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1. Editorial

The year 2010 continued to be a period of transition for our Institute. HEINZ HAUSER, who was head of the International Economics Department since 1981 and its managing director since 1993, finally left his position as director in 2009. His successor, CARSTEN FINK, commenced his activities at the University of St Gallen and at our Institute in February 2009, when in April of the same year, he was offered the position of chief economist of the World Organisation for Intellectual Property (WIPO) in Geneva. He therefore left the University of St Gallen at the end of July, so that this position had to be advertised again. We were finally able to recruit RETO FÖLLMI, who is teaching as Professor of International Economics at the University of St Gallen and acting as director of our Institute since 1 February 2011. We feel fortunate to have found in him a young and active colleague and are looking forward to a successful collaboration with him. At the same time, we would also like to extend our thanks to CARSTEN FINK who gave his support not only to the University but also to our Institute during the difficult period after his departure as well.

In spite of all the problems in connection with this transition, the work at the Institute continued with undiminished intensity. Many of our activities still focused on the impacts of the financial and economic crisis. This especially applies to SIMON EVENETT who together with RICHARD BALDWIN from the Graduate Institute in Geneva founded the *Global Trade Alert* initiative, a web-based tool for the global monitoring of national economic policies to identify protectionist state measures. Only rarely has research done at the University of St Gallen received such a high level of international interest. In 2010, GEBHARD KIRCHGÄSSNER concentrated his work on health economics and policy while MARK SCHELKER continued examining control mechanisms in democratic systems.

The 'regular' work of the Institute continued, of course, in the meantime. This included research, teaching 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, contributions to blogs and presentations to the general public.

This year, too, we can report good news about former collaborators who are still attached to our Institute as Research Fellows or Associates. In spring 2009, THOMAS ZIMMERMANN was appointed head of the 'Organisation, Law and Accreditation' division as well as member of the board of the Swiss State Secretariat for Economic Affairs (SECO). After having successfully completed his habilitation, CHRISTOPH SCHALTEGGER has been elected as Professor of Political Economy at the University of Lucerne and he holds this position since 1 August 2010. LARS FELD moved from the University of Heidelberg to the Albert Ludwigs University of Freiburg (Germany) where on 1 October 2010, he became head of the Walter Eucken Institute and director of the Economic Policy Department of the Institute of General Economic Research. As of April 1 of the current year, he will also be a member of the German Council of Economic Experts. We would like to take this opportunity to express our sincere congratulations on this honourable appointment.

The Steering Committee of our Institute acknowledged the valuable work of our long-standing managing director HEINZ HAUSER by also appointing him honorary president in May 2010. We are grateful that in this position, he will continue to support and advise us for a long time to come.

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, too, we would like to thank the management 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 has taken much longer than expected, could be concluded without major problems.

St Gallen, 11 March 2011

Prof. Dr Simon Evenett

Prof. Dr Gebhard Kirchgässner

2. Staff

Steering Committee

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3. Research Activities

3.1 Section International Economics

Director: Prof. Dr. SIMON J. EVENETT

Researchers:

JOHANNES FRITZ

DARYA GERASIMENKO

MALWINA NOWAKOWSKA

MARTIN WERMELINGER

(from left to right:

Sanna Maarala, Prof. Dr. Reto Föllmi, Michèle Lampert, Lukas Schmid, Prof. Dr. Simon Evenett,

Johannes Fritz, Darya Gerasimenko)

A) General Remarks

The scope of activities undertaken by the International Economics Section has not changed much in 2010 compared to previous years, however, the public profile of our work rose considerably. The careful analysis of international economic policy matters, using sound analytical tools and the relevant data, remains the approach taken by the Section. Nor did the mix of outputs change much either. 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.

The media profile of the Section's work grew substantially in 2010, with the following accomplishments:

- Over 30 editorials were prepared for newspapers and reputed internet sites.
- 25 quotations concerning the Section's work were found in the Swiss press.
- At least 75 quotations or references to the Section's work were found in the international press, including in the best international newspapers, including the Financial Times, the Wall Street Journal, the Economist, and the International Herald Tribune.
- Approximately 35 public policy presentations were given by members of the Section.

