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Exchange Rate Politics in Times of Crisis



Stefanie Walter showing Zurich to her special thesis advisor, Thomas Willett.

by Stefanie Walter

The extent to which international financial markets curtail states' political autonomy has been a hot topic of debate in recent years. Stefanie Walter looks at this question by analyzing how policymakers react when their currencies come under speculative pressure. Contrary to popular notions of omnipotent financial markets, policymakers successfully defend their exchange rate against almost every second against speculative attack. Why do some policymakers devalue in response to speculative pressure while other policymakers choose to defend? How do interest groups, political regime type, and the electoral clock affect the policy choices in response to such pressure? Walter combines different theoretical frameworks with a mix of quantitative and qualitative evidence to offer a political economy explanation for these questions in her recently completed dissertation.

The first part of the dissertation looks at the role of interest groups. It presents a novel approach to identifying exchange rate

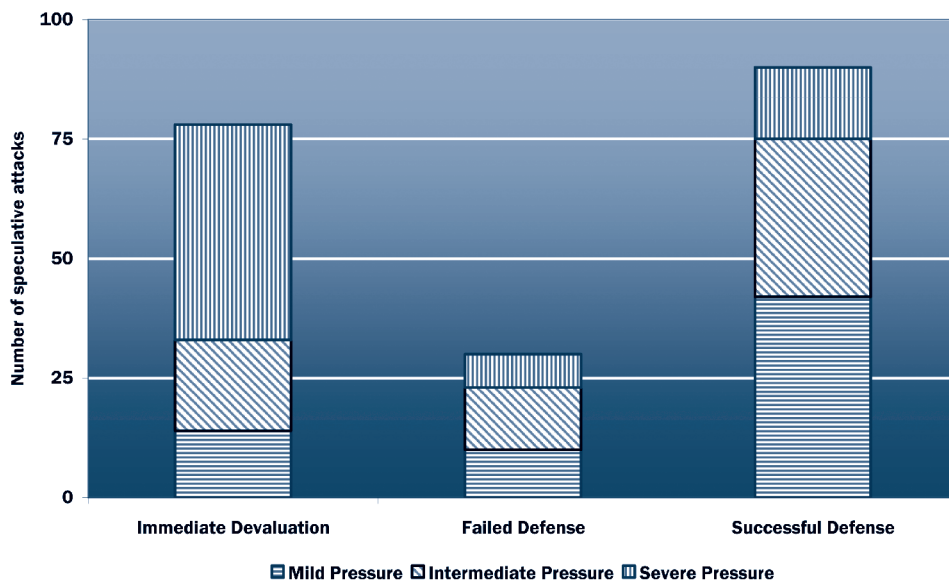
level preferences by taking into account the impact of monetary policy, the joint effect of competitiveness and balance sheet considerations, and the dynamics of preference formation. Exchange rate preferences are often purely framed in terms of depreciation or appreciation effects, but in periods of high exchange market pressure, high interest rate exposure can result in a re-assessment of a group's preferred policy outcome. That is, it may lead groups which initially preferred Exchange rate stability to favor depreciation in response to crisis. Comparative case studies of currency crises in Hong Kong, South Korea, Thailand, and Taiwan show that vulnerabilities to exchange rate and interest rate changes can explain interest groups' exchange rate level preferences and policy outcomes in these countries. Exchange rate stability was maintained when the private sector's vulnerability to devaluation was high. But when pressure intensified, exchange rates were subse-

quently devalued in countries where interest groups' interest rate vulnerabilities exceeded the potential costs of devaluation. This offers an explanation for the puzzling cases of failed defenses, where the authorities initially spend billions of dollars to defend their currency and subsequently devalue nonetheless.

Walter then investigates the effect of political institutions on currency crisis outcomes. The next chapter (co-authored with Thomas Sattler) looks at the effect of democracy *per se*. While the formal theoretical model finds a theoretically ambiguous impact of democracy on the outcome of currency crises, the empirical results clearly adjudicate in favor of a positive effect of democracy on the likelihood of an exchange rate defense. The estimation results from duration-selection models for 106 speculative attacks in developing and emerging market economies from 1983 to 2003 also suggest that there is no significant

In this Issue

<i>Exchange Rate Politics in Times of Crisis</i>	1–2
<i>Coping with Beggar-Thy-Neighbor Behavior in International Relations</i>	3–4
<i>Mens internationalis in corpore sano</i>	4
<i>Humanitarian Law through CIS</i>	4
<i>Practicing Citizenship and Struggling over Cultural Boundaries in Swiss Municipalities</i>	5–6
<i>Recent Speakers at CIS</i>	6
<i>Explaining Corporate Environmental Innovation in the German and Swiss Chemical and Food & Beverage Industries</i>	7–8
<i>International Political Economy at CIS</i>	8–9
<i>The Youth Encounter on Sustainability (YES) Japan 2007</i>	10
<i>Mapping Ethnic Groups – The GREG Project</i>	11
<i>Managing Biological Risks – Anticipation vs. Resilience</i>	12–13
<i>Conference Announcement</i>	13
<i>Books and Publications</i>	14–15



difference in the vulnerability of autocratic and democratic countries' currencies to speculative attacks.

The last part considers the extent to which politicians are willing to manipulate economic policy in return for better re-election chances and whether voters reward or punish the resulting deviations from economically optimal policy. It develops a rational political business cycle model in which incumbents face a tradeoff between their wish to signal competence and the high cost of exchange rate defense in response to currency crises. The model predicts that manipulation occurs at intermediate levels of exchange market pressure. The model's empirical implications are tested with a sample of 48 emerging market and industrialized democracies (1983-2003). The results show that defense is more likely before and devaluation more likely after elections, and that policymakers are more likely to devalue as the intensity of the crisis increases. In addition, and as predicted, incumbents who defend their exchange rate before elections have a higher probability of being re-elected when pressures on exchange rates are at an intermediate level.

