

# Summary

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*Switzerland's successful performance of recent decades rests in large part on an effective management of the economy*

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Switzerland has a record of strong economic performance, reflected in high living standards and successful public policy management in the social, regional and environmental fields. The roots of Switzerland's traditional success can be found in a combination of factors:

- The economy has been skilfully piloted to make the most of its central geographic position in Europe and to promote the development of value added niche markets.
- Openness to international trade and investment is underpinned by traditionally liberal policies on international trade. There is a broad mix of SMEs and large multinationals. Exposure to international competition does, however, vary by sector, and market openness today shows signs of fragility.
- The Swiss labour market functions well, combining one of the highest participation rates in the OECD with low unemployment. Labour market flexibility largely accounts for this good performance, promoted by policies and governance traditions such as the decentralisation of the wage negotiation system, the absence of a legal minimum wage, and a social consensus that prefers negotiation to confrontation.
- A high level of human capital development draws its strength from a strong system of secondary and tertiary education, with over 80% of the labour force in possession of a secondary diploma or having received vocational training.
- Monetary policy has secured an unusually low and stable inflation record.
- A highly developed financial sector (financial services account for 10% of GDP) makes a significant contribution to the economy. This has been encouraged by the openness of the economy, a relatively low tax burden, and a policy framework that has found an effective balance between protective rules and non-interventionist monetary and fiscal policies. Some parts of the sector perform less well however, and are not adequately exposed to competition, including venture capital markets and cantonal banks.
- Innovation has been traditionally strong, though there has been a tendency over recent years to focus on quality improvements rather than the more risky development of new products and processes, such as in the fast growing ICT sector.

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*Strongly anchored political and public governance traditions support a highly stable economy and society, but slow the process of change*

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The Swiss system of governance has played a defining role in shaping the economy and society. It is based on highly decentralised federalism and a system of participative

democracy by referenda, features that have hardly changed for well over a century. This has led to a high level of trust in government, public institutions and the legitimacy of public action. When decisions for change are well accepted, reforms are soundly anchored. But the system also slows the decision-making process, which affects the rate of reform. The referendum results of recent years suggest the emergence of sufficient consensus for reform, but differences of opinion over the details can be sharp, and it usually takes several years to reach agreement on important changes.

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*Slow growth in recent decades highlights the need for reform*

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The core problem faced by Switzerland is that growth has been slower than the OECD average for nearly two decades. During the 1990s, average annual GDP growth per capita stagnated, whilst it grew on average by over 1% or more in other developed economies. If this trend continues, it will undermine past achievements, lead to a continuing relative erosion in living standards over time, and leave the country ill equipped to face the demands of a rapidly ageing population. The proportion of elderly (65 years and over) to the working age population will reach 44% in 2035, compared with 25% today.

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*The reasons for slow growth: faltering productivity in the context of inadequately functioning product and services markets*

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The growth problem has its roots in the slow growth of labour productivity, and to some extent also in the inefficient use of productive capital, which together suggest low total factor productivity growth. The main explanation lies in the inadequate functioning of product and services markets, reflecting a lack of competition, together with the high cost of services supplied by the public sector or financed through compulsory contributions. Swiss prices are very high in international comparison, evidence of a problem with competition both within the Confederation and externally, as well as problems with the performance of the public sector. Another major policy challenge is to restore sound public finances. Inadequate control over public spending since the early 1990s has led to rising public deficits and debt. If this trend continues, it risks strangling growth prospects. A particular source of concern is control over health and social spending.

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*Important political and societal trends need to be taken into account in reform plans*

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The broader political and societal framework for the implementation of reform matters in the Swiss context. The Swiss system of democracy has a direct influence over decisions, small as well as large, that shape the economy and society. Factors of change today include an increasingly high age profile for the voting population, a growing influence of vested interests and single issue lobby groups especially in the organisation of referenda, and the growing importance of new media in political communication.

Growing Confederation responsibilities over time sit uneasily with the Swiss tradition of highly decentralised power. An important reform based on changes in fiscal relationships between the different levels of government is currently underway, and should help consolidate a new and more productive relationship with more timely decision making.

Beyond Swiss borders, there is the longstanding but growing challenge of keeping up with EU structural and regulatory change. Switzerland is not a member of the EU but its open economy and geographical position mean that it is heavily influenced by developments there. The EU influence encourages reforms which would be harder to push forward otherwise, such as in the network sectors. Changes enacted in the EU to the regulatory framework of sectors important to the Swiss economy need to be reflected in appropriate Swiss adjustments, if Switzerland is to remain a full participant in the EU Single market. Swiss companies and consumers otherwise risk losing out through exclusion from the wider EU Single Market.

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*Reforms so far: an awareness of the need for reforms, but moving forward at the right pace is proving difficult*

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There is rising awareness in Switzerland of the need for further reform to address the problem of slow growth, building on reforms that were started in the early 1990s, though not all stakeholders share this view. The rejection by popular referendum of accession to the European Economic Area (EEA) in 1992 triggered the adoption of a wide ranging "Revitalisation Programme". One major success of these reforms was the possibility to conclude a series of agreements with the EU covering a wide range of economic sectors.

Overall, reform remains often piecemeal and incremental, with much "work in progress" that needs completion. This is reflected in the construction of the internal market, where scope for further integration remains. Sectoral reforms are progressing at different rates across sectors, and the process of setting up independent regulators is slow. Efforts are also continuing to develop a more systematic framework to address the future of universal service in the network sectors. The population is deeply attached to public service, linked to concerns about ensuring the servicing of remote rural and mountain areas.

