

Economic Survey of Switzerland, 2005

Summary

While Switzerland is still a prosperous country, growth of per capita income has been weak and considerably below the OECD average for a number of years, mainly because of lacklustre productivity gains. In the absence of a significant pick-up in productivity, trend output growth will diminish further due to the ageing of the population, falling to as little as ½ per cent by 2020. At the same time, the dynamics of social spending are not sustainable in the long run. In this context, the authorities face two key policy challenges: raising growth performance and restoring better control over public spending.

Structural reforms are necessary to raise potential growth. The authorities, fully aware of this challenge, launched a growth package in 2004 which includes major advances, especially in the area of competition policy.

- In order to create a **competition** culture, it is important to go ahead with the package of measures proposed by the government, which includes a revision of the Domestic Market Act, eliminating regional and local obstacles to a unified domestic market, as well as reforms of the electricity and agricultural sectors. Reforms need to be accelerated in other domains, including telecommunications; and technical barriers to imports should be reduced by accepting products conforming to EU standards (the “Cassis de Dijon” principle). Finally, the resources of the competition authority should be increased and the political independence of its members ensured.

This Policy Brief presents the assessment and recommendations of the 2005 OECD Economic Survey of Switzerland. The Economic and Development Review Committee, which is made up of the 30 member countries and the European Commission, reviewed this Survey. The starting point for the Survey is a draft prepared by the Economics Department which is then modified following the Committee's discussions, and issued under the responsibility of the Committee.

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How can macroeconomic policy strengthen the recovery?

Can the fiscal policy framework be improved to control public spending better?

How can the old-age and disability pension schemes be made sustainable?

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- **Innovation performance** needs to be maintained at its current high level to preserve the competitiveness of the economy. Key in this area is the improvement of framework conditions, including strengthening competition, simplifying administrative burdens, reforming the bankruptcy law and enhancing the efficiency of the university system. Efforts are also needed to better fulfil budget spending priorities on education and research and to bridge the gap between fundamental research and the market.
- Despite very high employment ratios, **labour utilisation** could be increased by reducing tax disincentives for mothers to work, developing early childhood education and care, better integration of the disabled by the reform of the invalidity insurance and removing disincentives to the participation of older workers.

Reforms are also required to **restrain public and mandatory social spending growth**, especially in the medical, disability and old age schemes, to put an end to the sharp rise in taxation and mandatory contributions recorded over the last decade.

- Greater **transparency of the fiscal policy framework** would enhance the understanding of problems and raise the population’s awareness of the need for reform – crucial in a system of direct democracy. This will require disentangling the finances of the Confederation, of the cantons and of the social insurance system while including all levels of government in a fiscal policy framework extending to the medium and long term.
- An **overhaul of welfare programmes** is also needed to stop the sharp rise in mandatory social spending. Plans to reform the disability scheme, which would intensify early screening and help people to get back to work, should be implemented rapidly. A tighter control of medical spending will necessitate a deep reform of the health care system. This could be achieved by a range of measures instilling greater competition among providers and improving provider payment methods. Finally, ensuring the funding of basic pensions, including beyond 2020, will require *inter alia* an increase in the average number of years spent in activity, in view of the likely continued increase in longevity. ■

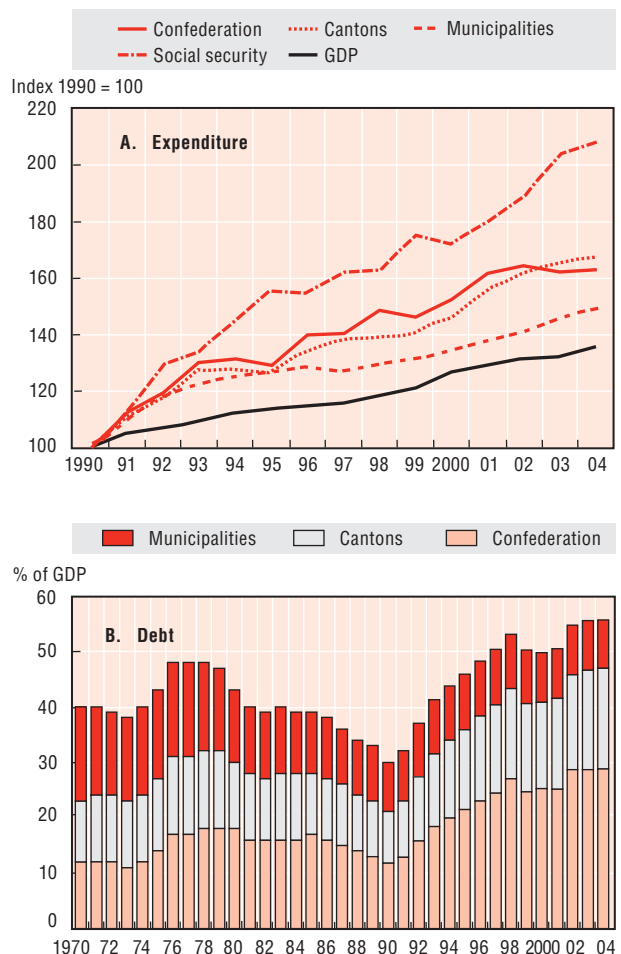
What are the key challenges?