The findings have implications for some broader political economy research questions. First, by emphasizing how short-run

concerns can outweigh the long-run benefits of exchange rate adjustments, the dissertation draws attention to the importance of combining time asymmetries and distributional concerns. Second, Walter's research supports the notion that crises do not mitigate policymakers' incentive to manipulate economic policy for political reasons. Even though crises increase the costs of policy manipulation, policymakers do not always implement the economically efficient policy. On the contrary, political considerations often seem to override all economic concerns even in times of crisis. Finally, the dissertation contributes to the literature on how globalization affects states' capacity to act. It shows that despite the increasing integration of international financial markets, politicians retain considerable leeway to implement those policies most consistent with their political goals. Compared with the view held by globalization skeptics, the dissertation paints a more optimistic picture about state autonomy in a globalized world.

The findings also have important policy implications. First, policy advisors need to understand that politics provides powerful incentives to deviate from economically efficient outcomes. Ignoring these incentives makes the implementation of good economic policies difficult at best and impossible

at worst. Rather than advocating one-size-fits-all policies, a stronger consideration of political constraints is likely to improve the chances for effective policy implementation. While the desirability of some of these constraints may be debatable, taking them into account will lead to more feasible policy advice. Second, some of these political constraints can be alleviated if addressed in good time. For example, measures that prevent the accumulation of large unhedged foreign currency liabilities in the first place (such as more carefully designed and well-sequenced capital account liberalization measures or strong regulatory systems) reduce the policy bias against timely devaluations. The findings suggest that prevention is the key to preserving policy autonomy in the face of speculative pressure. As an added benefit, such increased autonomy makes speculative attacks less likely in the first place.

Overall, Stefanie Walter's research shows that even in highly constrained situations such as currency crises, politics still matter. Within the limits imposed by the country's macroeconomic situation, policy preferences and political institutions shape policymakers' decisions in response to exchange rate crises. Policymakers use this latitude to implement those policies that are most conducive to their political survival. Hence, whether speculative attacks succeed or fail is not just a function of the speculators' aspirations and expectations. Rather, it is a product of political deliberations and economic constraints. ■

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Coping with Beggar-Thy-Neighbor Behavior in International Relations: Insights from Transboundary Water Pollution

by Thomas Bernauer

Environmental pollution is oftentimes a truly international problem in that pollution caused by one country negatively affects other countries. Most political science and political economy research on pollution thus far has focused on describing and explaining differences in levels of pollution between countries. In an effort to extend this research, a new project by Professor Thomas Bernauer's group examines the factors that induce countries to become better caretakers of the natural environment not only at home, but also vis-à-vis their neighboring countries.

The empirical focus of this new research is on international river systems. Rivers are the principal source of freshwater for humanity. Moreover, transboundary rivers transmit pollution between countries: in many cases, when upstream countries pollute the river, downstream countries suffer the consequences. The project examines the proposition that differences between countries in terms of their behavior towards downstream countries can be explained by political and economic factors, above and beyond geophysical conditions that also influence pollution (e.g. water

flow or temperature). For instance, does EU membership turn countries into better neighbors? Are more democratic countries more likely to be environmentally friendly vis-à-vis their neighboring countries? Does international trade between countries enhance their cooperation with regard to environmental issues? Does general international environmental commitment also produce less beggar-thy-neighbor behavior in transboundary upstream-downstream settings?

While prior research has established that democracy, EU membership, trade, and international environmental commitment tend to enhance environmental quality at the national level, there is not yet any empirical evidence that the same factors also contribute towards resolving upstream-downstream pollution problems. Another gap in the existing research is that it deals primarily with international treaties and formal negotiations but much less with "real" cooperation in terms of actual international problem solving. In other words, existing research does not take into account that many forms of international cooperation may be *ad hoc* and/or tacit,

rather than based on treaties and formal negotiations. Measuring and explaining *de facto* transboundary environmental externalities can help to fill these gaps.

Based on data from the European Environmental Agency (EEA) and other sources, Bernauer and his team constructed a dataset with the help of geographic information systems (GIS). The dataset includes water quality data from measurement stations along the major rivers in Europe from 1970 to 2003 as well as data on economic, political, and geophysical conditions. Since the geographic locations of the measurement stations are known, it was possible to identify those stations that are located close to international boundaries. Thus it was possible to identify measurement stations within a five-kilometer range of an international border in an upstream-downstream setting. Data from such stations indicate the level of pollution passed on to or received from another country, depending on the flow direction of the river. In addition to absolute pollution concentrations passed from one country to another, the project also focused on another, more narrowly defined aspect of beggar-thy-neighbor behavior: the levels of pollution that countries transfer to downstream neighbors relative to how much they pollute their own country.

Some of the political and economic determinants studied in the project have contributed to reducing transboundary externalities. Nonetheless, state behavior in this area is characterized by strong path-dependency, and incentives for upstream countries to free ride at the expense of their downstream neighbors are substantial. The forces of democracy, globalization, and national and international regulation and institutions may help in improving domestic environmental quality, but they do not easily produce good neighbors. For example, while democracy tends to reduce beggar-thy-neighbor behavior, the evidence also suggests that EU membership does not make countries better riparians, but



Cities and industries along international rivers are amongst the main drivers of transboundary water pollution.

Mens internationalis in corpore sano Humanitarian Law through CIS

may in fact contribute to more pollution of downstream neighbors.

Because countries remain rather flexible in placing their monitoring stations and reporting results to international monitoring networks, such as those of the EEA, the existing data may suffer from selection bias. To address this issue, a follow-up project examines where countries locate monitoring stations, what these stations measure, and whether there are predictable diffusion effects with respect to choice of location and type of information gathered. For example, one might assume that downstream countries place more monitoring stations close to where an international river enters their territory and carry out more comprehensive measurements in order to demonstrate their victim status. Upstream countries may have opposite incentives. ■

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Prof. Schimmelfennig looking far too chipper for having run 14.27km

By Mark Thompson

In addition to running the academic race, CIS was able to field the *CISsies* and *lost in politics*, two fiercely competitive teams of 14, to the annual SOLA relay race amongst members of ETH and the University of Zurich, a race that drew teams from Germany and even a joint team from distant Oxford and Cambridge. Professors, researchers and students challenged their collective endurance to the ultimate 116km test of grueling contention. Nils Weidmann, a CIS doctoral student of conflict research and resident relay running race rector, already had big designs for the CIS teams to improve on their team rankings of 653rd and 551st respectively from 697 total. He secured their consent to do so by continuing the new tradition – but only after anesthetizing the acolytes with his generous round of drinks at the victory celebration. ■

