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1. Editorial

The past year was a period of transition for our Institute which has not yet been completed. HEINZ HAUSER, who was head of the international economics department since 1981 and managing director since 1993, left his position as director effective end of July 2009 — one year after being appointed professor emeritus. However, he remains available to us in an advisory capacity, for which we are extremely thankful to him. His successor, CARSTEN FINK, commenced his activities at the University of St Gallen and at our Institute in February 2009. In April, he was offered the position of chief economist of the World Organisation for Intellectual Property (WIPO) in Geneva. As unfortunate as this turn of events was for the University of St Gallen and our Institute, we can understand why he accepted this offer. We would like to take this opportunity to express our sincere congratulations and wish him all the best in his new occupation. He left the University of St Gallen at the end of July, so that a definite successor for HEINZ HAUSER needs to be found. The search for a suitable successor has remained unsuccessful to date. Unfortunately for us, two promising and highly qualified candidates have turned down an offer from the University of St Gallen. Therefore, the position remains open and we are unable to say when it can be filled. This demonstrates how difficult it is, even for very good universities, to recruit professors with outstanding credentials today.

The Institute welcomes MARK SCELKER, assistant professor in the economics department of the University of St Gallen who has found his new home at the SIAW (Swiss Institute for International Economics and Applied Economic Research), where he is a member of the economic policy department. He graduated from the University of Fribourg in the year 2007 with a paper on audit courts and audit boards as institutions for the control of governments and bureaucracies, and will continue examining issues related to matters of political economy. We welcome his support at the Institute and in the economic policy department.

Even though our staff number has temporarily declined, the work of the Institute continued with unflagging intensity. Many activities focused on the financial and economic crisis in the past year. This applies to the publications and even more so to economic policy consulting. Here GEBHARD KIRCHGÄSSNER got involved at both national and Canton level, examining mainly to what extent it is possible at both of these levels to fight the crisis with economic policy measures or, at least, to help alleviate the social consequences. In actual fact, the options in Switzerland are very limited. Many suggestions that were advanced and discussed in public proved absurd and, fortunately, were not implemented. SIMON EVENETT got involved on the international stage, dealing with the problem of rising protectionism. In cooperation with Professor RICHARD BALDWIN of the Graduate Institute of International and Development Studies in Geneva, he repeatedly pointed out the dangers of creeping protectionism — receiving a marked response in international discussions, which was, for example, documented in an interview with the BBC in London and in reports about these activities in the Wall Street Journal.

The ‘regular’ work of the Institute continued, of course, in the meantime. This included research, education and consulting. As indicated in this annual report, our work once again led to many scientific publications and presentations at conferences as well as newspaper articles, publications in general-interest magazines and presentations to the general public.

We do not want to end this editorial without expressing our gratitude to the supporters and staff of our Institute. As the authority responsible for higher education, the Canton of St Gallen allows us the required autonomy to structure our research and consultancy activities. We would like to thank the members of the Governing Board, chaired by Professor PETER NOBEL, as well as the members of the Institute’s Association of Sponsoring Institutions, chaired by ERIKA FORSTER, who give us financial
support and are always approachable for valuable suggestions and advice. As always, we also want to thank all of our staff for making an essential contribution to our efforts with their commitment and dedication. This year, we would also like to thank the administration of the University of St Gallen for supporting our Institute to the best of their ability during this transitional phase so that the transition, which is taking much longer than expected, can proceed without major problems.

A very special ‘thank you’ goes this year to Heinz Hauser. In the 28 years that he spent with this Institute, he identified with it like no other and dedicated himself to us. Without him, our Institute would not have reached the position it holds today. This applies to our reputation in science, politics and among the general public, especially in regards to issues related to the world trade order, to the Aussenwirtschaft magazine — which probably would no longer exist were it not for him — as a flagship of our Institute (and the University of St Gallen), and last but not least, to the solid financial foundation of our Institute today. In addition, we would like to thank him for the many open discussions about economic policy problems we had the privilege of enjoying with him. We hope he will visit us often so that we may continue this dialogue for many years to come. We would like to take this opportunity to wish him the best of health, allowing him to pursue his hobbies with joy over the coming years.

