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1. Editorial

In 2006, the potential for research developed over the past few years could be further strengthened – research that meets rigorous academic standards, responds to pressing needs of public policy and, at the same time, is accessible to policy makers. Clear evidence of this is the fact that the competent authorities approved the application for a university-wide research priority called Work, Ageing and Welfare, one of two research programmes selected after a demanding internal and external evaluation process. Prof. Dr. GEBHARD KIRCHGÄSSNER and Prof. Dr. MICHAEL LECHNER played an important part in the preparation of the project application and together with colleagues from the departments of economics, business and cultural science, they will contribute a number of research projects in the areas of labour market research and welfare analysis. In order to strengthen interdisciplinary cooperation, participating colleagues created the St Gallen Research Centre for Ageing, Welfare, and Labour Market Analysis (SCALA). Bundling resources is an important step to better position research in the international academic discussion as well as in the policy debate in Switzerland. Work, ageing and welfare is a topic with a great potential for theoretical achievements responding to pressing needs of public policy. We are proud that our Institute is playing an important role in this venture.

On 1st December 2006, Prof. Dr. SIMON EVENETT and Prof. Dr. HEINZ HAUSER organised a research conference on Asian Regionalism, National Security and Free Trade Agreements. Given the rising trend for new bilateral and regional trade agreements particularly in the Asian area, this topic covers one of the main challenges for the multilateral trade order. By connecting bilateral and regional free trade agreements with regional security concerns, this conference contributed to highlight a relationship that has rarely been treated seriously in academic research. Participating researchers from Asia, Europe and the United States particularly welcomed the interlinking of theoretical discussions with topical policy issues. The concluding discussion on open research questions will give a strong impulse to our future work.

In spring 2007, a number of major multi-year projects in the area of labour market research will come to an end. However, prospects are good that new projects will allow us to continue our research and consulting activities in the area of labour market policy in the years to come. Continuity and a further strengthening of our potential characterised 2006 and will continue to be important objectives for 2007. This applies to our labour market research group as well as to the international economics and public policy departments.

We are very pleased to announce that Dr. MARKUS FRÖLICH, lecturer for econometrics at the University of St Gallen and former collaborator of our labour market department, received an offer for a professorship at the University of Mannheim. Congratulations! The academic success of our junior staff members is the best proof for the internationally competitive research conducted at our Institute.

We are convinced that this combination of internationally renowned research activities with its strong focus on pressing questions of national and international policy formulation contributes to strengthening the reputation of our university and the St Gallen region as a whole, since it has been formulated by the Rectorat as a strategic goal to implement the Vision 2010 of the University’s Governing Board. The Canton of St Gallen gives us a high degree of autonomy, thereby facilitating our international orientation; a governing structure for which we are thankful to the authorities.
Our thanks also go to the members of the Institute's Association of Sponsoring Institutions, chaired by ERIKA FORSTER, member of the Swiss Upper Chamber, who give us financial support and provide us with valuable suggestions and advice. Last but not least, we would also like to thank all our collaborators. Without their dedication and commitment, we would not be able to maintain our high level of activity in the national and international arenas.

St Gallen, 15th March 2007

Prof. Dr. Simon Evenett         Prof. Dr. Heinz Hauser

Prof. Dr. Gebhard Kirchgässner  Prof. Dr. Michael Lechner
1. **Staff**

**Steering Committee**

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Prof. Dr. **Aymo Brunetti**  
Ständerätin **Erika Forster**  
Prof. Dr. **Bruno Jeitziner**  
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**Departments**

*International Economics*

*Prof. Dr. Heinz Hauser*  
Christof Böhlter (since 1 June)  
Ingo Borchert  
Claudia Brühwiler (since 1 April)  
Martin Gedult von Jungenfeld (until 30.09.)  
Etiennne Huber  
Sangeeta Khorana (until 31 January)  
Andrea Mächler (since 1 October)  
Patrick Rudolph (until 31 October)  

*Economic Policy*

*Prof. Dr. Gebhard Kirchgässner*

Thomas Maag  
Silika Prohl  
Thorsten Uehlein
Labour Market and Econometrics

Prof. Dr. Michael Lechner

Stefanie Behncke
Beatrix Brügger (since 1 December)
Dr. Markus Frölich
Martin Huber (since 1 April)
Alexandra Krebs (since 1 April)
Dr. Ruth Miquel (until 28 February)
Dr. Rosalia Vazquez-Alvarez
Stephan Werner (until 31 October)
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Prof. Dr. Patrick A. Puhani
Prof. Dr. Jeffrey Smith
Prof. Dr. Jürgen Wolters