By Mark Thompson

CIS arranged for the sitting president of the International Committee of the Red Cross, Dr. Jakob Kellenberger, to give a short lecture series on humanitarian law during the summer semester of 2007. One of the few Swiss policy makers well known outside of Europe, Kellenberger provides an insider's perspective on the processes involved in applying humanitarian law. Through his extensive operational expertise, owed to the ICRC's presence in every major conflict, he commands a degree of practical and political knowledge of con-



ICRC

flict and legal topics that is rare in academic settings. By examining the current events that make the news, such as the crisis in Darfur or the ongoing conflict in Palestine, students at ETH Zurich are in a unique position to profit beyond merely acquiring the core concepts of humanitarian law. Dr. Kellenberger's holistic and interdisciplinary approach relies less on theory and more on a profound and incisive understanding of why conflicts are not always easy to solve. Despite the number of dire humanitarian situations he has had to deal with, he possess an odd mixture of idealism and sober objectivity about what can be done to blunt the effects of humanitarian crises. ■

Practicing Citizenship and Struggling over Cultural Boundaries in Swiss Municipalities

By Marc Helbling

To our knowledge, Switzerland is the only nation-state in the world where naturalizations are done primarily at the local level. Every municipality, be it a town of 100,000 or a village of 400 inhabitants, is accorded the right to decide who can become a Swiss citizen. Because the regulations at the national and cantonal levels are very sparse, each local political entity decides on the formal procedure and criteria for naturalizing its alien residents. Given the high degree of autonomy possessed by municipalities in this policy area, naturalization procedures, the applied criteria, and consequently the ratio of rejected candidates vary greatly from one municipality to another. The Swiss system of naturalization has aroused many political and judicial debates in the last few years after discriminatory decisions were made, especially when candidates from the former Yugoslavia have been refused Swiss citizenship in municipalities where the population decided on those applications by secret ballot. For three years, a research team under the direction of Hanspeter Kriesi has explored these municipal naturalization procedures with the financial support of the Swiss National Science Foundation.

Switzerland constitutes a unique case for the study of citizenship politics, but this should not suggest that inferences from this case are not possible. On the contrary, it should be considered a unique research opportunity that allows us to discuss citizenship and nationalism from new perspectives. Taking a closer look at naturalization processes was revealing in that it enabled us to go beyond formal regulations and citizenship laws and show us how national citizenship models are interpreted and put into practice, as well as which aspects of citizenship really matter. Using a local approach also allowed us to go beyond classic works on citizenship or nationalism, which often adopt macro-sociological and historical approaches. Investigating the application of citizenship laws in the clearly delimited field of Swiss municipalities and

talking to local decision makers enabled us to explore how ordinary citizens think about citizenship. Studying naturalizations in Switzerland eventually lead us to abolish the idea of homogeneous nation-states and to demonstrate that citizenship can take different forms and meanings within a nation-state, not only over time but also over space.

The main goal of our project was to find an answer to the question of why some municipalities pursue a more restrictive naturalization policy than others. An initial survey of more than 200 municipalities allowed us to get a rough idea of what approach we would have to take to establish the causal mechanisms. We were able to demonstrate that socio-economic and socio-structural factors have no influence on which naturalization policy is pursued in a municipality. A high unemployment rate, a large ratio of foreigners or a growing number of applicants from Muslim countries seem not to preoccupy the people who decide how many and which alien residents become Swiss citizens. Rather, cultural and political factors are decisive: the rejection rates increase when the local population has a restrictive understanding of citizenship, when the Swiss People's Party (SVP) is influential in local politics and/or when decisions are taken by secret ballot. Hence, it is how people think about citizenship, how political actors influence the naturalization procedures, and how decisions are taken that dictate which policy is pursued. This points to the contentious and political nature of citizenship and is a first confirmation of our main hypothesis according to which the outcome of a specific naturalization policy is the result of ongoing political struggles over the questions of who we are and who belongs to us.

These preliminary results forced us to rethink current approaches to the study of citizenship and nationalism. Nowadays, most scholars agree that constructivism is the dominant school of thought in this area of research.

Despite this widespread consensus, it is getting ever more difficult to understand what the idea of 'constructivism' really represents. The common wisdom among constructivists holds that it is how we imagine the nation that tells us who is allowed to be part of it. However, solely taking into account how people perceive their social environment does not allow us to grasp the dynamics of nationalism and citizenship politics. Claiming that ethnicity, race and nationhood are not things in the world, but perspectives on the world (Brubaker) might easily lead one to underestimate the importance of how the social and cultural shape the way we perceive the world. Lest we end up with individuals completely determined by their social environment, we have to conceive human beings as both agents and actors, as both socialized and improvising individuals. With the help of Bourdieu's political sociology, we tried to combine the symbolic and material aspects of citizenship politics. We defined a nation as a Bourdieuan field in which people confront, in a socially constituted space, their opinions on what constitutes the cultural boundaries of their nation. Such a definition does not predefine which categories lie at the basis of a nation; it even leaves open which actors participate in the processes of labeling the nation and which arguments are mobilized. It merely expounds that people incessantly struggle in political processes over the question of who they are and whom they exclude, and that the arguments of the more influential actors prevail. We thereby also followed Fearon and Laitin for whom the claim that a nation is socially constructed invokes a specific process by which a national self-understanding is produced and reproduced in interaction processes.

The precise mechanisms of these processes have been delineated by means of 14 case studies. To be sure, Swiss municipalities are not nations. Yet given the broad authority of Swiss municipalities in naturalization politics, we



Who receives the little red book is often a matter of politics rather than procedure.

can apply analytical instruments at the local level which we would otherwise use in other countries at the national level. By generating an indicator for the local actors' individual understandings of citizenship, we were able to distinguish diverging ideas on how cultural boundaries are drawn and how foreign residents who apply for Swiss citizenship are perceived. As we made clear from the outset, solely accounting for the way local politicians think about their nation leaves us unsatisfied. How do we know which attitudes are relevant when it comes to the final decision? To distinguish between majority and minority positions and to explain why a specific construction prevails, we opted to include the local power structures in our study. In order to trace the ways in which influence is exerted, we resorted to community power studies and social network analysis. As it turned out, accounting for both the symbolic and material aspects of naturalization politics enabled us to explain rejection rates and to distinguish various local citizenship models.