St Gallen, 4 March 2010

Prof. Dr Simon Evenett

Prof. Dr Gebhard Kirchgässner
2. Staff

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3. Research Activities

3.1 Section International Economics

Director: Prof. Dr. Simon J. Evenett

Researchers:
DARIO FAUCEGLIA (until 31st August)
JOHANNES FRITZ
DARYA Gerasimenko
MALWINA NOWAKOWSKA
MARTIN WERMELINGER

(from left to right:
Prof. Dr. Heinz Hauser, Michèle Lampert, Malwina Nowakowska, Darya Gerasimenko,
Prof. Dr. Simon J. Evenett, Johannes Fritz)
A) General Remarks

The year 2009 marked a watershed in the International Economics Section with the formal retirement of Prof. em. Dr. HEINZ HAUSER. After decades of leading this Section HEINZ HAUSER handed over these responsibilities to Prof. SIMON J. EVENETT, Ph.D. In a few words it is impossible to do justice to the numerous contributions that HEINZ HAUSER has made to the Section and to the SIAW over the years. Indeed, it was for this reason, that SIMON J. EVENETT, organized, with the Director of International Trade of the World Bank, Prof. BERNARD M. HOEKMAN, Ph.D., a conference on Valuing International Trade Rules in honour of HEINZ HAUSER in June 2009. That conference was attended by international trade experts from all over the world and provided an excellent opportunity to thank our colleague for his dedication to the University of St. Gallen and to the discipline of international economics.

The Section was temporarily joined by Prof. Dr. CARSTEN FINK, who was elected by the faculty to succeed HEINZ HAUSER. Upon accepting the Chief Economist post of the World Intellectual Property Rights Organisation (WIPO), CARSTEN FINK resigned, leaving HSG after one semester. His short tenure was marked by dedicated teaching to the International Affairs programme and the oversight of several students’ theses. All of us at the Section wish CARSTEN FINK well in his new enterprise, that of establishing serious internal economic research capacity at WIPO.

The scope of activities undertaken by the International Economics Section is not expected to change in the years to come. The careful analysis of international economic policy matters, using sound analytical tools and the relevant data, will remain the approach taken by the Section. The mix of outputs is not expected to change much either, reflecting the useful balance that has been established in recent years. This mix includes the publication of the journal Aussenwirtschaft, ably assisted by Miss MALWINA NOWAKOWSKA, and of academic papers in general. The production of expert and public policy reports, and associated publications and presentations, are important outputs too, not least because they raise the profile of the Section and the SIAW.

B) The Global Trade Alert: Monitoring Protectionism during the Global Economic Downturn

Much of the time and efforts of Prof. SIMON J. EVENETT, and his assistants during 2009 was given over to establishing, coordinating, and then implementing a worldwide independent initiative to monitor the discriminatory content of state measures taken during the sharp global economic downturn. In the first months of 2009 several trade policy analysts (including SIMON J. EVENETT) were concerned that the economic downturn would be severe enough as to induce a 1930’s-style resort to protectionism, shutting off export markets, and reinforcing losses of jobs as well as forestalling any economic recovery. The consequences for Switzerland, as an open trading nation, of such protectionism would be particularly severe. As a result, a number of protectionism monitoring initiatives were proposed; only one, however, was funded and that became known as the Global Trade Alert.

The Global Trade Alert seeks to increase the transparency of government policy choice during the recent global economic downturn by publishing reports on the internet of the likely impact of government measures on foreign commercial interests, be they importers, investors, migrants, or owners of intellectual property. The Global Trade Alert seeks to be fair, balanced, and symmetric. For example, news of state measures that liberalise trade are published as well as protectionist measures. Moreover, information on the measures affecting a nation’s overseas commercial interests is collected, not just information about the consequences of a government’s own actions. When comparability is possible, the Global Trade Alert website (www.globaltradealert.org) has been designed to generate statistics that have been used in numerous speeches and newspaper articles.
The Global Trade Alert is an initiative of the Centre for Economic Policy Research (CEPR), based in London. The CEPR is Europe’s most established network of academic researchers and Simon J. Evenett, is Co-Director of its International Trade and Regional Economics Programme. The SIAW acts as both the European partner of the Global Trade Alert as well as the coordinator of all of the regional nodes associated with the project. Approximately 20 persons around the world work part time on the Global Trade Alert.

