completed.

Saxony is particularly affected by EU eastern enlargement, since it borders on both Poland and the Czech Republic. Furthermore, Saxony has a high rate of unemployment. In an empirical study, the influence on the Saxon labour market of the expanded market between Saxony and eastern Europe will be analysed. Foreign trade effects will be theoretically modelled and econometrically estimated for Saxony and the new Länder.

Public Finance and the Promotion of Economic Development in Saxony

Public-finance research concentrated on extending the long-term forecast of the budget for the Free State of Saxony. In addition to the fiscal equalisation scheme, work focused on the second phase of the Solidarity Pact, future burdens from pension insurance, municipal revenue sharing, demographic change as well as the

design and use of assistance funds the framework of the project "Eastern Reconstruction". In this connection a research project was conducted for the Federal Office for Building and Regional Planning which examines the decline of the municipal investments observed in recent years as well as the state of municipal finances.

Not only the gradual expiration of the Solidarity Pact poses considerable problems for the Länder but also the modifications of EU structural assistance as of 2007. For the support period 2007–2013 the cards are being reshuffled in the allocation of funds during the current negotiations. On the basis of the restructuring of EU regional policy as of 2007 proposed by the EU Commission, Ifo Dresden carried out different model calculations for future funding for the new Länder. The study identified the necessary adaptation requirements and what can still be changed during the negotiations.

Projects Completed in 2004:

InnoDreiländereck

H. Schmalholz, for the Centre of Technology and Foundation Bautzen (Technologie- und Gründerzentrum Bautzen), January 2003 to December 2004, publication in: *ifo dresden studien 38*, Ifo Institute, Dresden, Munich 2005.

With its assistance programme EFRE 2000–2006, the European Commission supports innovative measures in three strategic project areas. The measures of the regional programme for Saxony carried out in 2002 to 2004 dealt with these strategic areas in the form of five individual projects. The project *InnoDreiländereck* is research in the first project area: Regional Economies Based on Knowledge and Technological Innovation.

Starting with a comprehensive analysis of the innovation potential available in the area of Oberlausitz-Niederschlesien among enterprises and universities, a number of possible measures was identified in which the innovative capacity of the economy and its competitiveness could be improved by implemen-

[Ifo study on the impact of EU eastern enlargement on Saxony](#)

[Model computations for the modification of EU structural aid](#)

Short supply of highly
qualified specialists
in 2006

ting concrete action and new projects. The project used the instrument STRINNOP (strengthening the regional innovation profile) – with the help of which an innovation profile can be created using ten investigation areas and numerous single indicators – to describe the regional innovation landscape, to derive policy recommendations and for the subsequent evaluation of implementation success. This approach has already been used by twelve other European regions to help develop their innovation strategies.

Public Infrastructure and Municipal Finance

T. Fester, M. Thum together with Ifo research professor H. Seitz, TU Dresden, for the Federal Office for Building and Regional Planning, August 2003 to September 2004, publication in: *ifo dresden studien* 37, Ifo Institute, Dresden, Munich 2005.

The infrastructure and the industrial investment promotion are key components and control instruments of the "Eastern Construction" project and thus important for economic growth. Against this background the study examined the decline in municipal investment activity in eastern Germany. After a detailed analysis of the development of municipal finances at a regionally disaggregated level, the causes of the investment decline will be examined, with high running costs and the high level of debt being the main factors.

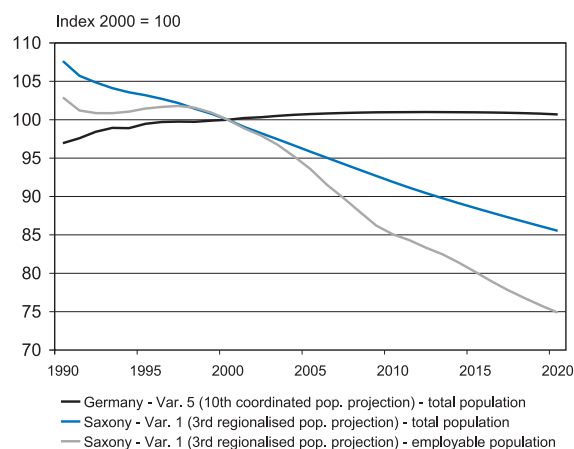
The research provides evidence that the Länder have expanded their share of available resources at the expense of the municipalities. A growing trend was also observed to use the reconstruction transfers to a smaller extent for investments. The study presents a detailed analysis of this problem, with a close look at the different investment support-programmes and the differences in their effects. A simulation calculation until 2020 is also made which includes the negative effects of the expiring solidarity funds and also the demographic effects on public finance. The results show that the budget structures of eastern German Länder and municipalities must be adapted in the coming years in order to again divert more funds into investments. In future, in light of demographic change and strained public budgets, the assistance funding must have a stronger programmatic and geographical orientation.