Emphasizing that naturalization policies are the outcome of political negotiation processes – whereby not only the ideas of local actors, but also the local power structures are relevant – reveals that understandings of citizenship are constructed in socially and culturally shaped fields that, in turn, influence the attitudes of individual politicians. By drawing on theories from social psychology and social

influence networks, we demonstrated how the individual habitus of local politicians is influenced by their contacts to other politicians in the course of decision making procedures and how a cultural compromise emerges within a municipality. We were able to show that local politicians contribute to the production and reproduction of citizenship politics, and that their opinions are structured during the decision making processes. ■

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Recent Guest Speakers at CIS

Is There a "Democracy Deficit" in Europe?

Prof. Dr. Andrew Moravcsik, Princeton University

The Short-term Society: A Study in the Problems of Long-term Political and Economic Development in Iran

Dr. Homa Katouzian, St. Antony's College, Oxford University

Geschwächte Staaten und prekarierte Männlichkeit: Neoliberalismus und Neue Kriege

Prof. Eva Kreisky, Universität Wien

Die Krise der nuklearen Nichtverbreitung: atomare Gefahren im 21. Jahrhundert

Dr. Oliver Thränert, Stiftung Wissenschaft und Politik (SWP)

Überlegungen zum Franken-Wechselkurs

Dr. Philipp Hildebrand, Schweizerische Nationalbank

Media Change, Political Communication and Democracy, NCCR

Panel discussion with: Gianpietro Mazoleni; Rüdiger Schmitt Beck; Hanspeter Kriesi; Frank Esser; Moderator: Stephan Klapproth

Wissenschaftskommunikation und Medien

Panel discussion with: Martin Senti; Marco Färber; Jonas Viering; Simon Hug; Moderator: Andreas Ladner

The Political Economy of Endogenous Optimism Currency Analysis: The Early Euro Experience

Prof. Thomas D. Willett, Claremont Graduate University

Theoretical and Empirical Models of Roll Call Vote Requests

Clifford Carrubba, Emory University

Beyond e-Voting: Assessing the Impact of ICTs on Modern Democracy

Alexander Trechsel, European University Institute

Democracy and Globalization

David Leblang, University of Colorado

The functioning of representative democracy in the European Union

Jacques Thomassen, University of Twente

Israel: The Strategy of the Iron Wall Revisited

Avi Shlaim, FBA, St. Antony's College, Oxford University

Distributional Conflicts in Mature Welfare State

Isabela Mares, Columbia University

Explaining Corporate Environmental Innovation in the German and Swiss Chemical and Food & Beverage Industries

By Jazmin Seijas Nogareda and Stéphanie Engels

Eco-innovation is considered key for the decoupling of economic growth and natural resource consumption. In their research, Stéphanie Engels and Jazmin Seijas have analyzed the determinants of environmental innovation in the German and Swiss chemical and food & beverage (F&B) industries, focusing on the effects of environmental regulation.

In neoclassical economics, environmental regulation is considered to impose costs on firms. But in the mid-1990s, the authors Porter and van der Linde (1995) championed the ideas that environmental regulation can trigger corporate innovation that offsets compliance costs. Since then, there has been an ongoing discussion about the likelihood of win-win opportunities that benefit the natural environment and simultaneously translate into profits for innovative firms. Eco-innovation is considered key for the decoupling of economic growth and the consumption of natural resources.

Environmental innovation refers to the introduction of inventions (either products, processes, or organizational changes) to the market, which reduces the ecological footprint of human activity. Unfortunately, environmental innovations are not sufficiently supplied because firms find it hard to reap all returns from their efforts. While it is already difficult to appropriate the benefits of conventional innovations, environmental innovations also benefit society at large by improving environmental quality. Hence the importance of environmental regulation to ensure that society is protected from negative externalities, i.e. environmental degradation.

Consequently, the question of how to encourage environmental innovation continues to be debated by politicians and researchers. There is still no consensus about the role of environmental regulation: whether it is detrimental or conducive to innovation, and its impact on corporate competitiveness. It is in this context that Engels and Seijas

analyzed the determinants of eco-innovations in their dissertation projects, focusing on the impact of environmental regulation. Their empirical research tested a combined set of hypotheses derived from environmental economics and evolutionary theory with data gathered through questionnaire-based face-to-face interviews with representatives of the German and Swiss chemical and F&B industries.

Environmental Innovation in the Chemical Industry

For the chemical industry the most important determinants of environmental product innovation were customer demand, regulatory stringency, and a higher distance to the end consumer. The aim to overcomply influenced the proportion of eco-innovation (compared to total innovations) positively. In the case of environmental process innovations, regulatory stringency and the administrative burden of regulation (quantity) had a positive impact, as well as firm size and corporate environmentalism (especially a firm's aim to overcomply). The importance of policy style variables was not supported, but the results call for further research. The insignificant variable innovativeness (R&D intensity) paired with the negative relationship between the proportion of environmental innovations and the amount of conventional ones, leads to the conclusion that environmental innovativeness needs a conscious decision and does not happen as a by-product of general innovation. The insignificance of market determinants emphasizes the importance of having conviction, i.e. corporate environmentalism.

Most importantly, the results show that environmental regulation induces innovation, which can have a positive impact on competitiveness. But regulation is less likely to do so than demand-triggered innovations. For policy makers, this implies that although environmental regulation cannot be considered detrimental to innovation *per se*, it should still remain the last resort where market demand for environmentally friendly products lags.