Research Associates

Dr. Christoph A. Schaltegger
Dr. Sacha Wunsch-Vincent
Dr. Thomas A. Zimmermann

Advice Service for Empirical Economic Research

Dr. Markus Frölich

Secretariat

Edith Memeti-Keller
Gabriela Schmid
3. Research Activities

3.1 Section International Economics

**Directors:** Prof. Dr. HEINZ HAUSER  
Prof. Dr. SIMON J. EVENETT

**Researchers:**  
CHRISTOF BÖHLER (since 1 June)  
INO BORCHERT  
CLAUDIA BRÜHWILER (since 1 April)  
MARTIN GEDULT VON JUNGENFELD (until 30 September)  
SANDEETA KHORANA (until 31 January)  
ANDREA MÄCHLER (since 1 October)  
PATRICK RUDOLF (until 31 October)

**Student Research Assistant:**  
ETIENNE HUBER

**Secretariat:**  
EDITH MEMETI-KELLER

(From left to right, front row: Michael Meier, Prof. Dr. Simon Evenett, Stefanie Hofmann, Edith Memeti-Keller, Prof. Dr. Heinz Hauser; back row: Dr. Thomas Zimmermann, Ingo Borchert, Christof Böhler, Maria Magdolna Tariska, Andrea Mächler, Claudia Brühwiler, Etienne Huber)
A) General Objectives of Our Research

Prof. Dr. SIMON EVENETT and Prof. Dr. HEINZ HAUSER co-chair the International Economics Section. Both share a strong belief that the Institute's activities should be based on rigorous theory but have a strong policy orientation.

Much of our research is devoted to developing a better understanding of the multilateral trading system and its consequences for international commerce and the wealth of nations. An important objective is to undertake research that is of interest to scholars, policy-makers, leading business people, and members of civil society who follow developments in the multilateral trading system. As a result, our research often draws upon institutional knowledge and recent policy proposals while, at the same time, using microeconomic tools and econometrics. In this respect, a challenge often faced is to maintain academic rigour without losing the non-academic audience for our research. The dissemination of our research to many different fora is a complementary objective, and we go to considerable lengths to present our research not only at academic conferences and international organisations such as the OECD, WTO, UNCTAD, World Bank, and regional development banks, but also to non-specialist audiences. Given the diverse audiences for our research findings, it should not be surprising that our writings are published in a wide range of different formats and sources, including our own publications, the journal *Aussenwirtschaft* and the *WTO-News*.

B) The Team

Prof. SIMON EVENETT, Ph.D. took up his post of Professor of International Trade and Economic Development, Department of Economics, University of St. Gallen, on 1st April 2005 and became a Director of the SIAW at the same time. He serves on the Programme Commissions for the Department of Economics’ Ph.D. Programme for Economics and Finance and the HSG Executive School of Management, Technology and Law. Furthermore, he teaches in many different courses with an international orientation in various teaching programmes of the HSG. His research interests cover international trade and related policy areas.

Prof. Dr. HEINZ HAUSER has chaired the International Economics Section since 1981 (since 2005 jointly with Prof. Dr. SIMON EVENETT). He is a member in the Programme Committee of the Bachelor and Master Programme in International Affairs and Governance where he mainly teaches international economics courses. He is the managing editor of the journal *Aussenwirtschaft* and the *WTO-News*. In his research, he concentrates on institutional questions regarding the WTO and its dispute settlement process.

After his departure from the Institute, Dr. THOMAS ZIMMERMANN was elected Research Associate. He continues to support the publication of the *WTO-News* – the newsletter he initiated and developed in the following years with great care. On behalf of the Institute, he also teaches in management seminars on international economy.

Dr. SACHA WUNSCH-VINCENT has also kept in close contact with our Institute as Research Associate. He is working with the OECD in a unit on digital trade.

INGO BORCHERT is a graduate of the Gerzensee doctoral programme and has joined the new PhD Programme in Economics and Finance. He received a one-year grant from the Swiss National Research Foundation to continue his studies at American and British universities, starting on 1st February 2006. After his return in February 2007, he will again join the research team in international economics.
CLAUDIA-FRANZISKA BRÜHWILER joined the Institute on 1st April 2006 as teaching assistant. In this capacity, she namely supports Prof. Dr. HEINZ HAUSER in the very intensive core course European Integration in the Master Programme International Affairs and Governance.

MARTIN GEDULT VON JUNGENFELD’s dissertation project concentrates on the relationship between liberalisation of financial services in the WTO and liberalisation of the capital account in the balance of payments. Until summer 2006, he was editorial assistant of the WTO-News, which does not only include the usual editorial tasks but also much of the production. He left the Institute at the end of September 2006 to concentrate fully on his dissertation project.

STEPHANIE HOFMANN-KOTHMILLER supports Prof. Dr. SIMON EVENETT in research and teaching. Since fall 2006, she has also been editorial assistant for the journal Aussenwirtschaft.

MICHAEL MEIER is research assistant to Prof. Dr. SIMON EVENETT and has taken the responsibility as editorial assistant of WTO-News.