Switzerland is still a prosperous country, but it is stuck in a low-growth trap and faces growing fiscal policy problems. While economic activity is affected to some extent by unfavourable conditions in Europe, low

trend growth has structural roots. Indeed, growth of production and per capita income has been among the lowest in the OECD for many years, largely reflecting weak productivity gains. In the absence of a significant pick-up in productivity, trend output growth will decline further due to population ageing, inducing growing fiscal pressures. In this context, the authorities face two key policy challenges:

- **Raising growth performance.** The most immediate challenge is to nurture the recovery, following the recent weakening of activity. In the longer run, raising potential growth will require improving labour utilisation and, more importantly, boosting productivity through better functioning product markets and stronger competition in sheltered sectors. Maintaining a strong innovation performance will also be key for preserving high living standards.

Figure 1. **Spending by all government levels has outpaced GDP**



Source: Administration fédérale des finances, “Statistique financière révisée”.

- *Restoring better control of public spending.* The insufficient control over public spending since the early 1990s first triggered a sharp rise in public debt and was then followed by a marked increase in taxes and mandatory social security contributions which has helped to keep the deficit down to currently 1¼ per cent of GDP. Problems to be tackled with priority include a lack of efficiency in the health sector, insufficient control of social spending in disability insurance, and deficiencies in the medium to long-term fiscal framework. ■

How can macroeconomic policy strengthen the recovery?

The economy has been hit by a renewed cyclical weakening since the end of 2004 and is expected to expand by only 1¼ per cent in 2005. This is the third such episode in less than five years, even though this one has not turned into recession. A lull in exports, against a backdrop of rising oil prices, interrupted the economy's fragile recovery, which had been driven by a resumption of exports and housing investment. While enjoying favourable competitiveness and profitability, along with a low cost of credit, businesses have remained cautious in hiring due to uncertainties about economic prospects. In this context, private consumption has expanded only moderately in 2004 and 2005. Employment growth has been modest, and the jobless rate has been steady at about 4% since 2003 – its highest level since 1997, although it remains low in international comparison. With tame wage developments reflecting a negative output gap of about 1%, inflation has remained very moderate despite sharply rising oil prices: it has hovered just above 1¼% on an annualised basis between January and October 2005, whereas underlying inflation was only ¼ per cent in October 2005.

Given low inflation and sluggish activity, the Swiss National Bank (SNB) has pursued an expansionary monetary policy. The three-month LIBOR has been kept at 0.75% since the autumn of 2004 and has been negative in real terms for about three years. Lower inflation than in main trading partners and a stable exchange rate of the Swiss franc against the euro have implied currency stability in real terms, despite the fall of the dollar until the end of 2004. Benefiting from easy monetary conditions and some improvement in the external environment, the economy seems to be picking up in the second half of 2005, and GDP could increase by 1¾ per cent

in 2006 and 2007, thereby exceeding the economy's estimated growth potential of about 1¼ per cent. Unemployment should start to decline in 2006, without generating inflationary pressures, even if oil prices stay high. Nevertheless, heightening tensions in the oil market and another setback in the European recovery could delay the recovery once again and limit its strength. *Keeping monetary policy easy is therefore necessary, until there are clear signs that a solid recovery is under way. Monetary conditions will eventually have to move towards a neutral stance. But the SNB, which enjoys substantial credibility that moderates inflation expectations, can afford to act very gradually.*

