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## **Economic Status of Switzerland: Past, Present and Future**

**Luncheon Speech**

**given by Secretary of State Franz Blankart**

**for the Members of the Swiss Society of New York,**

**the American Swiss Association**

**and the Swiss-American Chamber of Commerce**

**New York, April 25th 1990**

**Madam and Mr. Presidents,**

**Mr. Ambassador,**

**Mr. Consul General,**

**Ladies and Gentlemen,**

**Let me at the outset express all the pleasure I have of being among you and having the possibility of sharing with you some thoughts about where the Swiss economy is heading to. Some may think that this is a pretty boring subject, since the Swiss economy is condemned to permanent success. Well, for those easily bored, I have good news:**

**Switzerland's economic success is not to be taken for granted...**



## Introduction

Only a few years ago the Swiss used to be highly satisfied when assessing the performance of their economy. The most obvious post-war achievement was the combination of a solid real GDP-growth rate with unemployment and inflation rates well below the average of those of other industrialised countries. Moreover, the current account showed a comfortable surplus, and by the mid-Eighties the Federal authorities succeeded in turning the government budget deficit into a surplus; other countries still faced increasing public debts. International comparisons suggesting that Switzerland was the industrialised country with highest per-capita GDP seemed to confirm the success.

Although the overall performance of the Swiss economy since World War II may have been slightly less brilliant than the excellent achievement of the Eighties, there has been only one obvious flaw in the last 40 years: The recession of the Seventies. Starting in 1975, real GDP decreased by almost nine percent over two years, while the other European economies suffered only a moderate set-back. The main reason for the deep recession was that Swiss export industries not only faced the international business cycle slump, but also a substantial real appreciation of the Swiss franc. The deep impact of the recession and the long time it took for recovery have proven that the Swiss economy is not sheltered from serious turbulences.

As hinted at the beginning, recently the Swiss have become more sceptical when assessing the performance of their economy. The increased uncertainty is hardly due to fears of another imminent

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recession or to any other serious threat to the good macroeconomic performance. The observation that Swiss self-confidence is somewhat weakening when it comes to the own economy, seems to have two sources: First, several countries pursue successful macroeconomic policies and Swiss achievements lose their exclusive character. Second, many Swiss begin to realise that low unemployment, moderate inflation and a balanced government budget may be admirable, but that those are not the only relevant aspects when estimating their welfare. This kind of reflexion is mainly triggered by the single market programme of the European Community. As the programme is designed to increase the economic efficiency of Switzerland's neighbours, it is only natural to question the efficiency of the own economy.

If free and competitive markets are a prerequisite to an efficient economy, i.e. an allocation of the factors of production to their highest valued activities, the organisation of the Swiss economy does indeed offer some cause for concern. Certain industries have been partly sheltered from competition, and some government policies have created market distortions. In an environment that is determined to improve the working of its markets, those inefficiencies may be resented more painfully.

There are indications that concerns with the economy are no longer limited to specialists. For instance, the popular interest in comparing the level of *real* salaries with *real* incomes abroad has visibly increased. Although the comparisons published in different newspapers and magazines may often be subject to methodological objections, there is no doubt that Switzerland's record high nominal incomes lose much of

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their luster when their purchasing power is compared to the real incomes in the wealthiest neighbour countries.

The following paragraph is an attempt to explain the achievements of the economy by traditional Swiss policy and institutions. A further section is devoted to the actual discussion on areas of reform. Finally, the account presents some considerations on the future of the Swiss economy.

## 1. The Past

Simplifying somewhat, the actual Swiss economy may be characterized as successful on the aggregate level but probably subject to serious microeconomic distortions. Pretending to offer a complete and straightforward list of the causes responsible for this situation would be presumptuous. Thus, the following attempt to explain Switzerland's economic achievements is largely based on intuition.

### *The search for concordance*

Searching for the sources of the peculiarities of Swiss economic policy leads inevitably to the end of Second World War. In contrast with its European neighbours, Switzerland had neither suffered directly from warfare nor had the authorities seriously compromised with doubtful ideologies. Thus, there was no strong pressure to completely overthrow pre-war policy. Vested interests and economic principles had it easy to stand firm, while other European countries were completely rebuilding their political and economic systems. From an economic point of view, the most obvious pre-war inheritance may well be the tendency to favour solutions concordant with the interests of different concerned groups.