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 2010 was devoted to a worldwide independent initiative to monitor the discriminatory content of state measures taken during the recent global economic downturn. In the first months of 2009 several trade policy analysts (including 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 five reports in 2010, one coinciding with the G20 Summit in Seoul, Korea. 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. EVENETT have showed much of world trade is affected by a small number of "jumbo" protectionist measures. MR. WERMELINGER has also undertaken a study of the differential German and British exporter responses to the global financial crisis and the role that foreign subsidies might have played in that regard.

Financial support for the Global Trade Alert will continue into 2011.

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

1. Prof. SIMON J. EVENETT, Ph.D.

Although much of 2010 was spent by Prof. EVENETT organizing the Global Trade Alert, during this year he was also able to edit a number of high profile electronic books, namely, on global imbalances and on the US-Chinese dispute over the latter's exchange rate policy. Both books have been very well received. Moreover, Prof. EVENETT continues to co-direct the CEPR's International Trade and Regional Economics Programme.

With respect to teaching, SIMON J. EVENETT, Ph.D., 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. EVENETT finished his term in 2010 as 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 oversee the HSG's Executive (Business) School.

Professor 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. He remains a Member of the UK Competition Commission.

2. Dr. THOMAS A. ZIMMERMANN

Dr. THOMAS A. ZIMMERMANN works as head of the Department "Law, Organization and Accreditation" and Member of the Board at the Swiss State Secretariat for Economic Affairs (SECO) since spring 2009. At the same time, he has 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 2010, he also finalized his contribution to 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 examined the return of economic interventionism in the aftermath of the financial and economic crises. The conference volume is currently in production; moreover, the results were presented at a public convention of academics, policy makers and business representatives at the ETH Zurich.

D) Major Publications

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- SIMON J. EVENETT, *Uneven Compliance*, 6th GTA Report, CEPR London, June 2010.
- SIMON J. EVENETT, *Managed Exports and the Recovery of World Trade*, 7th GTA Report, CEPR London, October 2010.
- SIMON J. EVENETT, *Tensions Contained.....For Now*, 8th GTA Report, CEPR London, November 2010.
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- HEINZ HAUSER and KAI-UWE SCHANZ, *Das neue GATT. Die Welthandelsordnung nach Abschluss der Uruguay-Runde*, München, Oldenbourg 1994.
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3. Research Activities

3.2 Section Economic Policy

Director: Prof. Dr. GEBHARD KIRCHGÄSSNER

Researchers:

BERIT GERRITZEN

FLORIAN HABERMACHER

TERESA KÖRNER (since 1st February)

Prof. Dr. MARK SCHELKER

(from left to right:

*Berit Gerritzen, Florian Habermacher, Gabriela Schmid, Prof. Dr. Gebhard Kirchgässner, Teresa Körner,
Prof. Dr. Mark Schelker)*

A) General Objectives of our Research

In 2010, the activities of our group included contributions not only to political economy namely those authored by Prof. Dr. MARK SCHELKER, but also, and in particular, to problems of the health care system. Together with BERIT GERRITZEN, Prof. Dr. GEBHARD KIRCHGÄSSNER elaborated a major expert report on behalf of the Swiss State Secretariat for Economic Affairs (SECO) on this issue, and also became involved in the discussion currently led in Germany about a reform of the German health care system. His contributions have mainly dealt with the question if, and to what extent, Germany can benefit from the experience gained in Switzerland, but also with regards to the main differences (and similarities) between the two systems. In addition to this, our team once again authored publications 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 activities of the *Work, Ageing and Welfare Research Centre* which is supported by the University of St Gallen and made possible the foundation of the *St Gallen Centre for Ageing, Welfare, and Labour Market Analysis (SCALA)*. Prof. Dr. GEBHARD KIRCHGÄSSNER is leader of its *Economic and Political Determinants of Welfare* research unit. In addition, our group also carried out work relating to the research unit *The Economics of Ageing and Health*.

Prof. Dr. MARK SCHELKER and Prof. Dr. GEBHARD KIRCHGÄSSNER are also involved in the Sinergia project *The Swiss Confederation: A Natural Laboratory for Research on Fiscal and Political Decentralization*, a research programme financed by the Swiss National Science Foundation (SNSF) which started at the end of 2010. Prof. Dr. MARK SCHELKER is coordinator of the sub-project *Institutions and Regulation in Switzerland*.