The Growth Package is a recent initiative by the Federal Department of Economic Affairs which proposes a strategic agenda of key reform priorities. It sets out 17 specific measures for enactment in the legislative period 2003-07. If increasing competition in the internal Swiss market is one of the main objective of this programme, pursuing integration with the global economy is the goal of the new strategy for foreign economic policy, adopted in January 2005.

The need for further reform is underscored by the results of the OECD's recent Product Market Regulation project, part of a wider OECD study to identify the economic reforms that matter for sustained economic growth. Switzerland emerges with a relatively high level of product market regulation, including in comparison with other small countries, such as Austria which is also a federal country.

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*Further reform is needed across a range of policy areas*

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Policy areas for further reform include the following:

- Promoting internal market competition. A necessary reform of the current Internal Market Law is currently underway. It aims to tackle continuing restrictions on access to their markets by the cantons more effectively, by applying the EU inspired “Cassis de Dijon” principle, under which goods, and more importantly services, may be freely traded on the basis of mutual recognition of different rules (the principle can be applied internally as well as across international borders). Despite significant recent developments, competition policy also needs further strengthening to help in the development of the internal market. Public procurement markets, a key area for the integration of the domestic market, remain relatively closed, notwithstanding reforms started in the mid 1990s.
- Promoting a positive environment for international trade and investment flows. Foreign competition can be enhanced by adopting the “Cassis de Dijon” principle, which would help to eliminate technical barriers to trade. As Switzerland is not a member of the Customs’ union of the EU, it would benefit from fostering imports through a closer integration of agricultural markets and through more effective competition from parallel imports of patented products. Allowing parallel imports (shifting to a regional, if not international, exhaustion regime for patent law) would be another positive move. EU markets are of central importance to the Swiss economy, absorbing 63% of Swiss exports and providing 83% of Swiss imports in 2004. The current set of agreements provides a good basis for further development.
- Promoting a more efficient and effective public sector. This includes applying regulatory quality processes to changes aimed at curbing public spending, improving the management of public sector activities and publicly-owned enterprises, and promoting efficiency in health care.
- Improving the performance of the infrastructure sectors. These include electricity, telecommunications, postal services, rail, air transport and natural gas. Many of these sectors are of particular importance for the Swiss economy, being large relative to the size of the country. There is a need to ensure convergence with EU developments so as to secure efficiently connected and reliable markets. The extent of the Swiss lag with the EU varies, but all are in need of accelerated efforts to consolidate, complete or even in one case (electricity) to start reform.
- Reforming other sectors which have a broad impact on the economy. This includes the reform of the agricultural sector, and ensuring that the regulatory framework for financial services remains effective. There is an issue of increasing regulatory burdens on the financial sector.
- Sustaining a high level of innovation through support for SME growth. This includes further efforts at reducing administrative burdens. SMEs are an important part of the Swiss economy, accounting for two thirds of employment and 99.6% of enterprises.

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*Moving forward: building up a shared country wide strategy to mobilise support for change, harnessing both internal and external levers of reform*

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To help move reform forward at an appropriate pace, a variety of approaches, many of which are mutually reinforcing, should be considered. Governance and regulatory mechanisms that already exist can be used to better effect.

Encouraging the adoption of a country wide regulatory reform policy, together with stronger sustained communication, are important starting points. A broad “ownership” of regulatory quality principles to support reform at all levels of government needs to be developed. Strengthening the regulatory institutional infrastructure will help. This requires identifying current structures that could play a stronger role and ensuring that they are adequately resourced. Switzerland does face a need for co-ordination and increased policy coherence across a highly dispersed decision-making processes, spanning the collegially-based decision making of the Federal centre, the important role played by Parliament, and the powers devolved to the cantons. A permanent, visible and influential mechanism would help foster a greater coherence in regulatory frameworks, keep the focus on the policy priorities, and ensure that regulations are fit for their intended purpose.

Although current Swiss consultation processes are a major strength, a more co-ordinated approach to communication about reform, its rationale, implications and benefits, and involving all relevant stakeholders and citizens especially, is needed. This would help, not least, to counter the perspectives of vested and single issue interests which often succeed in taking the centre stage.

Specific internal levers of reform exist already but are not necessarily identified as such. They include a more strategic approach to the development of a network of strong and independent regulators which will help to clarify the different roles of government as owner and regulator of services, developing the role of the competition authority, and strengthening the voice of consumers. An important external lever of reform is the EU, where a closer relationship and broader strategic view of objectives for the development of agreements will help to strengthen internal reform efforts.

The more effective deployment of regulatory tools is another area for attention. These include administrative simplification, mutual recognition of rules to circumvent long delays in regulatory harmonisation, benchmarking regulatory practices and competition between firms, and a more determined approach to implementation of Regulatory Impact Analysis, which is not yet firmly rooted in the Swiss rule-making process. This could benefit from an improved linkage with the existing consultation processes.

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*A more systematic and timely approach to reform is needed*

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Because Swiss economic growth has stalled, there is a pressing need to find a path for stronger growth. Achieving this is possible within well established governance and regulatory processes, and is consistent with social and environmental objectives. But aspects of traditional approaches need to be adjusted and strengthened, in order to ensure timely change and to avoid Switzerland falling back over time relative to its OECD peers. A

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more systematic co-ordination of reform efforts, encouraging the participation of key stakeholders at all levels of government and including citizens, will also improve the functioning of a major Swiss asset, its system of direct democracy and related emphasis on consensus building, which ensures that change when it comes is well accepted. As a relatively late reformer in many sectors, Switzerland can benefit from the experiences gained in other countries to define an optimum path.