PATRICK RUDOLPH left the Institute at the end of October 2006 to join the KfW in Frankfurt, Germany. He entered a trainee programme in the area of transition and developing countries which provides him with a very supportive environment for his dissertation project in the field of development assistance.

MARIA MAGDOLNA TARISKA supports Prof. Dr. SIMON EVENETT in research and teaching. ETIENNE HUBER is editorial assistant for the journal Aussenwirtschaft.

CHRISTOPH BÖHLER (International Trade and WTO), ETIENNE HUBER (editorial assistant of the journal Aussenwirtschaft until fall 2006) and ANDREA MÄCHLER (country documentation for selected African countries with potential to become emerging economies) supported Prof. Dr. HEINZ HAUSER for selected projects.

C) Own Publications

1. Journal Aussenwirtschaft

The Institute publishes the journal Aussenwirtschaft and can already look back on 61 volumes. Since its start, the journal has been developed as a publication meant to bridge the gap between theory and practice. This aim manifests itself in a number of characteristics: The journal addresses with priority topics that play an important role in the economic policy discussion. The contributions should be well-founded in theory but – through their presentation – easily accessible for practitioners. It is also an important goal of the journal to present research contributions or economic policy statements made by members of the Institute to a wider public.

In 2006, we published two thematic issues. Number I concentrated on options for Swiss international trade policy while number IV contained seven articles analysing the European Union’s New Trade Policy Initiative of October 2006 from different thematic and regional perspectives. Over the year, Prof. Dr. SIMON EVENETT (Can the Doha-Round be completed in 2006 and Global Europe: An Initial Assessment of the European Commission’s New Trade Policy) and Prof. Dr. HEINZ HAUSER (Schweizerische Aussenwirtschaftspolitik zwischen Wunsch und Wirklichkeit and Die Zukunft des Welthandelssystems) contributed four articles. The expectation that the journal should provide well-based analyses of topical economic policy issues has been well met.
2. Newsletter WTO-News

In addition to the journal *Aussenwirtschaft*, our newsletter *WTO-News* is another important instrument to position the Institute internationally. On four pages, two important issues related to the international economic order are discussed. The contributions deal with systemic WTO questions and comment on important dispute settlement cases. Moreover, short book reviews provide information on new literature that is worth reading.

In 2006 one newsletter was published (another one was made available in January 2007). Prof. Dr. SIMON EVENETT commented on the outlook for the Doha Round, whereas Dr. SACHA WUNSCH-VINCENT evaluated the WTO U.S. Internet Gambling dispute case. Since *WTO-News* constitutes a very efficient instrument to make the Institute’s voice heard (the newsletter is distributed electronically and in paper version to approximately 4000 well-selected addresses), we will make sure that in the future, there are at least two *WTO-News* distributed annually.

D) Research Focus WTO

As already noted, the International Economics Section has primarily been dealing with WTO related questions over the past few years. Prof. Dr. HEINZ HAUSER has published papers addressing institutional issues. Prof. Dr. SIMON EVENETT is currently managing a multi-year research project on the accession process of new members. However, the research focus is supported by dissertation projects of our staff members as well. Dr. AXEL FLASBARTH analysed empirically important questions concerning the inclusion of labour standards in the world trading order. Dr. ALEXANDER ROITINGER examined the general tension between binding rules and flexibility in the WTO order. Dr. THOMAS ZIMMERMANN looked at the proposals for a reform of the WTO dispute settlement system that have been put forward since 1995 and analysed their potential systemic implications for the WTO. Dr. SACHA WUNSCH-VINCENT provided one of the first comprehensive studies on the treatment of digital content services in the WTO. SANGEETA KHORANA analysed the efficiency of preferential rules of access for development, using data on Swiss agricultural imports, while XUAN Li’s dissertation covers the protection of traditional medical knowledge, including a case study for China. Both authors will be awarded their doctoral degrees in spring 2007.

In addition to these successfully completed works, other dissertation projects dealing with WTO issues are currently being undertaken at the Institute: GATS liberalisation of financial services and capital account restrictions (MARTIN GEDULT VON JUNGENFELD), Reform of the WTO dispute settlement system – The new re-balancing paradigm (SIMON SCHROPP), Financial sector transformation in the Ukraine before WTO accession (VITALIY NOVIKOV), Regional and multilateral integration of the Euro-Asian Countries (SVETLANA NURMASHEVA), and Rules of origin in bilateral and regional free trade agreements in Asia (MATTHIAS SCHAUB).