Finally, Prof. Dr. GEBHARD KIRCHGÄSSNER together with Prof. Dr. JAN EGBERT STURM (Swiss Federal Institute of Technology Zurich) and Prof. RICHARD BALDWIN, Ph.D. (The Graduate Institute Geneva) initiated the *Ökonomenstimme* – an internet platform launched by the Center of Economic Research of the Swiss Federal Institute of Technology Zurich (KOF). This portal aims to offer a space for the discussion of economic issues in German-speaking areas, from economists for economists and all interested in such questions. A partner of and model for the *Ökonomenstimme* is the English platform *Vox*.

B) The Team

Prof. Dr. GEBHARD KIRCHGÄSSNER is the director of the Department for Economic Policy. 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 in economics and other social sciences. Since 2008, he is also acting as President of the Swiss Society of Economics and Statistics.

BERIT GERRITZEN joined our team in February 2009. After graduating from the Masters programme in Economics (MECON) with the best examination in the academic year 2009/10, she started a PhD in Economics and Finance (PEF) in autumn. Her dissertation will, probably, concentrate on issues of health economics.

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. In 2010, he participated successfully 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 economics.

TERESA KÖRNER joined our team in February 2010. She studied in Innsbruck as well as at the Universidad Nacional Autónoma de México and the Instituto Tecnológico Autónomo de México, both in Mexico City, and received a Master of Social and Economic Sciences at the University of Innsbruck in Austria. She is currently participating in the Swiss Program for beginning Doctoral Students in Economics at the Gerzensee Study Centre of the Swiss National Bank. She too will concentrate on questions of environmental economy in her dissertation.

Prof. Dr. CHRISTOPH A. SCHALTEGGER, who was a member of our team from 2001 to 2005 and is still attached to our Institute as a Research Fellow, completed his habilitation at the University of St Gallen in 2010 and is now Professor at the University of Lucerne.

Prof. Dr. MARK SCHELKER is Assistant Professor at the School of Economics and Political Science (SEPS) of the University of St Gallen and associated to the Department Economic Policy of the Swiss Institute for International Economics and Applied Economic Research (SIAW). In 2007, he obtained his PhD at the University of Fribourg on the work of audit divisions and audit commissions as institutions for the control of governments and bureaucracy. He continues to deal with questions of political economy.

C) Projects

1. A Comparison of Health Care Systems

The aim of this study mandated by the Swiss State Secretariat for Economic Affairs (SECO) and carried out by GEBHARD KIRCHGÄSSNER and BERIT GERRITZEN was to compare the Swiss health care system with that of other highly developed and similarly structured countries in order to identify potential opportunities for increasing efficiency and/or reducing costs without compromising its quality. West European member states of the Organisation for Economic Cooperation and Development (OECD) were especially suited for this comparison, but also Australia and Canada where the structure of the health insurance system is comparable to the Swiss system. A comparison between the different systems brought, among others, the following results:

- (i) The quality of the services provided by the Swiss health care system is undoubtedly high. Furthermore, the system is fair in the sense that through a general compulsory insurance scheme, every citizen is given access to a broad range of benefits. There are hardly any explicit or implicit access restrictions in connection with a too low income level.
- (ii) The cost of this system is very elevated, too, being second highest behind the United States both in absolute and relative terms (in relation to the Gross Domestic Product). A comparison of all OECD countries shows that only in Mexico and South Korea is the percentage of the expenses covered by private households higher than in Switzerland.
- (iii) With regard to the cost structure it is noticeable that compared internationally, inpatient care makes up a very large part of total health costs in Switzerland and contrary to the development in the rest of the OECD countries, this share has not been reduced during recent years.
- (iv) In an international comparison, the range of services covered by basic medical care is comprehensive. However, this observation does not apply so much to the area of prevention and not at all to dentistry.
- (v) Expenses for long-term care in Switzerland are among the highest of all OECD countries, with a privately payable share of 60 percent which is the highest among all countries taken into account.

International comparison shows that the factors defining the quality of a health care system are namely the scope and accessibility of services, access to medicines and, to a lower degree, patients' rights and information. The cost of the health care system is not only determined by income but mainly by the age structure of society and the financing of the system. While direct additional payments made by individuals have a dampening impact, the proportion of services covered by private insurances has a cost-increasing effect.