The budget deficit of the general government, while moderate in international comparison, has widened since 2000 to 1¼ per cent of GDP in 2003 and 2004. As the deterioration is partly structural, particularly at the federal level, the authorities developed a medium-term consolidation strategy to eliminate the Confederation's structural deficit, estimated at ¾ per cent of GDP in 2003, in accordance with the debt containment rule. This rule, which was supposed to apply as of 2003, is intended to keep the federal accounts permanently in structural balance. In view, however, of the impossibility of applying it to the letter without running the risk of penalising activity, the consolidation programme aimed first at stabilising the federal structural deficit and then at eliminating it progressively between 2005 and 2007, with the debt containment rule applying strictly thereafter. The initial implementation of this plan was broadly in line with expectations. A slight reduction of the structural deficit was even recorded in 2004 at the federal level, though the main impact of the federal plan was not expected to be felt before 2005. However, overall, the fiscal stance was roughly neutral in 2004 due to a slight structural deterioration in the social security accounts, and it is likely to have remained so in 2005. Beginning in 2006, it is due to turn slightly restrictive following the implementation of the federal consolidation programme. ■

Can the fiscal policy framework be improved to control public spending better?

The move in federal finances towards balance seems unlikely to be reversed by financial trends at other levels of government. However, this prospective improvement of government accounts should not

divert attention from long-term difficulties in controlling public spending, which have led to a sharp rise in the tax burden and indebtedness. While still moderate in international comparison, government debt has increased by more than 25 percentage points of GDP over the past 15 years. Taxation has risen by about 4 percentage points of GDP since 1990, and in addition the mandatory contributions to private insurance schemes have increased by 2 percentage points of GDP. Together, these amount to one of the steepest increases in the OECD. All levels of government have increased their spending more rapidly than GDP, but the sharpest rises concern social programmes, and the pressures in that area will intensify from 2010 onward because of population ageing. In response, the federal council's consolidation strategy also includes structural reforms of the disability and health insurance schemes that go in the right direction. Nevertheless, reforms could be more ambitious in a number of areas, and further improvements in the fiscal framework are called for.

The debt containment rule does not formally anchor federal spending in the medium term. The medium-term outlook, as outlined in the Confederation's 2007-09 financial plan, would seem optimistic on several counts, and it does not guarantee the respect of the rule over the coming years. In the first place, the plan is based on favourable growth assumptions. In addition, it does not include fundamental reforms that would guarantee the long-term sustainability of the federal budget. Some expenditure-raising measures, for instance stemming from the new infrastructure fund are excluded. Conversely, to finance disability insurance the plan relies on a 0.8 point VAT hike in 2008, which will entail a referendum and faces substantial opposition. Repeated recourse to consolidation programmes, which would impair the rule's credibility, cannot be ruled out in the future. *Hence, it would be desirable to give more prominence to the debt containment rule and the associated risks in communicating medium-term financial plans, given numerous projects for additional spending or tax cuts and the lack of short-term flexibility of the federal budget. One could also extend the use of financial referenda to the Confederation, allowing citizens to decide on proposals to increase spending in excess of a specific threshold.*

The high degree of budgetary interdependence between the various levels of government is a serious problem not only because it impairs transparency but also because it undermines implementation of the rule at Confederation level and thereby complicates con-

solidation efforts. The separation of the accounts of basic old age and disability insurance from those of the cantons as foreseen by the new fiscal equalisation project is a welcome movement in this direction. Transparency is especially important in the context of direct democracy to give the population a better grasp of the choices to be made and to garner the necessary support for social reforms, which has been lacking so far. *Consideration should be given to linking the Confederation's transfers to its revenues, rather than to the spending of the insurance schemes.* While such a reform would have redistributive effects which may increase the difficulties of finding sufficient political support, it would on the other hand reduce the crowding-out of the most productive outlays (education, research, investment) that has to some extent been observed in recent years. It would also underscore the urgent need for social security reform. In addition, a more comprehensive approach to budgetary issues should be formulated. Because of the federal structure of government and the fact that certain social outlays are administered by compulsory contributions to private insurance schemes, it is difficult to gain a coherent view of overall budget trends and prospects. At the national level, discussions focus mainly on the federal finances, which account for only one-third of the total budget. Also, because the accounts of the Confederation, the cantons, the communes and public and private social insurance schemes are interdependent, decisions taken at one level of government may affect spending of other levels of government, forcing ad-hoc cuts elsewhere to meet the deficit targets. *Regular formulation of consolidated medium- and long-term plans for all administrations, including compulsory private social insurance schemes, would make it easier to spot and rank problems and to convey policy priorities to the population. This would entail stepping up efforts to enhance the timely availability of standardised statistics and other information on budget policies. Even if cantonal budget policies are framed independently, it would be useful to evaluate them through a peer review system that would spur consolidation efforts.* ■

How can the old-age and disability pension schemes be made sustainable?