Through focusing the dissertation projects on one common thematic area, it is possible to yield synergies and to facilitate the exchange of ideas among doctoral students. For the Institute, this leads to the creation of a research programme that is mainly made possible through the self-financed work of our doctoral students.
E) Current Projects (Prof. Dr. SIMON EVENETT)

1. The political economy of trade policy and the WTO

In the last year Prof. Dr. SIMON EVENETT has been carefully following the Doha Round of multilateral trade negotiations, in particular trying to identify the deeper, structural factors which account for the little progress made during the latest trade round. In early 2006 Prof. Dr. SIMON EVENETT circulated a paper on the prospects for the WTO negotiations after the December 2005 WTO Ministerial Conference in Hong Kong, China. This paper argued that the electoral timetables on both sides of the Atlantic would make progress on the Doha Round very difficult before the next U.S. presidential election in 2008. At the time of circulation, this prognosis was regarded as very gloomy; however, the importance of domestic political factors (the central part of the argument) has now been much more widely accepted.

In order to examine the impasse at the WTO it was necessary to compare the positions and internal political dynamics of the leading trading powers (the United States, the European Union, Brazil, India, and China.) Much of 2006 was spent by Prof. Dr. SIMON EVENETT and his team trying to assemble a comprehensive picture in this regard. Three projects are worth noting in this respect. First, with MICHAEL MEIER, a paper was drafted on the determinants and likely trajectory of the current U.S. trade policy of “Competitive Liberalization.” This paper has received a lot of attention from trade policy analysts in Washington, D.C., and has been cited accordingly.

Second, again with MICHAEL MEIER, an analysis of the implications of the U.S. congressional elections of November 2006 for U.S. trade policy was undertaken. The SIAW’s analysis was the first to be circulated internationally and received considerable attention in the press (it was reported in the Wall Street Journal) and in various online “blogs” used by international economics experts. Third, a paper assessing the new European Union trade policy, titled Global Europe and announced in October 2006, was prepared. This paper contrasted the likely magnitude of the trade gains that could follow from the EU signing free trade agreements with India, Korea and the ASEAN nations with those likely to follow from other measures that European nations could take to bolster their companies’ exports to Asia. In the coming year further research on the leading trading powers is envisaged.

2. International Competition Law and Policy

Prof. Dr. SIMON EVENETT remained engaged in developments in this policy arena. He contributed a paper on the effectiveness of technical assistance programmes to the International Competition Network and presented it at their annual meeting in Cape Town, South Africa. Just before the same meeting he organised with Prof. Dr. FREDERIC JENNY of ESSEC France and the Cours de Cassation, a conference on the development-related implications of promoting competition and the proper enforcement of competition law. This conference was sponsored financially by the Canadian International Development Research Centre.

In other initiatives, Prof. Dr. SIMON EVENETT has written assessments on so-called competition advocacy and the implications of the recent resurgence of interest in industrial policy for the enforcement of competition law in industrialised and developing countries. With STEFANIE HOFMANN-KOTHMILLER, he has also assembled a large database of reports containing links between competition-related factors and the attainment of the Millennium Development Goals. This latter research was discussed at an OECD Joint Global Forum on Trade and Competition Policy and kindly has been sponsored by the Canadian International Development Research Centre.
F) Major Publications


3. Research Activities

3.2 Section Economic Policy

Director: Prof. Gebhard Kirchgässner

Researchers:
Thomas Maag
Silika Prohl
Thorsten Uehlein

Secretariat:
Gabriela Schmid

(From left to right: Thomas Maag, Prof. Dr. Gebhard Kirchgässner, Thorsten Uehlein, Gabriela Schmid)
A) General Objectives of Our Research

The research undertaken in 2006 by our department can be divided into two parts. First, our research in the field of political economy continued. Besides research on direct democracy and federalism, we also investigated the sustainability of public finances. Work in this area was again done in cooperation with former colleagues of our department, this time namely with Prof. Dr. Lars P. Feld (University of Heidelberg, Germany), Prof. Dr. Ulrich K. Müller (Princeton University, USA) and Dr. Justina A.V. Fischer who spent 2006 at the London School of Economics, Great Britain, and the Hoover Institute of Stanford University, USA, by means of a fellowship for prospective researchers granted by the Swiss National Science Foundation SNF. Second, a substantial part of our time was again dedicated to the annual report of the Swiss Council of Economic Experts (Kommission für Konjunkturfragen) which last year concentrated on the topic Reform of the Swiss Health Care System. Apart from these two main strands, a significant fraction of our resources was invested in completing the English version of a textbook on time series econometrics, written in collaboration with Prof. Dr. Jürgen Wolters (Free University of Berlin, Germany).

An important factor regarding our future research agenda was the decision of the University to found the St. Gallen Centre for Ageing, Welfare, and Labour Market Analysis (SCALA). Since past October, Prof. Dr. Gebhard Kirchgässner has been the speaker of this research centre, while also leading the research unit Economic and Political Determinants of Welfare.