A comparison of the structure of the Swiss health care system with that of other countries reveals mainly five distinctive characteristics:

- (i) In Switzerland, a comparatively high proportion of health costs is paid for directly by the individual citizens and not by the social health insurance;
- (ii) expenses for inpatient treatment make up a very high share of the totals costs of the health care system;
- (iii) dental treatment is almost completely excluded from the range of benefits;
- (iv) not taking dental treatment into account, prevention has a relatively low priority, and
- (v) there are no specific insurances for long-time care.

In addition to these observations, the comparison of health care systems shows further aspects with an inherent potential for increasing efficiency. This applies, for instance, to the price of pharmaceuticals. While it is true that in the past few years prices for patent-protected original drugs have largely been adapted to the average prices of other high-income countries in Europe, the low market share of generic drugs and their high price by international comparison shows that this area still holds considerable potential for cost savings.

However, increasing efficiency does not necessarily imply a reduction of costs. It can also mean an improvement of quality. This holds true, for instance, with regard to the information of the population about different aspects of the health care system. International critics, saying that compared to other countries, this information is only marginally developed in Switzerland, are justified. For example, there is still no information available about the quality of hospitals nor is there a comprehensive description of medicines available for a non-professional public.

A further aspect worth considering is the lack of insurance against damage caused by medical treatment, even if no malpractice by the doctor in charge can be proved. Given the known difficulties of proving medical malpractice, such a 'no-fault malpractice system' as it mainly exists in Scandinavian countries could considerably improve a patient's situation in such cases.

Finally, the role of competition in the health care system should be further clarified. In today's system, the focus is mainly laid on competition between health insurances, implying that by changing to another health insurer with lower premiums, the burden for the population can be alleviated. This is why such swaps are encouraged. However, as far as such a change of insurer is not connected with a change of the insurance plan to include fewer services – for example, from traditional insurance to a health maintenance organisation (HMO) insurance – nothing is saved and the total cost of the health care system therefore cannot be reduced. In fact, quite the opposite occurs. These changes incur considerable administrative costs which in turn must be covered by increasing the premiums. While choosing another insurer can make sense from an individual point of view, from a social perspective this confronts us with a prisoner's dilemma: If everybody tries to reduce his or her premiums in this way, the average premium will be increasing.

From the point of view of society as a whole, changing a health insurer only makes sense if lower premiums are justified by lower costs and not by a more favourable risk structure. The comparison

with similarly structured systems in Canada and Australia shows that, in these countries too, competition between health insurers essentially means competition for favourable risks. This is necessarily the case if risk compensation between insurers is not sufficient, something which has definitely been the case in Switzerland up to now. Whether this situation can be significantly improved by the new risk compensation system valid as of 2012 remains to be seen.

Furthermore, it is still unclear if increased competition would contribute to a cost reduction or rather to a cost-increasing quality competition, as is the case namely in the Netherlands. Competition is important in specific areas of the health care system, but it must be a carefully regulated competition where the roles of the State and the markets are carefully balanced. Only then are efficiency gains possible.

2. Political Economy

MARK SCHELKERS 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 auditor is one of the main supervising institutions in modern democracies. In particular the research focused on the influence auditor tenure and term limits on fiscal outcomes in the US states. Term length and term limits are crucial since they shape auditors' incentives to conduct effective and independent audits. 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.

Another research project in the context of the analysis of public auditing institutions focused on the influence of auditor competence and expertise on economic and political outcomes. More competent auditors are more effective supervisors, which reduces the leeway of public officials 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 expenditures. The straightforward interpretation is that improved auditor expertise is associated with higher long term credit ratings and lower government debt and expenditures.

A different research project by MARK SCHELKER asks whether voters are able to make informed and rational electoral decisions. Voters being able to make informed and rational decisions is a precondition for functioning democracies. Economists typically assume that voters are rational and that they are able to make informed decisions. This research project examines the extent to which voters are able to understand complex issues and make rational and informed decisions. The study tests this assumption by focusing on an electoral situation in which voters can reelect an incumbent who will be facing a binding term limit in this coming term. Term limited executives, lame duck, cannot be incentivized by the electoral process, since they cannot stand for reelection due to term limit legislation. Do voters take the impaired accountability of the incumbent executive into account when making voting decisions? The strongly developed system of separation of powers in the US provides the testing ground to estimate whether voters use divided government to discipline lame duck governors and moderate policy. The hypothesis predicts that lame duck governors should be confronted with an opposing party majority in the legislative with a higher probability than governors with intact reelection incentives.