Environmental Innovation in the Food and Beverage Industry

In the F&B industry, market and company-internal factors were significant for the introduction of environmental product innovations. A company's green commitment, pro-activeness (overcompliance) and firm size were most important. Being a first mover in order to gain competitive advantages remains key, the main players being small companies (niche players) rather than large firms. Retail guidelines and pricing as competitive factors had a significant negative effect on shares of environmental product innovations. Surprisingly, consumer demand had no significant influence as would have been expected considering conventional product innovations. In line with the findings of Cleff and Rennings (1999) and Johnstone (2005), none of the regulatory variables had an impact on green product innovation.

Environmental regulation had a positive effect on the number of environmental process innovations: the administrative burden of regulation (quantity) had a positive effect, and in general regulations were regarded as an incentive for improvement. The reliability of regulation showed negative correlations; as Hoffmann and Trautmann (2006) suggest, high perceived uncertainty fosters corporate environmental strategies and hypothetically green innovations. This would of course need further research. The number of conventional process innovations correlated with shares of environmental process innovations. There were either trade-offs between conventional and environmental process innovations or there were a limited number of green process innovations (technology limitations) to be introduced.

Like the results of the chemical industry, environmental regulation-induced innovations had mostly positive effects on competitiveness, while demand and cost savings had a significant negative impact. Accordingly, demand and cost-related environmental

International Political Economy at CIS

innovations involve competitive risks, but these are also associated with the introduction of conventional innovations. Environmental regulation should therefore foster regulations promoting market-based incentives.

Differences Between the Industries

In general, environmental regulation in the chemical industry was a more important trigger of environmental innovations than in the F&B industry. F&B industry regulation only influenced process innovations, whereas in the chemical industry it also affected product innovations. But common to both industries is the finding that certain regulations hamper green innovation. In the F&B industry strict retail guidelines limit innovation, while in the chemical industry pharmaceutical companies complained about their rigid production regulations.

Market demand was important in both industries, but was a stronger driver of green product innovation in the chemical industry. The role of customers differed markedly between the two industries; in the chemical industry corporate customers had a positive influence on environmental innovation, whereas the customer type (consumer or industrial) was irrelevant in the F&B industry. In contrast, consumers' high price sensitivity hampered environmental product innovation in the F&B industry.

These results, besides showing the benefit of focused industry research, have implications for policy makers. Environmental regulation mainly triggers the diffusion of process innovations. To foster green products, regulators need to introduce incentives to overcome the existing price disadvantage of such products. Furthermore, corporate proactiveness was an important driver in both industries, indicating that rewarding proactive firms may prove to be most beneficial. ■

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By Mark James Thompson

CIS does research in international political economy. Three speakers came to CIS to discuss current issues in the field and present their recent research results.

Globalization and Democracy

Which causes what, democracy globalization, or the exact opposite? The short answer, according to David Leblang, professor at Colorado University, is both. There is an obvious temporal correlation between the two phenomena, but the causal relationship between them has been a topic of hot debate. Leblang and his co-author Barry Eichengreen unravel the knotty issues of endogeneity that have plagued other studies on the relationship. After addressing the methodological issues, the two demonstrate that democracy and globalization do indeed reinforce one another, but that the process itself is dynamically instable whereby both democracy and globalization move together. Leblang provides evidence for what others have pointed out: namely that there is nothing inherent in this relationship that dictates there will be a natural progression towards more democracy and economic globalization. "A positive or negative shock could send the system off in a positive or negative direction without limit." Indeed, the collapse of international commerce leading in part to the rise of totalitarianism in the 1930s is exemplary of this type of scenario. This is tied to the fact that democracy determines how much societies interact commercially, and globalization generates its winners and losers within those democracies. When asked whether he personally believed globalization was positive or negative, he frankly stated that his preferences are given by his socio-economic position. The implicit statement was that if economic circumstance were to radically change, his preferences could equally radically change – creating the very dynamic instability he highlights.

The Swiss Franc as Global Economic Barometer

The recent positive trend in a democratizing and economically globalizing world has partially eroded the Swiss franc's competitive advantage as bastion of financial security. Philip Hildebrand, member of the board for the Swiss National Bank, was willing to share his thoughts on movements in the Swiss franc's exchange rate at an event organized by CIS and the Chair for Applied Macroeconomics at ETH in Zurich. One of the well-known attributes of exchange rates is their capricious nature. Rather than predict what the franc will do in the next few years, Hildebrand delved into the logic of the venerable currency's path since it went off the gold standard in 1973. Beyond the traditional economic determinant of a competitive export sector, where Switzerland has been racking up a surplus every year since 1973 except 1980, Hildebrand brought the role of the Swiss franc as a portfolio diversification instrument to the audience's attention. The former financier was quick to admit that the SNB had been skeptical about the direction the euro zone would take in that the ECB's track record had not yet been established; those concerns have since been allayed. He underscored what impact political and economic uncertainty can exercise over a currency; the euro has rebounded since its introductory phase after it was clear the ECB inherited the spirit of the German Bundesbank, and would not be a political player thing.

A poignant question came from an insightful elderly gentleman who boldly asked whether the SNB has been rendered obsolete by the arrival of the euro and the dominating effect of the ECB. Hildebrand took the question in stride and made it clear that the SNB remains independent as far as prudently possible, and pointed out a few instances where the SNB's policy was not in lockstep with the US Federal Reserve or the ECB. The deep economic interdependence of the Swiss financial system with a more stable European monetary partner has led to a significant decrease

in the volatility of the Swiss franc. And while the relative importance of the Swiss franc is in decline, Hildebrand argues this is a good thing. It means European financial markets are more stable and efficient and that the world economy is in decent shape. While the franc has lost importance, it is precisely in Leblang's dynamically instable world that the central banker underscores the fact that the franc is in a unique position to quickly reassume its traditional role as a safe haven

post; this argument was no doubt welcomed by eurocrats and europhiles alike when it made its debut around 1998 when the EMU was entering its last phase. However, Thomas Willett tempers both points of view by underscoring that while the Euro zone has not been the disaster that the Swiss National Bank and others predicted, it has not had the effect that proponents of endogenous OCA policy would have hoped for.



David Leblang speaking about democracy and globalization

from political and economic turmoil.