According to the law, the government is obliged to consult concerned groups before issuing new economic directives. Moreover, while cartel-laws usually prosecute collusive behavior (sometimes accepting it in certain clearly defined cases), the Swiss law attempts to fight only

abuses of cartels. Recently, after a revision which improved the position of the authorities, the government has become more active and attempted to dismantle some important cartels. Other collusions have been weakened by the fact that increasing foreign competition has succeeded in undermining member's discipline. Further integration of European and world economy will certainly contribute to erode the collusive power of the cartels and thus to improve the efficiency of the Swiss economy.

### *Government Activity*

Swiss companies have usually refrained from asking direct transfers from the government. Moreover, the attempt to solve structural and business cycle problems by nationalising or openly subsidising ailing companies and sectors has never been popular among the relatively conservative majority of the Swiss. As a result, government's share in GDP is well below the international average and important public activities are in general limited to sectors like telecommunications, transports, energy and water supply and the traditional public goods (e.g. education, justice, defense).

Of course, public share in GDP does not reflect the full impact of government influence on the economy. For instance in the case of agricultural policy, which is highly interventionist, an important part of the burden is borne directly by the consumers who pay prices above world or European market levels. For most farm products the degree of intervention, i.e. the relation between payment to the Swiss farmer and world market price, is among the highest of all countries.

Swiss agricultural policy has the same origins as the interventionism in other countries. If protection became particularly intense in Switzerland it had much to do with the feeling of being isolated during Second World War. After this experience the idea of a high degree of self-sufficiency gained broad support among the Swiss. Later, as the people's concerns with pollution were growing, the farmers successfully emphasised their part in helping to maintain a healthy environment.

However, criticism is growing. Consumers and taxpayers become increasingly aware of the cost of that policy. Furthermore, our agricultural policy is jeopardising the liberal Swiss position in the GATT, and it is one of the main obstacles to a possible adhesion to the European Community.

An additional source of government-induced inefficiencies is public procurement. For a long time, the fact that public authorities tended to favour local suppliers when buying goods and services has been accepted as a logical feature of pronounced Swiss federalism. Recently the discussion on the liberalisation of public markets in the European Community has attracted attention on the cost of public procurement in Switzerland. The highly decentralised procurement system, by favouring local producers, has a strong tendency to segment markets and thus to conserve economically inefficient firms. In other sectors there are serious indications that the companionship of suppliers and authorities has seriously jeopardized the incentive to develop new products. If the members of the European Community succeed in mutually opening their public markets, the burden of traditional public

procurement in a small country like Switzerland might well become a costly problem.

### *The External Dimension*

The source of Switzerland's considerable economic success is to be found in the dependence on external markets. For instance in the important machine and chemical industries it is easy to find companies exporting 80 percent or more of their production. Those industries are submitted to the competitive pressures of world markets and they hardly benefit from the shelter of the domestic market. The consciousness of being dependent on world markets (the export share amounts to 37 percent of GDP) has led Switzerland to advocate free trade within the GATT, to become a member of the European Free Trade Association (EFTA) and to conclude a free trade agreement with the European Community.

In the domain of manufactured products the free-trade policy is consistent. Although non-tariff barriers are not totally absent, the obstacles to international transactions are far from being as important as those of other industrialised countries. Switzerland has not been willing to impose "voluntary" trade restrictions to trade-partners.

As Switzerland is characterised by an almost total absence of natural resources (except for hydropower) heavy industries could never develop. Moreover, as large scale production is also impeded by the small labour and land markets, Swiss producers found their comparative advantage mainly in specialised and differentiated products with a high value-added share of human capital, the only



important large scale industry being capital intensive chemical products. The necessity to survive in the world markets is an important incentive to research and development. Thus, Switzerland has one of the highest r&d shares in GNP, although direct government support is very modest by international comparison.