Demographic Development of the Free State of Saxony Analysis and Strategies Regarding the Shrinking of the Labour Force

W. Gerstenberger, B. Grundig, C. Pohl, H. Schmalholz, M. Thum, M. Dittrich and G. Markwardt, for the *Sächsische Staatskanzlei*, November 2003 to March 2004, publication in: *ifo dresden studien* 36, Ifo Institute, Dresden, Munich 2004, and extracts in: *ifo Dresden berichtet* no. 3/2004.

In the next 20 years the effects of demographic change will also be visible on the labour market in Saxony. The supply of labour will decrease due to the shrinking population of working age people. Demographic change may also affect labour demand if, for example, innovative enterprises fear locational disadvantages because of the shortage of young talent. In the light of demographic change, it is task of policy-makers to recognise the dangers for Saxony and design suitable counter-strategies. The identification of possible measures, with which the Saxon government can counteract the long-term loss of human capital, is the goal of this project.

Population of Saxony and Germany



Source: Statistical Office of Saxony; Federal Statistical Office, Germany; calculations by the Ifo Institute.

The study shows that labour markets will develop very differently, depending on the qualifications of workers in Saxony. Without countermeasures, qualified workers could be in short supply already in 2006, which would impair growth opportunities in Saxony. No long-term

improvement of the job chances for lesser qualified workers from demographic change is evident, however. To react to the changing size of the labour force and to safeguard the supply of human capital in Saxony in the long-term, some policy instruments are available, whose effectiveness is examined in the study. In particular a new direction in immigration policies and later retirement could decrease the threatening shortage of highly qualified workers. The increase in the labour participation rate of highly qualified women, on the other hand, is of lesser importance quantitatively. Whereas the above-mentioned policy measures can bring results already in the short and medium term, the formation of new human capital is only conceivable as a long-term strategy.

The research results were presented at the symposium, Demographic Summit: Demographic Change in Saxony, which was organized by the Saxon State Chancellery and the Bertelsmann Foundation, and met with wide media response.

Dresden Labour Market under Demographic Change, Part I

M. Berlemann, B. Grundig, C. Kriehn, M. Thum, feasibility study for the capital city of Dresden, November 2004 to December 2004.

In this feasibility study the starting points and methodology for an analysis of the effects of demographic change on the labour market of Dresden were discussed. This was based on the expertise on demographic change in Saxony prepared by Ifo Dresden for the Saxon State Chancellery.

The methodology for the Dresden project is not completely identical with that of the Saxony project since further important variables must be included in a local study. The extensive commuter relationships with the surrounding rural districts, for example, play an extremely important role, since the labour supply for Dresden comes from both the city and its surroundings. In an expanded study, further scenarios of the development of labour demand must also be considered.

Dresden as a University city offers favourable general conditions for satisfying the rising demand for qualified

specialists. If labour scarcity among the highly qualified arises, a modification of migration behaviour of graduates can set in. More graduates would then find sufficiently attractive jobs in Dresden and would not have to migrate for professional reasons. The follow-up study will estimate the additional potential labour force that will arise due to non-migration.

Improvement of the Market Position of Saxon Industrial Firms

H. Schmalholz for the *Sächsische Aufbaubank*, June 2004 to November 2004.

Studies in the mid-1900s confirmed that the sales prices of eastern German products that were qualitatively equivalent to western German products were much lower. A survey of 30 enterprises of the Saxon metal and electrical industries confirmed that price concessions were used as a stimulus to gain a foothold in the markets in the early 1990s but that they no longer exist. The study revealed a great number of successful business stories that the public is not sufficiently aware of, not only in the growth centres but also in the border areas. Businesses expend great efforts on expanding their product offer, either to safeguard market shares with a new product or to implement innovations in new products and processes in order to remain competitive.

European Regional Prospects 2004

M. Votteler for Cambridge Econometrics Ltd., January 2004 to March 2004, publication in: European Economic Research and Advisory Consortium, ERECO (eds.), *European Regional Prospects. Analysis and Forecasts to the Year 2008 for European Cities and Regions*, Rotterdam 2004.

Within the framework of the project for Cambridge Econometrics Ltd., the regional analysis and forecasts made by Cambridge Econometrics were tested and analysed for the eastern German NUTS-2 regions. This led to the identification of the stage of development of the new Länder as well as the development outlook for the coming years. For the city regions Dresden and Leipzig, which correspond to the Saxon government districts, the economic profile and development outlook were also determined. The project builds on

[Dresden offers attractive jobs for university graduates](#)

[ERECO research project](#)

the work of previous years: "European Regional Prospects 2003" and "European Regional Prospects 2002".

Current Projects:

Labour Market and Social Welfare in the New Länder

B. Grundig, C. Kriehn, M. Thum ongoing since June 2003.

For the reform of social welfare and unemployment assistance, the Ifo Institute put forward its welfare-to-work proposal in 2002. The reform proposal contains a scenario for eastern and western Germany without dealing in detail with regional differences. However, the new Länder in particular are in a special situation, both with regard to the labour market situation as well as the fiscal consequences of the reform for the Länder and municipalities. The project will thus examine the impact of the reforms on the labour market and public budgets in the new Länder and Saxony in particular.