B) The Team

Prof. Dr. Gebhard Kirchgässner is the director of the Department for Economic Policy. Since January 2004, he has also been president of the Council of Economic Experts (Kommission für Konjunkturfragen) of the Swiss Government. In his research, he focuses on current 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 of the economic and social sciences.

Thomas Maag joined our group in April 2006. He is a doctoral student in our University’s PhD programme in Economics and Finance and last year, he participated in the Gerzensee programme for prospective PhD students. He will do his PhD thesis in the framework of SCALA.

Silika Prohl has been a team member since July 2005. At the end of last year, she completed her dissertation about the sustainability of public finances.

Thorsten Uehlein has been a team member since autumn 2003. In his doctoral thesis, he explores the effective corporate income taxation in EU member countries and its effects on foreign direct investment.

C) Projects

1. Political Economy and Public Finances

With the exception of a survey on the fiscal effects of direct democracy which was written together with Prof. Dr. Lars P. Feld, papers in the area of political economy and public finances were mainly concerned with the connection between democratic rights, cultural impacts, income, and subjective well-being of the citizens. This research was done together with Dr. Justina A.V. Fischer and with the collaboration of David A. Dorn and PD Dr. Alfonso Sousa-Poza from the Research Institute for Labour and Labour Legislation of our University, using data from national and international surveys.
Generally, the culture of a country represented by its language or the family of languages it belongs to, has an essential impact on the answers of the respondents. In an international comparison, we could also establish a connection between the extent of democratic rights and the level of subjective well-being: The more pronounced democratic rights are the more satisfied are the people, and this effect is stronger in traditional democracies than in countries where democracy has been established only after the fall of the Iron Curtain in 1989. However, taking the language variables into our equations, we did not find a significant connection between the extent of direct people's rights and the level of subjective well-being, a finding that contradicts earlier results of other authors who claimed to have identified such a connection. Concerning the effect of income, our results speak rather in favour of the relative income hypothesis: People's satisfaction depends particularly on their position within the income distribution of their society and hardly on the absolute extent of their income.

In 2006, our most important work in the field of federalism was an expert report on the possibilities of decentralisation in Jordan which was elaborated on a mandate of the Swiss Agency of Development and Cooperation (SDC) of the Swiss Federal Department of Foreign Affairs. This expert report was prepared in collaboration with Prof. Dr. BERNHARD Ehrenzeller who headed the project and KILIAN MEYER, both from the Institute for Legal Studies and Legal Practice of our University, as well as THORSTEN UEHLEIN. At the beginning of January, we spent one week in Jordan and conducted a series of interviews with the corresponding Ministers and Secretaries of State. Whether the process of decentralisation in Jordan initiated by the King will continue and whether our proposals regarding this matter will be taken into consideration remains to be awaited.

Further work in this area concerned the new financial equalisation system in Switzerland as well as possibilities for a reform of federalism in the Federal Republic of Germany.

The main focus in the area of public finances was on the sustainability of the finances of the Swiss Confederation. This work was done in collaboration with SILIKA PROHL. For the first time, this question was studied using a rather long time period, from 1900 until 2002, with the assumption of a structural break during the Second World War. If we use the whole sample, the sustainability hypothesis cannot be rejected for the fiscal policy of the Swiss Confederation. However, analysing the time periods before and after the Second World War separately, important doubts emerge whether this also holds true for the more recent past. Hopefully, the Confederation's debt brake now being in force will in the future lead to a fiscal policy that is again sustainable.

In her doctoral thesis which was finished last autumn Mrs. PROHL performed similar investigations for some "rich" OECD countries on the one hand and for the 15 "old" member countries of the European Union on the other hand. Also permitting structural breaks in the development of public finances, she came to the conclusion that the null hypothesis of sustainable finance policy cannot be rejected in these cases either. Taking into account that the sample included countries such as Greece, this result is at least somewhat surprising.

Finally, an expert report on the possibilities and effects of a debt brake in the canton of Zurich, Switzerland, was elaborated on behalf of its fiscal authority. In this case as well, only the future will show whether the proposals of the expert report have the potential to be at least partially implemented or not.

2. Reform of the Swiss Health Care System

Studies in this field arose in the context of the annual report of the Swiss Council of Economic Experts which explicitly dealt with this subject in 2006. The starting point was, inter alia, that behind the United States, Switzerland has the most expensive health care system in the world, this in absolute as well as in relative terms i.e. as a share of GDP. Even allowing for the fact that the Swiss health care
system has a very high quality, this suggests that there exist possibilities for savings and/or increased efficiency.

Up to a certain limit, higher health care expenditure (per capita as well as in relation to GDP) leads to an improvement of objective health indicators such as life expectation and subjective indicators such as satisfaction with the health system. Switzerland, however, is probably beyond this limit; the same standard might be achieved with lower expenses as well.