A better fiscal policy framework is, however, no substitute for wide-ranging reforms in the old age, disability and health insurance systems, which are three key areas underlying the sharp rise in public spending. Because of population ageing, a deficit in the

basic old age system (AVS) will emerge between 2007 and 2010, reaching around 1½ per cent of GDP by 2020 and probably more than 3% of GDP by 2040. After the overhaul of the AVS was rejected by a referendum in 2004, deep reforms were put off until 2008 or 2009. Lowering benefit levels, an extension of years of work – which is not incompatible with making the retirement age more flexible – and recourse to additional funding cannot be avoided. *Linking years of work at least partly to life expectancy would limit the extent to which replacement rates need to be cut while at the same time ensuring that the burden of adjustment is shared equitably between generations. It is important not to delay enacting reforms so as to allow enough time for the insured to adjust.* A late decision could also pose problems of fairness if the ageing-related rise in the average age of the electorate would marginalise younger generations in the democratic decision-making process.

An even more urgent reform, currently being discussed, involves disability insurance, which is accumulating deficits. To stem the sharp rise in the number of beneficiaries, the proposal seeks to intensify early detection of people at risk of becoming long-term beneficiaries and to facilitate their return to work. These proposals are a step in the right direction, even though their limited short-term effect makes supplementary financing inevitable. In fact, most of the deficit is due to the entitlements of current pensioners which cannot be reviewed and a better control of the inflow has only a long-term effect. The additional resources should not substitute for efforts to keep spending under control, which would be assisted by a strict separation of disability insurance financing from that of the basic old age system and of other administrations. The effectiveness of the proposed measures will depend on how they are implemented. *Since the difficulties leading to disability often have non-medical causes, the already existing case-by-case approach has to be strengthened using a multidisciplinary approach entailing enhanced co-operation amongst the various social services (disability, health, employment).* Since 2002, firms have become more and more aware of the costs of invalidity pensions. Reacting to the evolution of the financial markets, private and mutual institutions running pension funds started to charge firms with experience-rated contributions largely based on the risk of invalidity (as was already the case before for the daily allowances in the sickness insurance. *Incentives to firms to avoid invalidity pensions are useful to the extent that firms have a strong influence on access to disability pensions, but*

they need to be applied in such a way as to avoid discouraging the recruitment of persons with health problems.

Occupational benefit funds have improved their financial position since 2002, thanks to rebounding financial markets and the various measures taken, such as greater flexibility in minimum yield rates. Yet further reforms are still needed. *The recently decided cut in the rate for converting retirement savings into annuities for people in the compulsory second-pillar scheme would not seem sufficient, given longer life expectancy and the likelihood of low nominal yields in a low inflation environment. A further cut in this rate seems necessary. The growing use of early retirement financed by second-pillar funds, contributions to which are tax deductible, should also be curtailed.* To avoid misuse of the tax benefits attaching to such pensions, the minimum age for receiving second-pillar early retirement pensions was raised from 55 to 58. *These measures could be complemented by a decrease in the ceiling on tax breaks.* The budgetary cost of the subsidies cannot be justified by their positive effect on private saving, since the effect on national saving is likely to be minimal. Furthermore, the tax breaks are regressive because of the progressiveness of the tax schedule and constitute implicit government financing of early retirement for the wealthiest workers, which spurs similar demands from those of more modest means. *At the same time, the conditions favouring the employment of older workers should be improved. Reducing the progressive nature of contributions to the second pillar of the pension system, which now rise as a function of age, would be welcome, but transitional issues are difficult to overcome.* ■

How can health system costs be better controlled?

There is consensus on the need to reform the health care system. But implementing changes is difficult, as shown by the failure to overhaul the health insurance system in late 2003. Yet the *status quo* is not tenable from the financial point of view, and it would seem necessary to adopt a set of coherent measures, even if some of these entail limitation of choice. In this spirit, the government has presented Parliament with a large number of reforms, which usefully clarify the logic of the system in terms of regulated competition, even though international experience suggests that deeper reforms should be envisaged in some