Possibly Endogenous Currency Areas

Yet just as the Swiss National Bank is getting used to a European monetary area that is not a basket case in more ways than one, there may be storm clouds on the euro zone's horizon. The purported economic logic behind the formation of the euro was that the Common Market should be an optimal currency area (OCA). But where traditional OCA analysis has focused on the preconditions for an efficient monetary union, some hold that opting for a common currency can induce changes that make currency areas optimal ex

The Claremont professor's fleeting sojourn to Switzerland, as special adviser for Stefanie Walter (see first Article), gave him occasion to share his recent findings on European monetary union with CIS faculty and students. What is both novel and ironic about Willett's research is that the European monetary union is a product of political will rather than economic efficiency, but it is precisely political will that may in fact be the central obstacle to creating a stable monetary area. The pressures for reform that come from sharing a common currency have been slow to take hold in the European labor market. And despite the economic recognition of the need to control fiscal free-riding within the euro zone, embodied in the Growth and Stability Pact, the treaty has not been effective in dealing with some member states' imprudent fiscal policy. Even being within the 3% deficit limit, still means states can accumulate debt; Italy even saw its sovereign debt rating take a hit as its debt went over 108% of GDP. Some are now asking whether Italy can afford to maintain 15% less competitiveness vis-à-vis Germany.

It is these type of strong economic tensions that are putting politicians in tough positions. The political reflex in the past was to devalue, but with that option (supposedly) off the table, politicians have to reform economies. Exactly how strongly endogenous the political will in Europe is to make itself an OCA remains to be seen. ■

The Youth Encounter on Sustainability (YES) Japan 2007



On a cultural visit: YES participants and lecturers in front of The Great Buddha in Kamakura

By Patrick Lichtner

The YES courses were conceived and organized by ETH Zurich's Center for Sustainability – a founding member of the Alliance of Global Sustainability AGS (MIT, ETH, University of Tokyo, and Chalmers University). This spring's YES course was held at the Tama Campus of Hosei University, 40 km outside of Tokyo. A total of 35 dedicated participants attended, including students from Europe, the Americas, Japan, Asia, and Africa. The YES program is recognized as a forerunner in sustainability education, comprising state-of-the-art teaching methods, such as interactive lectures, working groups, role plays, games, poster sessions, company visits, case studies, movies, debates and presentations combined with unique social and cultural activities. The

session is part of a larger project's effort to create a competence network and resource center for promoting leadership in issues of sustainable development.

I was given the opportunity to participate in the two-week program, which covered topics like natural and human systems, energy and materials, water, health and nutrition, economics, psychology, sociology and policy, taught by an expert international faculty. Most of the faculty also stayed for the duration of the course for in-depth auxiliary discussions. The YES program truly lived up to its goal of using a holistic and interdisciplinary approach to addressing sustainability issues. We were encouraged to express our

ideas by doing joint artwork. Even during the academic sessions, an artist would give his perspective by creating a visual representation of the issues under discussion. I found this to be fascinating and complementary to the underlying issues by visualizing them from an artistic perspective – often fascinating and even complementary to the underlying theoretical dimensions. Another major building block consisted of case studies on the role of social and institutional drivers in shaping a sustainable society done in cooperative group work throughout the course. It was an especially enriching experience to deal with different cultures and the diverse perspectives of students who came from a wide variety of disciplinary backgrounds, including eco-

Mapping Ethnic Groups – The GREG Project

Nils B. Weidmann

nomics, engineering, architecture, sociology, international studies, natural sciences, environmental sciences, law, and forestry.

Besides the full load of academic work, some excursions were designed to illuminate aspects of sustainability. Aside from visiting Japanese gardens, villages, shrines and Mt. Fuji, the trip to downtown Tokyo was accompanied by a lecture on urban planning en route; we also toured a company known for its energy efficiency. Direct contact with Japanese culture, through observation of the Japanese delegation's behavior and exposure to their perspectives during discussions and free time, certainly proved to be a powerful and lasting experience contributing to intercultural understanding.

Overall, I found YES to be a valuable experience and great complement to my MACIS studies. My thanks and appreciation go to CIS for its overall support and for making a successful application possible under the very tight time constraints, and to ETH for its substantial financial support that made participation in YES possible. ■

The role of ethnicity in conflict processes remains as controversial as ever. After the end of the Cold War, the field of ethnic conflict experienced a surge of scholarly interest. More recent research, however, has focused more on civil wars in general and tends to dismiss ethnic explanations for conflict. The current literature relies extensively on cross-

Our GREG project ("Geo-referencing of Ethnic Groups", in collaboration with Prof. Jan Ketil Rød from the Norwegian University of Science and Technology in Trondheim) is an effort to create an electronic map of ethnic groups worldwide. Using geographic information systems (GIS), the settlement areas of ethnic groups are represented as polygons



Example of an ethnic map from the GREG project. Numbers are identifiers for the groups.

national statistics, often leaving unanswered the question of what mechanisms drive observed conflict patterns.

CIS's International Conflict Research group's work is motivated by the need to examine the link between ethnicity and conflict in more detail. By disaggregating from the national level to the level of ethnic groups, our research examines the role of these actors more closely. The literature suggests that the geography of ethnic groups – i.e. their location in their country or their settlement pattern – should be an important factor in determining the types of conflict patterns we see. However, in order to test hypotheses of this kind, we need spatial information about ethnic groups.

(cf. Figure 1). This map then allows for the computation of the geographic variables for ethnic groups. At present, the dataset consists of about 9,000 ethnic group polygons and is used for various research projects in our group. The first results from our studies that rely on the dataset are promising and they also underscore the usefulness of GIS as a tool for social scientists. ■

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Managing Biological Risks – Anticipation vs. Resilience

By Sergio Bonin

The “International Biodefense Handbook 2007” from the Center for Security Studies (CSS) compares political, strategic, and structural approaches to biosecurity in seven countries and five international and supra-national organizations. It provides an overview of national and multilateral biodefense efforts by examining important policies in this field and through an inventory of the institutions and actors involved.

The menace of diseases caused by naturally or deliberately released viruses, bacteria, or toxins poses a serious challenge to institutions and agencies at the international, national, regional, and local levels. It confronts states with a multitude of complex issues in domestic and security policy as well as in foreign affairs. Most of these have a multidisciplinary character affecting a wide range of distinct sectors: public health, civil protection and emergency management, national security, military defense and research, civilian research, the national economy, animal health, and environmental protection. The Biodefense Handbook examines all of these sectors on a country-by-country basis as well as with respect to various international organizations.