The Global Trade Alert was formally launched on 8 June 2009 in London, U.K., by the UK’s First Secretary of State and former EC Commissioner of Trade, Lord Mandelson. Subsequent launch events took place in Brussels, Washington DC and Geneva. The Global Trade Alert produced three reports in 2009, one coinciding with the G20 Summit in Pittsburgh, USA. According to our estimates, the findings of the Global Trade Alert have been mentioned in over 200 media articles and news programmes around the world, including several articles within Switzerland. Many of these articles directly mention the University of St Gallen. Moreover, the Global Trade Alert has been covered by the very best business press in both the German- and English-speaking worlds.

The assistants of Simon J. Evenett, have been very involved in the execution of the Global Trade Alert. This initiative has provided our doctoral students with an opportunity to write articles on pressing matters of international trade policy. To date, Miss Darya Gerasimenko has established a reputation as one of the few Russian trade policy experts that writes in English. Moreover, Mr. Johannes Fritz and Mr. Martin Wermelinger have showed government use of antidumping laws to regulate imports has changed during this crisis.

Initially, it is planned that the Global Trade Alert will last 12 months, through to June 2010. In early 2010 consideration is being given to the merits of extending this initiative and, if so, in what form.

C) Contributions of senior members of the Section on International Economics

1. Prof. Simon J. Evenett, Ph.D.

Although much of 2009 was spent by Prof. Simon J. Evenett organizing and executing the Global Trade Alert, during this year he was also able to finish off his research on potential changes to Chinese commercial policy so as to make it less damaging of the environment, to promote upgrading in manufacturing, and to promote the development of that country’s service sector. Moreover, Prof. Simon J. Evenett continues to co-direct the CEPR’s International Trade and Regional Economics Programme.

With respect to teaching, Simon J. Evenett, maintains a broad portfolio within HSG and elsewhere. In addition to teaching masters and doctoral students in economics, Prof. Evenett also teaches HSG’s MBA and EMBA programmes as well as in the fast-growing and successful International Affairs programme. Prof. Simon J. Evenett remains President of the Commission to run Doctoral Programme of Economics and Finance (PEF) at the HSG. During the past year he led the successful application for a renewal of funds for this programme from the Swiss National Funds. He is a member of the commission for the Doctorate in International Affairs and Political Economy as well as a member of the Commission to overseas the HSG’s Executive (Business) School.

Professor Simon J. Evenett retained his relationship to the Ross School of Business, University of Michigan, where he holds the post of Visiting Professor of Corporate Strategy. In addition, he is a Visiting Professor at the Graduate Institute, Geneva. In 2009 Prof. Evenett was appointed a Member of the UK Competition Commission. Since his appointment to the latter body he has conducted a review of several cases as well as begun to hear two appeals against a UK regulator’s decisions.
Much of the writing of Simon J. Evenett, during 2009 concerned the implications for openness and globalization of the global economic crisis. In addition to editing three reports for the Global Trade Alert (mentioned earlier), he collaborated with Prof. Richard E. Baldwin, Ph.D., and World Bank colleagues on two larger volumes discussing crisis-related responses.

As the Global Trade Alert initiative generated more information on contemporary protectionism, Prof. Simon J. Evenett, also wrote up an analysis of its likely determinants and assessed the impact of various international trade initiatives (such as the public commitment by the leaders of the G20 countries not to engage in protectionism) in the light of these developments. This analysis has subsequently been published in Business & Politics. It is expected that the Global Trade Alert initiative will generate many other opportunities for research projects.

2. Prof. em. Dr. Heinz Hauser

2.1. Expert Reports

Prof. em. Dr. Heinz Hauser has contributed three expert opinions during 2009. Together with Prof. Dr. Christian Hauser and Prof. Dr. Peter Moser from the HTW Chur he authored a study on the importance of firms listed on the stock exchange for the Swiss economy. The study can be downloaded from http://www.economiesuisse.ch/web/de/publikationen/studien.