In addition to the analysis for Saxony, work is being done on a model for implementing the Ifo concept at a regional level. Without changes or exceptions in the legal system, however, implementation that retains the stimulus of the Ifo concept will hardly be possible. An improvement in what welfare recipients can earn in addition and the performance of wage substitute services is only possible to a limited extent. The low transfer withdrawal rates called for in the Ifo model and no transfer withdrawal for earnings up to EUR 400, are not in accord with existing regulations. In addition a reduction in transfers for those who do not work is problematic but is urgently necessary if the incentive system is to function.

Migration in the Expanded European Union

C. Pohl, M. Thum ongoing since 2002, excerpts published in: *ifo Dresden berichtet* no. 2/2004.

In its last report, the Expert Council for Immigration and Migration pointed out that some economic sectors in Germany are already experiencing bottlenecks in fin-

ding qualified personnel. This problem will intensify due to the amplified demand for well-trained employees – as a result of technological progress – and demographic change. Immigration is one instrument for coping with the coming challenges. It is, however, not only necessary that the immigrants are well qualified people but that they are also successfully integrated into the labour market and society. Since the majority of EU member states face similar challenges, the competition for highly qualified employees will intensify. This study examines Germany's appeal as an immigration country and the integration of immigrants into the labour market.

Governance and Efficiency of the Public Sector in the CEE Countries

C. Pohl, T. Fester ongoing since 2001, excerpts published in: *ifo Dresden berichtet* no. 2/2004.

Since the beginning of the 1990s great amounts of foreign direct investments have flowed into the new EU member states. The attractiveness of these countries for businesses is seen especially in their smaller regulation density and their efficient administration in addition to their low labour costs and smaller burden of taxation. However, in its monitoring reports, the European Commission reaches the conclusion that the problem of corruption is still widespread in the central and eastern European countries. Against this background it is analysed to what extent the new EU member states have achieved headway in recent years in fighting corruption and in reforming the public sector.

EU Structural Fund Promotion in Saxony, Eastern Germany and the CEE countries

T. Fester, M. Fuchs, C. Pohl ongoing since 2004, excerpts published in: *ifo Dresden berichtet* no. 4/2004 and no. 5/2004.

At the latest in the course of the enlargement of the European Union with ten new members on 1 May 2004, the discussion on the future design of the EU budget and also EU regional and structural policies will be taken up. Assistance from the Structural Funds and how these funds are spent are essential elements of the economic and structural policies of the new Länder.

The Ifo welfare proposal in the new Länder

The new EU member states already profit from the current support period, 2000–2006, and receive Structural Funds for 2004–2006. In 2007 fundamental change in regional assistance will occur, with the beginning of a new support period (2007–2013) and the complete integration of the new members into the EU support and assistance system. The study will thus examine the impact on Germany and especially Saxony and the new Länder of the various proposals for the design of the new support period, such as the proposal of the European Commission.

Estimation of the Impact of the Summer 2002 Flood on Saxon GDP

M. Berlemann, G. Vogt, ongoing since 2004.

This project will estimate how the economy in Saxony would have developed had the 2002 flood not occurred. With the help of the business-cycle forecasting, an ex-post forecast of the most important economic sectors will be made and then compared with actual developments. The background of the research is the question of whether the post-flood reconstruction measures “artificially” exaggerated economic growth for 2002 and 2003, reducing Saxony’s chance of remaining an EU Target One support area.

Experimental Stock Markets as a Forecasting Instrument

M. Berlemann, T. Fester, B. Grundig, C. Pohl, G. Vogt, on-going project since 2004.

The goal of this project is to examine the extent to which experimental stock markets can be used as a forecasting instrument in the area of macroeconomic variables. A fundamental concept has been worked out in a paper. The next step is to design concepts on how experimental share markets can be used in the area of industry forecasts, e.g. for sales. In addition the employability of an expert forecasting system in the area of business-cycle forecasts (of GDP, unemployment rate, inflation) will be examined by means of experimental markets.

Federalism and Convergence Processes within Countries

M. Berlemann, C. Leßmann, M. Thum in co-operation with G. Hirte, Technical University of Dresden, ongoing since 2004.

This project is an empirical examination of the effects that the institutional design of a federal system has on convergence (or divergence) processes between the individual regional authorities within a country. Important institutional features are the national revenue sharing system, the tax and spending autonomy of local governments or their legislative competency. In a first step, suitable indices will be created that realistically reflect these and other institutional features in order to determine their influence on the spatial differences in standards of living, using a panel-analysis for several countries. These disparities are registered by means of various indicators of living conditions, for example, income spreads, per-capita GDP or life contentment.

Measuring the impact of federalism