One of the main challenges to the comprehensive management of biological incidents lies in the varied sources of biological risk, from state and terrorist attacks to natural outbreaks.

States: Assessments of state capabilities regarding biological weapons rely heavily on intelligence estimates and are hard to undertake, not least because the boundaries between defensive and offensive research programs on biological agents are blurred and many components have dual-use applications. Nevertheless, around ten to twelve states are believed to maintain an offensive

biological weapons program, a number that seems to have remained more or less stable over the last 20 years.

Non-State Actors: Uncertainty is a key characteristic of the bioterror threat. Nightmare scenarios involving the potential extinction of entire civilizations, which are theoretically possible but highly unlikely, must be contrasted with the considerable difficulties a terrorist group faces when trying to pro-

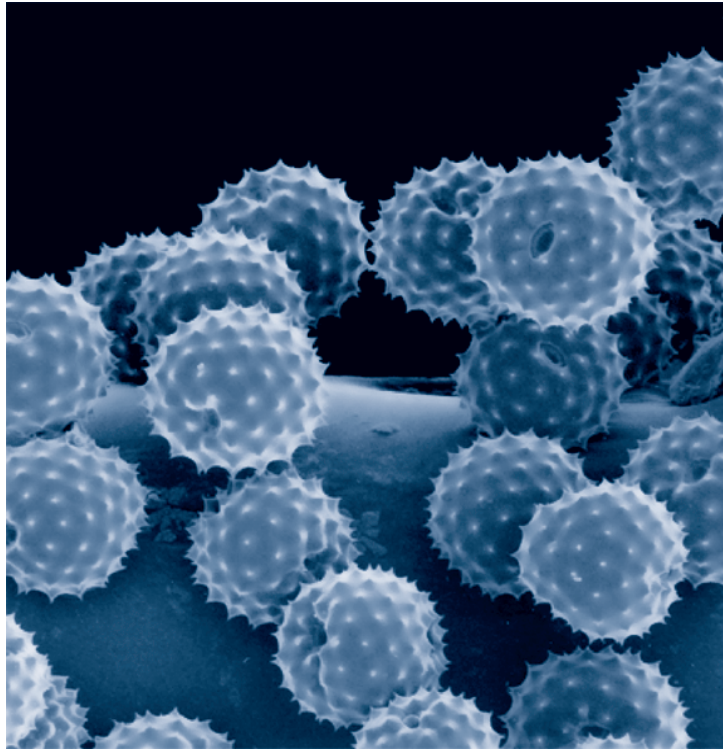
duce a biological weapon and carry out an attack. The manufacturing of a biological WMD with a high level of destructiveness is virtually impossible without state support, because preparing and carrying out an attack that inflicts thousands of casualties involves a series of major hurdles.

are AIDS, tuberculosis, and malaria, but the annual wave of influenza also kills an estimated 1 to 1.5 million people worldwide. Furthermore, the world is now facing the looming threat of an influenza pandemic. According to the World Health Organization (WHO), the world has now moved closer to a pandemic than at any time since 1968, in that all the prerequisites for the start of a pandemic have been met with the emergence of the H5N1 subtype, with the exception of efficient human-to-human transmission.

The great level of uncertainty, especially concerning the terrorist dimension of the biological threat, largely accounts for the differing and ambiguous threat perceptions and assessments among policy-makers and experts. The three sources of the threat, which affect previously unrelated domains – namely the public health sector and the national security apparatus – may cause competition for the allocation of scarce resources among uneven stakeholders and lead to a potentially problematic integration of health issues into national security considerations. However, since many

defensive measures can be applied irrespective of the exact source of the threat, and keeping in mind that natural outbreaks are inevitable, whereas terrorist or state-supported bio-attacks are not, it is more beneficial to propagate an “all-hazards” approach, which allows for a comprehensive and integrated understanding of the problem. Such an approach is also far more cost-effective and politically sustainable, especially in the absence of a deliberate release.

As others have pointed out, there were no deaths from bioterrorism in the time between 1900 and early 2001, leaving the five



Weaponized anthrax designed to stick. (Source: Oak Ridge National Laboratory)

Natural Outbreak: Worldwide, naturally occurring infectious diseases are the main causes of death and disability in humans and are likely to become even more important over the next decade. Each year, over 14 million people die from often preventable infectious diseases. Among the deadliest

Conference Announcement

people killed by the anthrax letters in fall 2001 as the only victims of a lethal bioterrorist attack in the last 100 years. Contrasted against the millions of deaths from often preventable infectious diseases annually, there is a clear and historically unprecedented imbalance between resources committed and the actual manifestations of the different sources of threat, especially in the case of the US with its huge civilian and heavily terror-focused biodefense complex. While some argue that preparations for a bioterrorist attack serve the “dual use” of enhancing other public health activities, others warn that a terror-focused biodefense program diverts time, attention, and resources away from more pressing public health problems.

A biodefense approach that is slanted towards a terrorism scenario may imply unnecessary costs. For instance, there are good indications that the al-Qaida network only developed an interest in biological weapons after viewing media appearances by US government officials discussing the topic. Also, massive buildups in a state's biodefense program increase the risk of unintended transfers of expertise and material from laboratories to potential perpetrators. In addition, the secrecy and lack of transparency surrounding defense-related research into weaponized agents may foster mistrust among countries concerning the true intentions of such activities and may enhance the risk of proliferation, as some countries fear that offensive capabilities may be maintained in the framework of a secret biodefense program.

An inclusive understanding of the problem makes it easier to focus on synergies instead of trade-offs between the partners and sectors involved. Apart from the activities of the intelligence services and certain police and military responsibilities, most of the precautionary and response measures – especially in the health sector – can be employed as protection against deliberate or naturally occurring releases of biological pathogens.