domains. This would strengthen incentives to control prices and the supply of health care. This is especially so in the case of the proposed abolition of the requirement to contract with all health care providers, which would give insurers greater ability to negotiate medical fees with individual providers and to control the number of medical acts, whereas, at present, the number of medical acts is not subject to an effective control. *Collusive practices during fee negotiations, between both suppliers and insurers, have to be excluded to ensure effective competition. The latter would be strengthened if the market was better integrated by removing barriers induced by the canton-based organisation of both health supply and insurance, which narrows the scope for effective competition. The shift to a prospective hospital financing system based on Diagnosis Related Groups from a retrospective one based on bed days should also prompt cost consciousness. Nevertheless, the continuation of joint hospital financing by the insurers and by the cantons limits the incentives for each party to rationalise the supply of hospital care, cut costs and increase the use of outpatient care. A shift to cantonal subsidies allocated directly to funds could probably overcome some of these difficulties, provided that it is combined with efficient freedom to contract for health insurers also in the area of hospital services. A lowering of high drug prices will entail reducing the obstacles to imports. Generic drugs that have been authorized for sale in the European Union should be made more readily available, for example based on the simplified admission procedure foreseen in the law on medical products and medical devices.* High drug prices having been widely criticized, the government intends to obtain price decreases of existing reimbursed drugs by revising them more frequently (15 years after initial admission, 2 years after patent expiration date). An extension of the panel of reference countries is discussed, by adding additional countries which have a pharmaceutical research capacity. Mindful that prices received by companies across all markets have an effect on research and development expenditures and ultimately, the number of new drugs coming on line, the need for incentives for research and development by pharmaceutical companies will be taken into consideration in the pricing process. Achievements in R&D can be reflected in an innovation surcharge being added to the daily treatment cost of the reference drug although calibrating this surcharge remains delicate. Such decisions are taken after consultation with the Swiss Drug Committee where the pharmaceutical industry is represented. *Targeting co-payments better on the most*

price-elastic demand for care (drugs, outpatient care) would also help to contain spending. ■

How can the effectiveness of government interventions be raised?

Efforts have been made to modernise the administration and enhance the effectiveness of government action. Foremost amongst these is the renovation of federalism, which aims at ensuring that those who decide on outlays also fund them. Rapid implementation of this project, which has been under way for several years, is desirable since it would foster more effective use of public funds thanks to a better division of tasks between the Confederation and the cantons, and better budgetary relations between levels of government. Also, the recent initiative to develop a “culture of effectiveness” in the federal government will help. *This initiative should be coupled with increased use of benchmarking of the cost and effectiveness of government programmes at lower levels of government.* For example, the publication of government employment and pay statistics at the federal and cantonal levels, and for major cities, by area of spending would probably help to moderate operating costs. *Efforts to catch up in the development of e-government would be another way to foster effectiveness. ■*

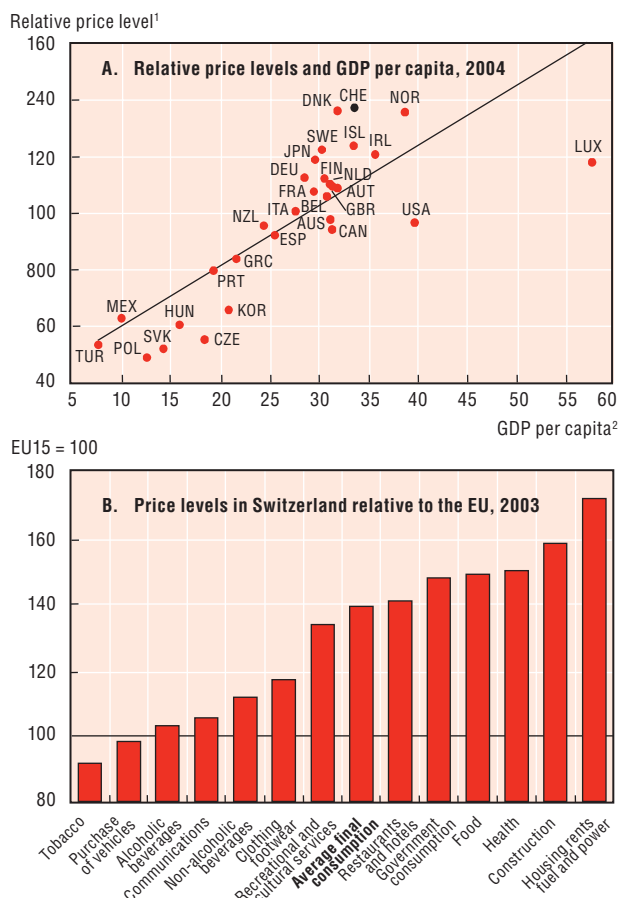
Are the recent series of measures directed to bolstering competition sufficient?