However, the Swiss development is no special case but in line with an international trend towards an increase of health care expenditure. Thus, at least some reasons for this increase might be beyond the Swiss system and can hardly be invalidated if quality were not to decline.

With two exceptions, the cost structure has remained relatively constant over time: The share of costs for ambulant treatment has clearly increased, while the share for dental treatment has clearly decreased. The costs for stationary treatment pro rata have hardly changed. They continue to amount to almost half of the total costs and are very high in an international comparison.

There are three central goals public health should achieve: (i) It should be prevented that necessary medical care is not provided because of a patient’s inability to pay, (ii) wasteful spending should be avoided, and (iii) the system should reflect the individual preferences of the citizens. There are, however, trade-offs between these three objectives.

The particular difficulties in the health care system result from the common occurrence of three problems: (i) As patients are hardly able to evaluate what is appropriate for them in their respective situation, the doctor as the supplier of medical services largely determines the demand of these services ("supplier-induced demand"). (ii) Because a large part of these services it is not paid via the market where costs and benefits are in equilibrium but via insurances where this principle is relaxed, the problem of "moral hazard" emerges, i.e. that people change their behaviour after having contracted an insurance. (iii) If the premia do not depend on the risk, there is the danger of "adverse selection", i.e. only patients with high risks will take out an insurance contract. In order to cope with the latter problem, insurance was declared mandatory. This, however, creates additional difficulties, the most important one being that it provides incentives for the insurance companies to attract good risks instead of making efforts to reduce costs.

These causes can explain why the expenses of the health care system are higher than necessary to achieve optimal medical care of the population. However, they cannot account for the fact that the costs of this system have a higher growth rate than the income of the citizens. The fact that the services of this sector are "superior goods" might be responsible for the latter trend, meaning that the demand for these goods is rising over-proportionately compared to income. Thus, even after reforms, health insurance premia will still have higher growth rates than income. This cannot be changed by political measures if the quality of medical care is to be preserved.

This does not preclude, however, that savings can be achieved by reforms. For example, in the domain of basic medical care, the obligation of the insurers to take out contracts with all physicians could be abolished. Insurance companies should have the option to contract only with a selection of doctors and/or hospitals, provided that the mandatory services in basic medical care are guaranteed. They might offer different contracts, some with free and others with restricted choice of suppliers of medical services. This is, perhaps, the best measure to reduce costs as it would put pressure on physicians as well as hospitals to reduce costs and this could at least somewhat counterbalance the cost-increasing effects of supplier-induced demand.

Moreover, the risk adjustment system between the insurers should not only be definitively fixed but also shaped prospectively and oriented to some distinct criteria. The incentive for insurers to select
risks can hardly be abolished completely but it can surely be strongly reduced. This would also encourage them to make more efforts towards cost-reducing measures in order to be able to offer their clients low premia.

Regarding the reimbursement of hospitals, a change from the daily allowance lump sum to a case-based lump sum remuneration should be made as far as possible. In order to circumvent possible problems in connection with this financing form, a corresponding monitoring organisation (e.g. according to the example of the United States) would have to be created. Thus, significant cost savings in the hospital sector could be realised without lowering the quality of medical care. Furthermore, in the long run and with the exception of services in the public interest such as emergency services, a change from dual to monistic financing of hospitals should be made, meaning that hospitals would exclusively be financed by the insurances companies and not, as it is today, largely by the cantons.

With regard to newly admitted medical drugs, price adjustments according to the international price development two years after the drugs’ introduction should be accompanied by more regular revisions in order to prevent having to fix these prices for fifteen years. In this way, prices in Switzerland might converge towards the currently lower price level of its neighbouring countries. Additional savings might result from the admission of re- and parallel imports from EU countries. This could lead to a clear price pressure on medical drug prices in Switzerland.

All these considerations show that there is indeed no ideal solution. However, there are significant saving potentials that can be exploited while maintaining the quality of the Swiss health care system. In this process, competition can play a decisive role. It is not the remedy to solve all problems, but it can contribute to solve or at least to alleviate some major problems. A good solution depends on a combination of elements of competition paired with intelligent public regulation.

3. Applied Econometrics

After the German version of the textbook *Introduction to Modern Time Series Econometrics* was published in January 2006, our activities in this field were mainly characterised by the completion of the English version, again written by Prof. Dr. GEBHARD KIRCHGÄSSNER together with Prof. Dr. JÜRGEN WOLTERS (Free University of Berlin, Germany) and forthcoming with Springer in 2007. This textbook was developed from lectures held at the Free University of Berlin, Germany, and at the University of St Gallen, Switzerland. It emphasizes the practical application of methods and is intended to serve as an introduction for Master level students in particular.