In an expert report to the Swiss Insurance Association SVV Prof. Dr. Hato Schmeiser and Heinz Hauser analyzed the merits of a bilateral Insurance Agreement and a general bilateral Service Agreement Switzerland with the EU. The economic impact of both would be beneficial for the Swiss insurance industry, but negotiation dynamics speak for a general service agreement and not an isolated insurance agreement.

On behalf of GTZ (Deutsche Gesellschaft für Technische Zusammenarbeit) he authored an expert report for the Kingdom of Saudi Arabia to the topic "Policies to Encourage the Internationalization of Saudi Corporates". Together with other expert reports they prepare the ground for the elaboration of the 9th development plan 2010 - 2015 of the Kingdom.

2.2. Research

During 2009 Heinz Hauser prepared three paper or book chapter contributions which will appear 2010. For Die Volkswirtschaft, issue 1/2-2010, he wrote an article on 90 years Swiss foreign economic policy. For a book project of Avenir Suisse on Sovereignty of Switzerland in a Globalized World, he analyzed Swiss foreign economic policy under the aspect of sovereignty. The relationship Switzerland - EU in the global context will be an important aspect of this dimension. Finally, for a book project of Progress Foundation and NZZ Libro Verlag he authors a blueprint for foreign economic policy for a city state. All three contributions have as common theme opportunities for a sovereign foreign economic policy in an increasingly globalized world.

3. Dr. Thomas A. Zimmermann

Dr. Thomas A. Zimmermann was appointed head of the Department “Law, Organization and Accreditation” and Member of the Board at the Swiss State Secretariat for Economic Affairs (SECO) as per 1 May 2009. At the same time, he continued his activities as a research associate at SIAW-HSG, teaching in a management development program on behalf of the institute and offering a preparatory seminar for the chairs of the yearly “Model WTO” Conference which is organized by oikos St. Gallen. In 2009, he also participated in the research initiative “Global Governance in a Plural World”, co-sponsored by
the Region of Lombardy and the Catholic University of Milan (ASERI). In this context, he wrote a paper on the return of economic interventionism which is due to be published in early 2010.

**D) Major Publications**


3. Research Activities

3.2 Section Economic Policy

Director: Prof. Dr. Gebhard Kirchgässner

Researchers:
Berit Gerritsen (since 01st February)
Florian Habermacher
Dr. Mark Schelker (since 01st August)

(in the back: Prof. Dr. Gebhard Kirchgässner, Florian Habermacher, Berit Gerritsen
in the front: Gabriela Schmid, Teresa Körner)
3. Research

3.2 Department Economic Policy

A) General Objectives of our Research

In 2009, the activities of our group were mainly concentrated on problems of the economic and financial crisis. Prof. Dr. Gebhard Kirchgaessner not only published several articles on these subjects in scientific journals and newspapers but also was active as a consultant at the national and cantonal level. Furthermore, he became involved in the discussion currently led in Germany about a new orientation of Economics as a reaction to the crisis. In addition to this, our group once again authored papers on political economy and methodological questions of economics and other social sciences.

It is also to be mentioned that we were again involved in the research area Work, Ageing and Welfare which is supported by the University of St Gallen and made possible the foundation of the St. Gallen Research Centre for Ageing, Welfare, and Labour Market Analysis (SCALA). Gebhard Kirchgaessner was acting as speaker of this research centre and leader of its research unit on Economic and Political Determinants of Welfare.

Finally, the advisory activity of our group with respect to problems of direct democracy and federalism was also continued. Gebhard Kirchgaessner was consulted by the Committee of Internal Affairs of the State Parliament of Thuringen with regard to the Gesetz zur Änderung der Thüringer Kommunalordnung (a law for more direct democracy in Thuringen’s municipalities). Furthermore, he participated both at a workshop of the Committee on Local and Regional Democracy of the Council of Europe which took place in St Gallen in May, and a conference organised by the Forum of Federations in Saragossa on the subject of the new financing model for the Spanish autonomous states.

B) The Team

Prof. Dr. Gebhard Kirchgaessner is director of the Department for Economic Policy. In his research, he focuses on topics in economic and, especially, fiscal policy, on questions of political economy, in particular in connection with the Swiss institutions of direct democracy and federalism, as well as on basic methodological questions in Economics and other social sciences. Since March 2008 he is President of the Swiss Society of Economics and Statistics.