Increasing the potential growth rate of the economy, which is among the lowest in the OECD, is the most important and a well-understood challenge. Even taking account of the revenue generated by investment abroad, and of positive terms-of-trade effects, the standard of living has declined in relative terms when compared with Austria, the United States and the average of the large euro area countries at a rate of between ½ and 1% per year over the past 15 years. The lack of dynamism cannot be attributed to a chronic lack of demand as slow growth is a long-standing feature. Rather the phenomenon has structural roots, and it stems above all from meagre productivity growth, even though hours worked by females is also low in international comparison. However, since labour resources are better used than in most other OECD countries, it is primarily faster productivity gains that would halt the erosion of the advantage of Switzerland in terms of living standards.

The main reasons for sluggish productivity growth are a lack of competition in sheltered sectors, inefficient product market regulations and high costs of services delivered by the public sector or financed by compulsory contributions. Consumers pay a high price for the lack of competition, with a general price level that is some 40% above the EU average. In the past, reforms aimed at improving the competition framework were narrow and the pace of reform slow. Initiatives were often taken in reaction to developments in the European Union, and reform attempts have sometimes been blocked by popular vote. Potential gains from changes, are, however, likely to be substantial, and competition policy has appropriately moved up the policy agenda. The new Cartel Law gives the Swiss competition authorities important new means to combat restraints and has been brought closer to international standards.

In 2004, the government launched a package of 17 structural policy measures to be implemented during the current legislature in order to raise potential growth. These measures, which include significant advances in the area of competition, go in the right direction and should be implemented in a timely fashion. Major proposals currently examined by the Parliament concern the revision of the Domestic Market Act, which would eliminate the regional and local obstacles to a well-functioning national market and will guarantee the freedom of exercising a profession anywhere in the country. Reforms are also planned in the public procurement market and in network industries, especially in the electricity sector, where liberalisation has been very slow. Internal reform is complemented by the adoption of a comprehensive strategy in foreign economic policy through which deep integration of Switzerland in the world economy is sought. As one of the first elements of this strategy, the authorities are, for example, exploring the possibility of negotiating a free trade agreement with the United States, which would also bolster competition, given that the United States is Switzerland's second largest trading partner.

Figure 2. Consumers pay dearly for the lack of competition



1. Purchasing power parities divided by the exchange rate, OECD = 100
 2. In thousand USD, converted with the PPPs.
 Source: Eurostat and OECD, National Accounts.

There is still much scope to reduce protection and consolidate a culture of competition. In this regard, the adoption of the “Cassis de Dijon” principle to unilaterally eliminate technical barriers to imports is an important initiative, though it should not be undermined by the granting of exemptions. The provisions of the new Cartel Law should be applied vigorously, while the competition framework could be improved further by ensuring the political independence of the members of the Competition Commission and by raising its resources. In network industries, reforms have in general remained slow and their pace should be accelerated, especially in the postal services and the electricity and gas sectors. More rapid opening to international competition in agriculture, which is more heavily subsidised than in any other OECD country, would also help. Finally, price competition could be stimulated, for instance, by making competition of imports of patented products more effective. ■

What are the main challenges for the Swiss innovation system?

Due to very high labour costs, Switzerland needs to maintain a top position in innovation performance to preserve its competitiveness and living standard. On balance, its innovation performance has been

amongst the best. Among others, the country occupies a top position in knowledge-intensive market services which attracts many people trained in science and engineering and related to this it is also a heavy user of ICT. However, innovation performance has weakened somewhat in recent years. The weakening resulted to some extent from the protracted economic slowdown, but there are areas in which policy reform could strengthen innovation. The increased globalisation of R&D poses a challenge for Switzerland, as multinationals account for an important part of domestic R&D. Moreover, there are signs that innovativeness is lacking in small firms in sheltered service sectors. *Although maintaining the nation's attractiveness for multinationals remains important, boosting the innovative capacity of SMEs and removing obstacles to their growth should move up the policy agenda. This would require improving conditions for*

entrepreneurship and better bridging the gap between fundamental and applied research. Another challenge facing the Swiss innovation system is the growing knowledge economy and increased competition from emerging countries. Due to the emphasis on vocational education, participation in tertiary education is quite low in international comparison. *Efforts to reform the university system and further upgrade average educational attainment should be pursued steadfastly.* ■