The main difference is one of focus. While bioterrorism preparedness is based on an anticipatory strategy that focuses on the specific threat of a terror attack involving already identified biological weapons agents, the general model of infectious disease preparedness is designed to focus not on a specified threat, but on the capability to respond to a variety of unanticipated virulent infectious diseases. This amounts to a strategy of resilience. These differences in focus have widespread implications for the implementation of readiness and response measures, especially with regard to the prioritization of agencies, the resource allocation between the public health and security sectors, the emphasis placed on the different first responders, and the relationship between national and local responsibilities. The narrow focus of the anticipation strategy bears the risk of failure in case a biological incident does not correspond to the established guidelines and targeted agents, whereas general improvements in the health sector – with a partial focus on terror-related health issues – can surely help prepare the public health system for a bioterrorism attack.

The International Biodefense Handbook 2007 is available for download in full-text at <http://www.crn.ethz.ch/>. ■

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The Political Economy of International Organizations

Conference Program

Sunday, 3.2. – Friday, 8.2.2008 at the Centro Stefano Franscini at Monte Verità, Ascona, Switzerland

The international conference aims at bringing together economists and political scientists working on the political economy of international organizations, in particular the UN, the IMF, the World Bank, the WTO and the EU. It will deal with questions of the institutional structure of these organizations, their impact on the incentives of the international bureaucracy, and the effects of these incentives on policy outcomes and administrative efficiency. Moreover, incentives of other political actors interacting with these institutions will be considered, in particular individual governments, commercial lobbies and NGOs. Related to this, there will be a discussion on the relationship between the policy of international organizations and the political economy within individual countries. Finally, it will also be considered to what extent the expansion of the field of activities of some organizations or the introduction of new international organizations challenges other already existing ones, which new incentives arise out of this situation and how individual organizations react to this challenge.

After an initial session on general political economy issues relevant for all international organizations alike, particular sessions will be held to discuss each of the organizations individually. In this context, one major aspect will be the assessment of the interaction of these organizations with developing countries, from the representation of their interest within these organizations to the impact of the organizations' policies on their national political economies.

For more details see: <http://www.cis.ethz.ch/events/PEIO>

Recent Publications

Featured Books

Sean S. Costigan & David Gold, (eds.): *Terrornomics*. Aldershot, UK: Ashgate Publishing Ltd, 2007.

Terrorist leaders have articulated that economic warfare is a key component of the new terrorist agenda. Governments have accentuated the role of economic tools in their counterterrorism policies while maintaining emphasis on the application of military force, or 'hard power', even though such tools often prove unnecessarily blunt or even sorely inadequate. Given the complexity of the global threat posed by modern transnational terrorist groups, combating terrorism with a mix of 'hard' and 'soft power' is more important than ever.

Terrornomics brings together contributions from international scholars and practitioners to provide a multifaceted view of contemporary financial counterterrorism and terrorist funding efforts. It employs key concepts, terms, case studies and policy recommendations to advance our understanding of the threats and possible courses of action, thus enabling us to grasp the critical financial and economic issues while providing potential counterterrorist strategies.

Myriam Dunn, Sai Felicia Krishna-Hensel & Victor Mauer, (eds.): *The Resurgence of the State. Trends and Processes in Cyberspace Governance*. Aldershot, UK: Ashgate Publishing Ltd, 2007.

The transnational architecture of global information networks has made territorial borders less significant. Boundaries between spaces are becoming blurred in the evolving information age. But do information and communication technologies networks really lead to a weakening of the nation-state?

This volume revisits the 'retreat of the state' thesis and tests its validity in the 21st century. It considers cyberspace as a matter of collective and policy choice, prone to usurpation by governance structures. Governments around the world are already reacting to the information revolution and trying to re-esta-

blish their leading role in creating governance regimes for the Information Age.

Myriam Dunn, Victor Mauer & Sai Felicia Krishna-Hensel, (eds.): *Power and Security in the Information Age. Investigating the Role of the State in Cyberspace*. Aldershot, UK: Ashgate Publishing Ltd, (forthcoming).

The marriage of computers and telecommunications, the integration of these technologies into a multimedia system of communication that has global reach, and the fact that they are available worldwide at low cost seems to be bringing about a fundamental transformation in the way humans communicate and interact. But however much of a consensus there may be on the growing importance of information technology today, agreement is far more elusive when it comes to pinning down the impact of this development on security issues.

This volume focuses on the role of the state in defending against cyber-threats and in securing the information age. The notion that is most uncritically accepted within the overall information security debate is that state power is eroding due to the effects of information and communication technology and that the state is unable to provide security in the information age. This volume challenges the unidimensionality of this statement. Without denying that new challenges for the state have arisen, authors in this volume argue that too much credence is often given to the spectre of an erosion of sovereignty.

The handbook compares different political, strategic, and structural approaches to biosecurity in seven countries and five international and supra-national organizations. It provides an overview of national and multilateral bio-defense efforts by examining important policies in this field and through an inventory of the institutions and actors involved. It is an important step towards a comprehensive overview of existing efforts in biodefense.

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New International Relations Security Network (ISN) Resources

Russian Analytical Digest: <http://www.isn.ethz.ch/pubs/ph/details.cfm?id=17933>

Think Tank Directory with the Foreign Policy Research Institute (FPRI): <http://www.isn.ethz.ch/pubs/thinktanks/>

Primary Resources in International Affairs (PRIA): <http://www.isn.ethz.ch/pubs/pria/>

Case Studies

Global Oil to 2030: A Quantitative Assessment in the Context of International Affairs <http://www.isn.ethz.ch/pubs/ph/details.cfm?lng=en&id=30696>

Why Nuclear Energy May Not Be the Answer <http://www.isn.ethz.ch/pubs/ph/details.cfm?lng=en&id=30596>

Global Warming and the Industrial System: <http://www.isn.ethz.ch/pubs/ph/details.cfm?lng=en&id=30366>

The Kashmir Issue: Differing Perceptions <http://www.isn.ethz.ch/pubs/ph/details.cfm?lng=en&id=27333>

Dossiers

Mediation and Facilitation in Peace Processes: <http://www.isn.ethz.ch/news/dossier/mediation/editorial/index.cfm>

Child Soldiers: <http://isn.dev.isn.ch/news/dossier/childsoldiers/editorial/index.cfm>



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