Another cause of the important international alignment of the economy is the fact that aggregate savings largely exceed the amount that can be profitably invested within Switzerland. Supported by a regulation of cross-border capital transactions that used to be very liberal compared to policies of other countries, the country has become an important net capital exporter. Direct foreign investment has become one of the pillars of economic success as it was often the only possibility to expand beyond the narrow limits of Switzerland's small output and factor markets and to create large, internationally competitive firms.

There is no doubt that international involvement explains much of Switzerland's economic success: The country has profited from the usual welfare effects from free trade; it has offered attractive investment opportunities in foreign economies which generate a comfortable net capital income from abroad; it has set limits on government or collusive power to manipulate market outcomes.

## **2. The Present: The need for reform**

With its imperfections the Swiss economy may not fully comply to the ideal of a competitive market economy. However, it may have been relatively efficient in an international environment characterized by heavy government intervention, overregulation and stop-and-go policies. Some observers have put forward the hypothesis that the main reasons for Switzerland's relative success in the past was the very sluggish legislation procedure. While in other countries, after winning the elections the leading party or coalition is normally able to shape the rules and institutions according to own interests and beliefs, Swiss legislation is a very slow piece-meal work. As the government is a broad coalition from right wing parties to social democrats the search for common positions is very onerous, and important matters have to pass the barrier of popular polls.

When international policy tended towards more regulation and extended government control of GNP, as was the case especially in the Sixties and the early Seventies, the sluggish political process prevented Switzerland from copying too many foreign mistakes. Presently however, other countries not only aim at deregulation, privatisation and liberalisation, but their efforts have also reached a pace which is breathtaking compared to the dynamics of traditional Swiss policy. Thus, one of the most important challenges to the Swiss economy is the fact that it cannot count any longer on comparative advantages based on foreign weaknesses.

Surprisingly, internationally oriented industries are not always unconditional advocates of an adjustment to EC or other international standards. In general they favour measures to preserve and improve free access to international markets for goods, services and capital but they rarely propose a complete alignment to European regulations. In the case of the large multinational companies this position may be explained by the fact that they are well established in the EC and that they can easily switch activities between different countries; thus, Switzerland's policy is not really decisive for their future. They may even favour a certain distance to the Community as a hedge against possible flaws of the European market. However, even firms with substantial production activities in Switzerland are not very enthusiastic about fully adopting European regulations, as for instance the principles of EC competition policy or company-regulation differ from traditional Swiss perceptions.

Thus, management and board of many companies in Switzerland are sometimes half-hearted when it comes to reforms of the company-law. Today the informational content of the annual reports of many Swiss companies is below international standards. Recently some of the largest Swiss companies have adopted international disclosure standards in their financial statements (usually to have their shares listed at foreign stock exchanges) and eliminated the anti-foreigner bias in their registration policy. However, for management and board of other companies accepting European rules could sensibly augment the control by shareholders and the competitive pressure of takeover-threats.

In some economic areas the consensus for reform is relatively broad. For instance the sales tax needs a reform to improve compatibility with the value added tax of the EC-countries or some of the outdated structures of financial markets need a reshaping to improve the efficiency of Switzerland's financial centre. Thus, although the enthusiasm for reform may be limited by the attempt to save some of the comfortable features of domestic markets, the internationally competitive sectors of the Swiss economy are aware of the necessity to adapt part of Swiss regulations and institutions to international standards.

### 3. The Future

The assessment of the future of the Swiss economy is tightly connected to expectations about future relations with the EC. Recognizing this fact does not imply that the importance of economic relations with other countries or regions or that problems in the GATT are considered of secondary order. But it is practically impossible to delimit the scope for future developments of the Swiss economy without having some notions on the coming position towards the EC. First, the case is of enormous quantitative importance as the EC-countries are Switzerland's most important economic partners and it has almost become a truism to point to the fact that the Swiss economy is more interdependent with EC-markets than the economy of most EC-members themselves. Second, as I have hopefully just shown, adapting Swiss economic policy and institutions to European standards would considerably reshape the economy in all its aspects and the effects would not be limited to its EC-oriented sectors. Third, the EC-policy of extending free trade to new areas is certainly precursory to the future policy on a broader level, for instance in the GATT.