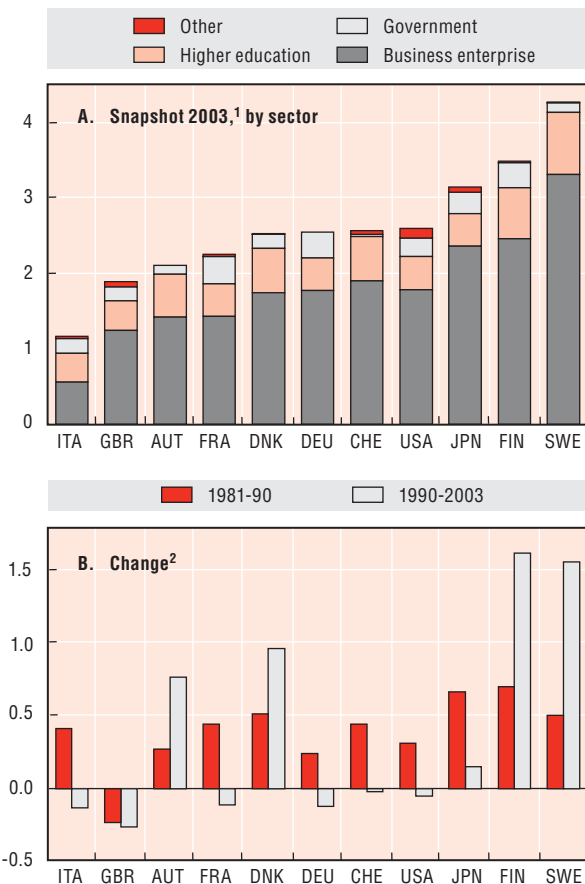
Entrepreneurship and tertiary education: room for improvement?

Boosting product market competition would go a long way towards raising incentives to innovate, especially in sheltered sectors and by small firms. Moreover, the larger size of the domestic market, due to the removal of local barriers, could stimulate firms to grow in some sectors. Administrative burdens are also an important obstacle to entrepreneurship, especially due to the lack of co-operation among cantons. The government's initiative to simplify administration goes in the right direction. But more should be done to modernise public administration by increasing the use of information and communication technology. A third obstacle to entrepreneurship is the bankruptcy law which in situations relevant for new undertakings extends *de facto* creditors' claims against a bankrupt entrepreneur indefinitely. Beyond its deterrent effect on the creation of businesses, entrepreneurs are less likely to take risks and may refrain from expanding their activities, in particular if it would require using bank credits. There is therefore a need to reform the bankruptcy law. Finally, equity financing and venture capital still play only minor roles in the financing of new ventures and innovation projects. Although this could reflect low demand, as entrepreneurs want to retain control of their business and refrain from risk-taking, there is room to improve framework conditions for such modes of financing. Current proposals to reduce the double taxation of dividends, and hence the cost of equity financing, could be more ambitious. The government's plan to introduce a tax-transparent company structure for venture capitalists goes in the right direction, while restrictions on pension fund investments in venture capital should be relaxed and initial public offerings facilitated.

The quite low participation in tertiary education results in a limited domestic supply of scientists and engineers. This is compensated to some extent by large

Figure 3. **Although remaining strong, innovation performance has weakened in the 90's**

Gross domestic expenditure on R&D in per cent of GDP



1. 2002 for Austria, Denmark and Italy; 2001 for Sweden and 2000 for Switzerland.
 2. Or closest period where data are available.
 Source: OECD (2005), *Main Science and Technology Indicators*, Vol. 1.

inflows of foreign scientists and engineers and substantial R&D activity in other countries. *However, if Switzerland is to keep its position in the global value chain, there is a need to expand tertiary education, especially at university level.* Significant efforts have already been made by upgrading vocational education at the secondary school level and creating universities of applied sciences which made it possible to conclude vocational education at university level. *This strategy should be pursued by further strengthening vocational curricula and continued reform within and among universities of applied science.* The authorities are currently preparing a reform of the whole university system, which will improve the quality and efficiency of university education – by reducing, for example, the time required to complete studies. Key elements include a consolidation and specialisation of the very fragmented university landscape, the introduction of a standard cost-related education subsidy per student in each field, and the development of quality assessments. While this reform faces resistance from universities, which may have to undergo restructuring, it is necessary nonetheless. The implementation of the Bologna process, which aligns the structure of studies with other European universities, will also put increased pressure on Swiss universities to raise the attractiveness of their studies to both Swiss and foreign students. *In addition to a more efficient use of public resources, more private resources could be tapped. Raising tuition fees for tertiary education should be studied, though the latter should be accompanied by a loan system with income-contingent repayments.* Tuition fees would also contribute to induce quality enhancements in the university system through pressures from students' choices. Another Swiss specificity is the under-representation of women in tertiary education, especially in sciences and engineering. *The incentives facing women to undertake tertiary education may be reduced by limited career prospects; adopting more favourable family-work reconciliation policies could help in this respect. However, specific efforts may also be needed to stimulate women's interest in sciences and engineering from an early age, since the share of women in these fields is extremely low in international comparison. Finally, more policy attention should be devoted to lifelong learning, which is key in a knowledge society. Measures such as promoting the recognition of qualifications, creating a time entitlement to adult education and training and providing some financial support would raise participation in such human capital development.* ■

Can innovation-specific policies be enhanced?