This hypothesis is tested using US state data from 1975-2000. A majority of US state governors are subject to term limit legislation. At the same time the US system allows voters to directly elect the legislative as well as the executive. This regularly leads to divided government control. These two features of the US system provide the perfect testing ground for this hypothesis. Consistent with the theoretical arguments lame duck governors increase the probability for divided government by about 10 to 15 percent. The estimated effect is always statistically significant and very robust to changes in model specifications. The findings are a direct test of whether or not voting decisions follow rational patterns. The results strongly suggest that voters are able to even take institutional factors into account which influence their ability to incentivize public officials. Voters systematically use the electoral instruments at hand to discipline policymakers and moderate public policy.

Finally, MARK SCHELKER, SIMON LUECHINGER and ALOIS STUTZER analyze the influence of institutional restrictions on bureaucratic discretion on bureaucratic rents. Voters and elected officials have to delegate legislative and executive authority to bureaucratic agencies, which in turn allows civil servants to exploit their monopolistic position and informational advantage to extract rents. The control problem arises by information asymmetries, for instance, by the fact that the quality of public goods provision is difficult to estimate because it cannot be compared with goods produced in the market. Information asymmetries and the monopolistic position of bureaucracy in the provision of public goods lead to a considerable discretionary leeway which can be exploited by the administration to its advantage. Such leeway for self-serving activities of the bureaucracy are interpreted as bureaucratic rents. Institutional reforms that strengthen accountability and reduce the discretionary leeway in the public sector can alleviate this well-known problem. Such reforms gained new urgency as cash-strapped governments in U.S. states and around the world are forced to cut back spending. Adequate institutional reforms may provide a way to reduce spending without the need to reduce services by the same amount. In the empirical analysis the authors propose a new concept to measure bureaucratic rents. They suggest subjective well-being differences between workers in the public administration and other workers as a measure for bureaucratic rents. Based on this comprehensive concept for measuring utility, it is possible to empirically estimate utility differences between workers in the public and private sectors depending on different bureaucratic control mechanisms. With data for the U.S. states in 1992-1994, the empirical analysis estimates how institutions intended to strengthen bureaucratic accountability and reducing bureaucratic discretion affect this subjective well-being difference. In states with high transparency, elected auditors, and legal deficit carryover restrictions the difference is smaller. The findings are consistent with limited rent extraction under these institutional conditions.

3. Environmental Economics

FLORIAN HABERMACHER and GEBHARD KIRCHGÄSSNER intensively examined the possibility of reducing carbon dioxide (CO₂) emissions by means of CO₂ taxes or certificates. Starting point is the 'green paradox' as formulated by HANS-WERNER SINN of the Ifo-Institute in Munich, Germany, according to which the measures of the Kyoto protocol actually do bring about a reduction of CO₂ emissions in the signatory countries but at the same time also increase such emissions in other countries. They are therefore without effect or, in the worst case, even lead to a more rapid depletion of fossil fuels and thereby to a further aggravation of climate change issues. A CO₂ tax would therefore not be an effective instrument of climate policy. This argument is based on a very simple model which assumes constant extraction costs and does not take into account the possibility of backstop technologies in the future, *i.e.* technologies that generate power from solar or wind resources, for example, which could replace fossil fuels.

If these assumptions are dropped and replaced by the hypothesis that the increasing depletion of fossil fuels is accompanied by an increase of extraction costs and that, after a certain point in time, this increase will lead to the competitiveness of backstop technologies even without government subsidies, then it can be shown that a CO₂ tax is indeed an effective instrument to reduce the consumption of

fossil fuels and to mitigate climate change issues. The same holds true for a system of internationally tradable emission certificates as provided for by the Kyoto mechanism. This still applies even if not all countries participate in this policy. Thus, under more realistic assumptions, the 'green paradox' does not hold.

D) Major Publications

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