A second work from this field which was done in collaboration with Dr. ULRICH K. MÜLLER (Princeton University, USA) deals with the question to which extent those who provide economic forecasts are willing to admit errors. This was examined by means of the semi-annual forecasts of the Working Group of Economic Research Institutes of the Federal Republic of Germany. Since the end of the sixties, this association of economic research institutes has been providing biannual forecasts (spring/autumn) for the current half year (one-step forecasts) and the following six months (two-step forecasts) as well as presenting values for the past six months. Our question was whether the revision of the two-step forecasts six months later take into account all newly available information or whether there is a tendency to conceal the forecast errors by revising them somewhat less. In fact, there can be found a tendency for the latter.
D) Major Publications


3. Research Activities

3.3 Section Labour Market and Econometrics

Director: Prof. Dr. MICHAEL LECHNER

Researchers:
STEFANIE BEHNCKE
BEATRIX BRÜGGER (since 1 December)
DR. MARKUS FRÖLICH
MARTIN HUBER (since 1 April)
ALEXANDRA KREBS (since 1 April)

DR. RUTH MIQUEL (until 28 February)
DR. ROSALIA VAZQUEZ-ALVAREZ
STEPHAN WERNER (until 31 October)
STEPHAN WIEHLER
CONNY WUNSCH

Secretariat:
EDITH MEMETI-KELLER
GABRIELA SCHMID

(From left to right, front row: Prof. Dr. Michael Lechner, Conny Wunsch, Alexandra Krebs; back row: Dr. Rosalia Vazquez-Alvarez, Beatrix Brügger, Stephan Wiehler, Martin Huber; top row: Dr. Markus Frölich)
A) Research Goal

The main goal of our research group is to develop and improve the empirical tools commonly used in the analysis of economic data. This allows for a better understanding of economic phenomena, with the additional benefit of providing high quality advice for the implementation of economic policies. To attain this goal we make extensive use of econometric methods and quantitative economic analyses, develop new estimation techniques, and assemble or employ new data sources in the process using, for example, administrative data at the micro-economic level provided by national authorities. We design and implement pilot applications, either independently or in co-operation with various other institutions. Once the usefulness of new tools and data has been established, non-university institutions should be able to employ them in routine applications. We require that all of our projects add to the scientific knowledge base as defined by the standards of the scientific community. With that aim in mind, we expect that each individual project will produce at least one, if not more, publications in respected peer-reviewed scientific journals. In addition, the members of our research group have contributed and will continue to contribute to national and international scientific workshops and conferences. At present, the main focus of our policy-relevant work relates to labour markets, education and health economics. However, this list of research topics is not exhaustive as we are constantly expanding our field of research activities when interesting issues arise.

B) The Team

During 2006, the members of our research team were again active participants in the scientific community. The team contributed to the scientific debate by producing a variety of discussion papers and technical reports, publishing articles as well as participating in and co-organising various scientific conferences. In addition, the group was also engaged in teaching activities at the Department of Economics of the University (HSG). In terms of teaching-related activities, the group has been involved in the creation and implementation of new graduate study programmes. Details of all of these activities (both publications and conferences attended) are listed below. In the following further detailed information is provided on each member of the team.

**PROF. DR. MICHAEL LECHNER** (at the SIAW since 1998), Professor of Econometrics, leads the team and is chairman of the Programme Commission of the PhD Programme in Quantitative Economics and Finance (PEF).

**DR. MARKUS FRÖLICH** (since 1998) is a lecturer and adviser on Empirical Research in the Department of Economics (HSG). This position involves responsibility for providing advice on empirical economic research and on the analysis of economic data. The position, which is instrumental for the Department of Economics, is under the auspices of our Institute (SIAW) and thus forms part of our group’s teaching activity. Dr. Markus Frölich also lectures in the PEF programme.

**DR. RUTH MIQUEL** (since 1998) left us in the first quarter of 2006 after a long and successful period with the group.

**DR. ROSALIA VAZQUEZ-ALVAREZ** (since 2003) is a lecturer at the Department of Economics in the Bachelor, MIQE/F and PEF programmes. In 2006, she intensified her research in the area of health economics.

**BLAISE MELLY** (since 2001) successfully completed his PhD in October 2006 and is now continuing his research at the SIAW as a post-doc.

**CONNY WUNSCH** and **STEPHAN WIEHLER** (both since 2002) have made further progress towards completing their doctoral theses.
S tefanie Behncke (since 2004) is in the process of developing her thesis project after successfully completing her graduate studies.

S tephan Werner (since 2005) left us at the end of October 2006.

Alexander Krebs and Martin Huber (since 2006), both beginning PhD students, joined us this year.

**C) Current Projects**

1. **Active Labour Market Policies in Switzerland**

Over the past three years (2004-2006), our research group has been conducting two research projects on the effectiveness of an active labour market policy in Switzerland on behalf of the State Secretariat for Economic Affairs (SECO). Their final goal is to actively promote the reintegration of the unemployed into the labour market. In 2006, Stefanie Behncke, Dr. Markus Frölich, Prof. Dr. Michael Lechner, and Stephan Werner participated in both projects.