Switzerland stands out in not providing direct financial support for business R&D. This seems appropriate, given the already very high level of business R&D and hence the risk of large deadweight losses. The country also has a very strong basic research capacity, which is only partly funded by the public sector. One main source of concern is the availability of sufficient public resources for research and the difficulty in fulfilling spending priorities on education and research in recent budgets, due to fiscal consolidation and mandatory increases in social spending. Public funding is important to sustain basic research, which is widely available, and to support the transfer of technology between academics and businesses. *To preserve the world-class research and education outputs of several tertiary education institutions in Switzerland, national public funding for research must be given a high priority. Enhanced co-operation at the international level should not endanger national research funding. Beyond this, there is a need to better bridge the gap between fundamental research and the market. This should be achieved through boosting the funding of R&D at public research institutions by substantially increasing the resources of the Commission for Technology and Innovation (CTI).* CTI finances R&D for the business sector at Swiss public research organisations according to a public-private partnership model for innovation in products and services. The commission's bottom-up approach to strengthen technology transfers between academics and firms, its coaching services for start-ups as well as its nation-wide education programme for would-be entrepreneurs, go in the right direction. ■

How can labour market performance be raised further?

Beyond efforts to boost productivity, a higher rate of labour utilisation would also raise potential output. Despite very high employment rates, the full-time participation of women in the labour market is hindered by a number of obstacles. Removing these would also help offset the expected decline in labour force growth due to population ageing. Factors that maintain female participation at a low level include the system of joint household taxation, which, combined with a very progressive tax schedule, creates heavy work disincentives for married women. *A reform proposal to remove the marriage penalty, if accepted, would*

exempt 50% of the second labour income from taxation (with a maximum exemption of CHF 55 000). In the longer run, it would be even better to switch to a separate tax regime or at least offer the option of separate taxation, as is the case in most other OECD countries. The second major obstacle is the lack of affordable full-time childcare, both for pre-school and school-age children. Federal efforts to develop care facilities for young children, including out-of-school care, have produced mixed results. The provision of childcare facilities is hindered by the decentralisation of responsibilities to the municipal level, where coordination is lacking and the economic and tax benefits from increased women's activity are only partly internalised. Similarly, the Confederation has little say on the age of compulsory schooling, the development of early childhood education and schooling hours, which are typically short and non-continuous. A recent proposal to give the Confederation the right to set uniform rules for compulsory schooling (and higher education) if the cantons cannot agree among themselves (and/or with the Confederation) could overcome coordination issues, but it would require a constitutional vote. *Greater involvement of the Confederation, especially by ensuring a better co-ordination across levels of government could also help overcome problems in the provision of early childhood education and care. Moreover, the supply and quality of childcare could be more effectively raised and the matching with parents' needs could be improved by redirecting part of the public funding for childcare from the suppliers to the parents. Efforts should focus on raising the provision of childcare rather than increasing child*

benefits further, since these tend to reduce labour supply by mothers and poverty levels are relatively low.

The signing of an agreement for the free movement of persons with the EU and its extension to new member countries should allow Switzerland to reduce labour shortages during cyclical peaks, and import high- and low-skilled labour complementary to the domestic labour force, thereby somewhat reducing the risk of delocalisation of firms. However, the opening will be gradual and until at least 2014 Switzerland retains the right to re-impose quotas. Because of this, and because incentives to migrate will diminish as living standards in Eastern European countries catch up, the agreements are not expected to lead to large migration inflows. However, even though only small inflows are expected, measures were introduced to avoid social dumping, such as the possibility to impose minimum wages and/or extend collective agreements. *The various measures protecting incumbents should be used with care in order not to undermine the flexibility of the labour market.* ■

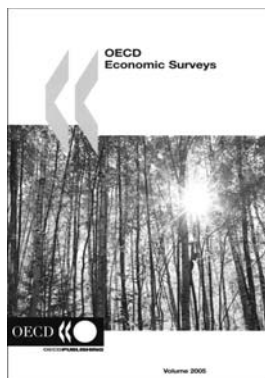
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