It seems reasonable to base scenarios on an intermediate policy, as an imminent application for EC-membership is as unlikely as total ignorance of the need for reform. Such an intermediate policy could take the form of membership in the planned European Economic Space (EES), the common organisation of EC and EFTA-members. Although the institutions and the substance of such an organisation are still to be determined, it is aimed at creating a large European market, based on the achievements of the Community. Joining the EES, as opposed to

EC-membership, would not demand the adoption of the full range of EC rules. Thus, it is conceivable that Switzerland could preserve a certain autonomy in some of the most controversial fields such as agriculture or foreign labour policy. A partial reform is also to be expected if Switzerland decides not to join the EES or if the attempt to found the EES fails. Although in such a case it is very difficult to predict areas of reform and the understanding of the EC towards Swiss proposals and requirements, pressures to adapt to international standards in less controversial areas would certainly support an intermediate policy.

Whatever its degree of integration, it is very unlikely that the Swiss economy or single sectors will suffer a recession-like shock from not entirely participating in the EC or EES. Restructuring of the European economy to prepare for the single market has set off an investment boom that would have been unthinkable a few years ago, when the continent was supposed to suffer from "eurosclerosis". The income effect of the European investment boom has already been beneficial to Swiss exporters as it increased demand for their goods and services. However, there are costs of non-participation, due to remaining barriers between Switzerland and the Community. Those barriers grant EC-producers a cost-advantage when competing with Swiss products in European markets, and Swiss consumers will not benefit to the same extent from increased competition as EC consumers will. Thus, costs take probably the form of a potential real growth rate below the full-membership rate.

It is almost impossible to develop a more precise perception of the future course of the Swiss economy. The implications of the decisions to be taken are far beyond the reach of usual Swiss piece-meal policy.

Thus, it would be doubtful to extrapolate the future course from past behaviour of the Swiss economy and especially of Swiss citizens. For this reason, many questions are still open: How will the Swiss perceive a decline of their relative advantages? In case it is fully resented, will they accept it as an unavoidable burden to preserve remaining economic and political autonomy? And what are the areas considered to be necessary parts of that autonomy?

If Swiss authorities and citizens are fully aware of the trade-off between autonomy and economic performance and take their decisions accordingly, there is no reason to be pessimistic on the future of Swiss welfare. In case the Swiss prefer high economic performance and an easy access to European culture and education they will sooner or later join the EES, or even the EC; otherwise they have to renounce some of the benefits of integration to preserve the desired amount of political and economic autonomy.

The major danger to the future of the Swiss economy is a wrong assessment of the consequences of the different choices. The Swiss tend to overestimate the power of their virtues, such as diligence or high quality work, to protect them from the turbulences of international markets, and their strong aversion to changes often leads them to ignore important innovations abroad. Although, as already mentioned, the discussion on European integration has inspired a growing number of Swiss to question some of their achievements, there is a danger of underestimating the benefits of integration or the costs of autonomy. An additional reason for caution is the traditional course of Swiss policy. As mentioned, Swiss policy has usually attempted to find solutions compatible with the interests of the different influential

groups. In the future, with increasing divergence between the goals of domestic and outward oriented sectors, easy compromising won't be possible any longer and Swiss policy needs to be based on new criteria.

I shall not finish without mentioning the importance for Switzerland of not being exclusively focused on Europe, as this may be increasingly the case for some branches of the Swiss economy. We absolutely must counter-balance the influence of the Community by an added impetus in our relations with the rest of the world. This is vital for our national sovereignty. Here, let me stress how crucially important our relations with America are. The American market is essential for our goods, investments and services. We are thankful that America remains committed to an open, welcoming market in the framework of a reinforced multilateral trading system within GATT.

The concerns I have expressed should not conceal the fact that *I am basically optimistic about the future of the Swiss economy*. Therefore, if much of this account deals with its possible weaknesses and relatively few space is devoted to its strengths, this may be justified with the attempt to evade one of Murphy's laws:

*"If everything seems to be going well, you have obviously overlooked something".*