Berit Gerritzen joined our team in February 2009. She is a Master's student in Economics (MECON) and supports Gebhard Kirchgaessner as member of his professorship staff.

Florian Habermacher has been a team member since 2008. He studied at the Swiss Federal Institute of Technology Lausanne, where he received a Master of Science in Environmental Sciences and Engineering. He has been admitted to the Ph.D. Programme in Economics and Finance and is currently participating in the Swiss Program for Beginning Doctoral Students in Economics at the Gerzensee Study Centre of the Swiss National Bank. In his dissertation, he will address questions of environmental policy.
PD Dr. Christoph A. Schaltegger, who was a member of our team from 2001 to 2002 and is still attached to our Institute as a Research Associate, completed his habilitation at the University of St. Gallen and will take up a position as full professor at the University of Lucerne in the summer of 2010.

Dr. Mark Schelker is Assistant Professor at the Department of Economics of the University of St. Gallen and associated to the Department Economic Policy of our institute. In 2007, he got his Ph.D. from the University of Fribourg; his dissertation was about the role of auditing institutions for the control of governments and bureaucracy. He will continue to work on questions of political economy.

C)  Projects

1. The Economic Crisis

In discussing the economic crisis, how to fight it and what we can learn from it, the focus was on three aspects. For one thing, the practical political question – especially within Switzerland – was the extent to which economic policy measures can be used to counteract the crisis. In view of the fact that Switzerland — next to the banking crisis — was mainly affected by a crisis of the export industry, effective measures to address the situation were severely limited. Other countries had a larger range of choices and took advantage of them. However, they are now also facing much greater difficulties getting their public budgets back under control.

In addition to these practical political questions, the internal scientific discussion revolved around the extent to which economists bear a share of the blame and, if so, what they should learn from this crisis. There seems to be no question that economists share in the responsibility, although some colleagues dispute this. After all, the past decades were defined by an unprecedented triumph of economic concepts. None of the other social sciences had a similar impact on the development of society. On the other hand, many governments — once again with the support of economists — took measures to fight the crisis that are diametrically opposed to the doctrine prevalent until recently.

Based on the resulting discussion, both at the scientific level and by the general public, the following conclusions seem inescapable:

(i) Economists have to accept their share of the responsibility for the current economic situation. First of all, this implies that they deliberate once again about the appropriate role of government for economic development. Hardly anybody will accept the current enormous impact in the long-run, but a return to the situation before the outbreak of the crisis in 2007 is also hardly conceivable.

(ii) To accept the share of the responsibility also implies that useful and feasible proposals are made how such crises can be prevented in the future or, at least, how their social consequences can be mitigated. Thus, new, not necessarily more, but better or more appropriate regulations for the financial sector are needed. But rules are also needed in order to prevent that banks become ‘too big to fail’, be it, that they are impeded from becoming too big, be it, that rules are developed which allow that even as large banks as the UBS can get bankrupt without the catastrophic systemic consequences we are afraid of today.

(iii) The fact, that several aspects of our economic systems have to be reconsidered and that new rules have to be set in some areas does, however, not imply that everything should be forgotten we have learned from Economics. In the current situation two points are particularly important. First, given today’s necessary concentration on the short-run, business cycle aspects of the economy, the long-run, growth aspects of the policy measures should also be taken into ac-
count. Straw-fires, that rapidly deflagrate, but create future burdens, are useless. Second, it is important, in particular for a small open economy like the Swiss one, that the international markets are kept open and no room is given to protectionism.

In German-speaking regions, the crisis and especially the failure of mathematical models in financial economics provoked fundamental criticism of modern Economics, dominated by the Anglo-Saxon countries, and led to demands for a return to national traditions, sometimes the German Historical School but especially Ordoliberalism. Modern Economics was, for example, marked in an editorial published in the economic section of the *Neue Zürcher Zeitung* (NZZ) as “dismal economics”. There is no doubt that Ordoliberalism has its merits, especially with respect to the new economic order in Germany after World War II. But on the other hand, its fundamental concepts which remain valid have not only been accepted by modern Constitutional Economics but are also found to some extent in political philosophies such as those of John Rawls. However, using these merits of ordoliberalism as an excuse to disconnect from international developments appears rather odd. Science, too, has become globalised and disengaging in this manner would almost certainly lead to marginalisation. While this does not speak against (international) competition between various approaches in Economics, it does speak against following a separate path in German-speaking countries.