The first project investigates the efficiency of the Regional Employment Offices (RAV) in Switzerland with the aim of developing recommendations to increase their effectiveness. In particular, we analyse the impact of certain RAV characteristics (e.g. organisation) and case worker strategies on jobseekers' employment chances. The micro-econometric estimates are based on a uniquely informative data base merging administrative information from the placement offices (AVAM), the payment system (ASAL) and the old age and survivors' insurance system (AHV) with data from a written questionnaire that was sent to all case workers and RAV managers in Switzerland. This informative data set allows controlling for jobseekers' characteristics, characteristics of the RAV and the local labour market. We put particular emphasis on the robustness of our results by applying both parametric and non-parametric estimation techniques. We also analyse effect heterogeneity by looking at different types of jobseekers.

In the course of this project, we have been able to identify a multitude of factors that increase job-finding rates. Among them are a less cooperative attitude of case workers towards their clients, direct and gentle contacts with employers, increased cooperation with other institutions and private placement offices, clear guidelines by RAV managers as well as by the cantons, increased tenure, and a younger age.

The second project, the Statistical Assisted Programme Selection (SAPS), aims at helping case workers in the Regional Employment Offices (RAV) to place jobseekers into an appropriate programme. In 2005, a pilot study was conducted in 21 RAV offices. Randomly selected case workers received specific advice as well as individual-specific expected employment outcomes for their clients via an internet-based expert system developed by us. This pilot study was continuing through to December 2005. In early 2007, about one year later, we will investigate whether clients with a case worker who received our support were more successful in finding a job than those with advisors who did not receive that support.

2. **Active Labour Market Policies in Germany**

Prof. Dr. Michael Lechner, Dr. Ruth Miquel, and Conny Wunsch conducted two research projects on behalf of the Institute for Employment Research, which is part of the German Federal Employment Agency. Using micro-econometric techniques, these projects studied the effects of various nationwide vocational education measures on the success of finding employment in Germany for participants in such programmes. These types of measures represent one of the most important components of active labour market policies in Germany. The aim of these two research projects is to better understand the
effectiveness of such labour market measures. Both research projects rely on extensive administrative micro-data sets.

The first research project focuses on the long-run effects of training programmes and their changes over time. Following programme participation on a monthly basis over a ten-year period (1986-1995), we find a clear positive correlation between the short-, medium- and long-run employment effects of training and the unemployment rate at the start of the programme. Furthermore this correlation does not vanish when we control for changing compositions of participants and programmes over time.

With regard to the second research project, first results derived from programmes conducted in the period 2000-2002 in East Germany show the typical negative short-run employment effects (so-called lock-in effects) for all types of training. However, even in the medium run (after 2.5 years) none of the programmes exhibits significant positive effects on employment.

3. Active Labour Market Policies in Austria

Starting in May 2005, we have been conducting an evaluation study in direct co-operation with the Austrian Federal Ministry for Economics and Labour (BMWA). Headed by Prof. Dr. MICHAEL LECHNER, the research group members are Dr. RUTH MIQUEL, STEPHAN WERNER, and STEPHAN WIEHLER. Using administrative data and modern micro-econometric methods, this project concentrates on the question whether different forms of programmes for different types of participants can lead to different effects on employment or salary, for example. The results indicate that effects do not only depend on programme type, but also on gender, age group and education of the participants.

In a further study, we concentrate on the effectiveness of a multiple participation in labour market programmes, so-called programme sequences. Within the dynamic treatment evaluation framework, we explicitly allow for the fact that effects of a programme participation at an earlier stage of the sequence influence the participation decision in another programme at a later stage of the sequence.

4. Econometric Methods

As part of the project Statistically Assisted Programme Selection (SAPS), we further explored the econometric methodology used for accounting for selection bias and combining different data sources. In the framework of a pilot project, the devised methodology has already been implemented in several regional employment offices (RAV) in Switzerland to guide case workers in their choice of active labour market programmes. However, this methodology could also be applied in other fields, e.g. in medical or therapeutic counselling where due to confidentiality reasons, it is often the case that only limited access to data sources is granted. The background of this methodology and possibilities for its implementation are discussed by Dr. MARKUS FRÖLICH in an article forthcoming in the renowned Journal of the American Statistical Association.

Evaluations of government-sponsored employment and training programmes typically focus on their impact on total earnings and cannot separate the effect on employment from the effect on individual wage rates. If we want to estimate the effects on potential wages, we face a double selection problem because wage rates are only observed for those who are employed, and the employment status itself may be affected by the training programme. Prof. Dr. MICHAEL LECHNER and BLAISE MELLY are currently developing a general framework allowing to address this issue.
D) Major Publications