2. The Political Economy of Direct Democracy

Work in this field mainly dealt with the problems of direct democracy. A study explored several issues related to referenda, some of which are not even perceived so that argumentation in this field is sometimes extremely naïve and/or ideological. For example, this applies when individual scientists or politicians in Germany demand a referendum on a specific issue, in the hopes that the majority of the population will back the proponent against Parliament on the matter in question. This fails to take into account that direct democracy only represents a meaningful political system if it is designed as a permanent process, rather than occasionally presenting specific issues to citizens for a vote. But then one also has to live with the fact that people will sometimes reach a decision one does not desire.

Another problem in this context is that direct democracy as well as unanimity are being demanded at the same time. For example, this applies in case of votes on constitutional issues of the European Union (EU) where the agreement of all member states is required. Experience in Switzerland has shown that these requirements are practically irreconcilable since decisions reached unanimously by all cantons are extremely rare. If referenda are to be introduced, for example at EU level, the unanimity rule would generally have to be revoked.

Work in the area of ‘direct democracy and human rights’, a subject which has recently again come to the fore following the results of the vote on the minaret initiative, also relates to political economy. The underlying cause of this problem is the conflict between the principles of democracy and the rule of law, which is revealed in Switzerland especially when an initiative is accepted which cannot be reconciled with the European Convention on Human Rights. These two principles are also backed by different philosophical traditions. The extent to which this problem which generally always applies, is particularly severe in direct democracies, is not only discussed in theory. There is a whole series of empirical studies, both for Switzerland and for the United States, that investigate whether direct democracy imposes more or less severe restrictions on the rights of minorities — or takes them into account to a greater or lesser extent — than a strictly representative system. Unfortunately, the results of these studies are not unambiguous. The possible conflict between the two principles is revealed the most clearly where the death penalty is reinstated by initiatives, for example in California, after it has been abolished there by the courts. Every country has to find its own solution to this problem. In
doing so, one needs to be aware that concrete solutions will always require compromises between
these two principles, but there are, nevertheless, solutions which only require a very minor curtail-
ment of direct political rights. Constitutional jurisdiction can play a major role here.

One of the studies examines and comments on elements of direct democracy and the federal system in
Germany from a Swiss perspective. In doing so, the conflict between direct democracy and the rule of
law mentioned above is addressed at the outset. Another conflict exists between the demand for uniform
living conditions, which is derived from the German constitution, and the demand for fiscal
autonomy by the states and municipalities. Fiscal relationships between the Federal Government and
the states in Germany are extremely complex today. The Federal Government has a say in almost all
taxes of the states, and the states have a say in almost all taxes of the Federal Government, to the ex-
tent that one can refer to the situation as a ‘joint decision trap’. Even the two federalism reforms of
recent years hardly had an impact on this. A major step forward would be taken if the Federal Gov-
ernment could independently set its share of income taxes and if the states as a whole could do the
same, even if the individual states did not have the authority to set their own tax rates. However, giv-
ing the individual states own tax authority would also be desirable, of course, along with scaling back
financial equalisation. Today’s system with extremely extensive equalisation takes away virtually all
incentives for the individual states to take care of their tax base.

3. The Political Economy of Public Auditing Institutions

MARK SCHELKER’S research agenda of the past year consisted of further advancing our understanding
of the influence of public auditing institutions on public sector outcomes. The office of the public audi-
tor is one of the main supervising institutions in modern democracies. Usually, audit offices are fairly
large bureaucracies, for example, the US Federal Audit Agency alone, the Government Accountability
Office (GAO), has a budget of roughly half a billion US dollars, and the German Bundesrechnungshof
(German Federal Audit Office) and its associated offices employ more than 1,400 individuals. Despite
these facts, there is almost no economic research on public auditing institutions. Auditors conduct
financial audits and various forms of performance audits and are supposed to serve as watchdogs
over the executive and the bureaucracy to improve transparency, fight misappropriation, fraud, cor-
ruption, wasteful usage of public funds, and general inefficiencies.

In particular, last year’s research focused on the influence of office terms and minimum professional
education requirements of the chief auditor on policy outcomes. These research endeavours are part of
a larger research effort to analyse the influence of institutional details of public auditing agencies.
Earlier work by MARK SCHELKER and Prof. Dr. REINER EICHENBERGER, University of Fribourg, has es-
tablished that auditing institutions in the public sector significantly influence policy outcomes. The
main findings are that the appointing mechanism and the audit mandate impact on policy outcomes.
A strong result is that more extensive audit mandates — including a mandate to conduct performance
audits, audits of the budget draft and individual investment projects ex ante to their implementation
— reduce public expenditures and taxes.

One of last year’s research projects analysed the influence of auditor tenure and term limits on fiscal
outcomes in the US states. Term length and term limits are crucial since they shape incentives of pub-
lic auditors. These aspects have not been the subject of economic analyses even though they proved to
significantly influence accountability and auditor performance in the corporate sector. The empirical
analyses provide evidence that auditor term limits have a strong positive and statistically significant
effect on credit ratings. States in which a term limit constrains auditor tenure to a maximum of 8 years
feature significantly higher credit ratings. When it comes to the tenure length, the results tend to show
a negative u-shape relation between term length and credit ratings, which suggest that fairly short and very long auditor tenure reduces credit worthiness as measured by credit ratings.

A second research project focused on the influence of auditor competence and expertise on economic and political outcomes. More competent auditors are more effective supervisors, a fact that reduces the leeway of agents to misreport. Since citizens and investors depend on fiscal information to make decisions, the quality of reported information is crucial. If competent auditors improve the quality of fiscal information, they can observe a more reliable signal about the state of public finances, which enables them to make more appropriate decisions. The empirical results support this hypothesis and document that minimum professional education requirements for the State Auditor are positively correlated with credit ratings and negatively with public debt and expenditure. The straightforward interpretation is that improved auditor expertise is associated with higher long-term credit ratings and lower government debt and expenditures.

4. Methodical Foundation of Economics and Other Social Sciences

In this area, ministered by Gebhard Kirchgässner, the main focus was put on further developing a study on ‘minimal morals’ to be published this year which deals with the question to what extent moral behaviour of a large number of citizens is necessary for a good functioning of the political and economic system. In philosophy as well as in economics there is the argument, basically going back to Adam Smith, that with the existence of sensibly constructed institutions, individuals’ moral behaviour is not necessary because given the ‘right incentives’, it will be in the self-interest of the individuals to behave according to moral norms. It can be shown, though, that this is not generally the case. There are many cases where one’s own action has no or hardly any retro-effect on the acting protagonist so that it is not possible to provide such incentives. This holds true, for instance, for voting decisions of individual citizens but also for many judges’ decisions. It is still important, though, that such decisions are taken responsibly. Due to the fact that numerous persons are involved in such decisions, moral requirements in this area cannot be too high and can be referred to as ‘minimal morals’ here.

Even though such situations also occur in economic life, they are much more common in politics. For instance, a consumer harms himself if he wastes his money while a voter does not have to bear the consequences of a ‘wrong’ casting of a ballot as his single vote has no influence on the overall outcome. Consequently, there is a problem in transferring the economic approach to the area of political sciences as this approach works with incentives that are hardly effective here. A further problem is linked to the fact that the economic approach usually deals with collective decisions, i.e. outcomes resulting from a large number of single, more or less independent individual decisions. Therefore, it is generally enough to merely observe typical behaviour of individuals without investigating the behaviour of single individuals as well. In political science, by contrast, this approach is not possible as soon as actions of single actors such as governments are investigated. This shows that the transfer of the economic approach on issues of political science can lead to problems that hardly ever occur in connection with traditional economic questions. This, in principle, gives room to alternative methodological approaches. However, up to now such alternatives have hardly ever turned out to be more successful.
D) Major Publications


