Jean-Pierre Roth: Switzerland - small, but global

Speech by Mr Jean-Pierre Roth, Chairman of the Governing Board of the Swiss National Bank, at the Swiss-Argentine Chamber of Commerce, Buenos Aires, 16 November 2004.

*   *   *

Argentina is a country that fascinates us Swiss. At one time it offered my fellow countrymen a new home when they could no longer see a future in Switzerland. Today, Argentina largely attracts business people and tourists. As you know, Switzerland is a tiny country in comparison with Argentina. Situated in the heart of Europe, it has more or less come to resemble one huge agglomeration. It is therefore not surprising that many Swiss view Argentina as a land of space and opportunity. But as to what Switzerland could mean to the Argentineans is only something I can guess at. Perhaps you still associate my country with chocolate and watches. On the other hand, maybe you recently visited Switzerland and discovered that a great deal has changed. The country has become more liberal-minded and has begun to question its traditional views - partly of its own accord and partly as a result of external pressures.

I am delighted to be here this evening and to have this opportunity to give you a brief overview of the challenges facing Switzerland in an era of growing globalisation, under the heading “Switzerland: small, but global”.

1. Switzerland according to common view

Switzerland has the reputation of being a special case - one which in some ways is slowly becoming a normal case. A good example of this is the development of the public spending ratio. Still quite low by international standards at the beginning of the eighties, it has now almost reached the EU average. As in most industrialised countries, the financing of the social security system has become a political hot potato also in my country. At the same time, the wealth gap between Switzerland and other OECD nations is shrinking; and there is no consensus as to how Switzerland might boost its economic growth. Political debates have intensified and politicians’ telegenic skills have become an issue there, too.

However, certain aspects of Switzerland’s time-honoured image still prevail. Despite all the prophecies of doom, our democracy is under no threat; the Alps still shine in all their majestic glory; and the Swiss people - a fifth of whom are non-Swiss in origin - are just as hard-working, punctual and reliable as ever. The level of employment is in fact remarkably high: almost 80 percent of the population of working age are in employment. While it is true that the unemployment rate rose sharply at the beginning of the nineties, it is still less than half as high as the EU average. Important areas of the working world, such as unemployment insurance and the protection against unfair dismissal, are regulated in such a way that companies are willing to create new jobs, and the unemployed are anxious to find work again quickly.

In addition, Switzerland still has a very competitive export sector, which is well able to hold its own in today’s global environment. It comprises both large international companies as well as a great deal of small and medium-sized enterprises. These are able to maintain their leading position in the world, thanks to high productivity and innovative products.

A greater cause for concern, however, is our domestic economy. It includes a number of different sectors, such as agriculture, tourism, and trade and industry, as well as public and semi-private areas, such as telecommunications, post and electricity. In many sectors, the domestic industry is not productive enough and too costly. Many prices are kept high by state regulations, cartels and other anti-competitive agreements. The enforcement of the Domestic Market Act, which was introduced in the nineties with the purpose of standardising the Swiss market, failed at a cantonal level. As a result, price levels in Switzerland are significantly higher than they are abroad. The affected sectors put forward the argument that like hadn’t been compared with like and that the differences in quality hadn’t been taken into consideration. There is undoubtedly some truth in what they say. Furthermore, the desire to mitigate competitive pressure may reflect a Switzerland that wants to avoid conflict. Indeed, this attitude has, in many respects, proved highly advantageous for the country. Nonetheless, it doesn’t change the fact that international competition has increased and that the Swiss are making the most of the growing number of possibilities to avail themselves of goods and services from abroad.

Of course, we can’t talk about Switzerland without also talking about the Swiss franc. The Swiss franc forms the basis for the Swiss National Bank’s monetary policy autonomy and for price stability. It also underpins the efficient Swiss capital market, which is characterised by a low interest rate level, when compared internationally, and which represents an important locational advantage for the country.

The European political and economic environment - of which Switzerland is an integral part - has, however, gone through a great deal of change. It is therefore not surprising that our relationship with Europe is a topic of much discussion in my country.

2. Switzerland and the European scene

For almost six years now, Switzerland has been surrounded by the single European currency. And for six years we have been trying to make it clear to our friends abroad that Switzerland is nevertheless not an island, but is in fact deeply integrated into Europe. Approximately 20 percent of our workforce comes from EU member states. A total 60 percent of our exports go to the EU and 80 percent of our imports come from there. A large proportion of the transit travel from the north to the south of Europe goes right through Switzerland. In order to make this more efficient, we are currently digging a 57-kilometer-long railway tunnel through the Gotthard Mountain - an undertaking that is going to cost Switzerland a lot of money. So I hope that it will manage to be the longest railway tunnel in the world - for a few years at least.

The country’s economic relations with the European Union are governed by the Bilateral Agreements - this comes after the electorate voted against Switzerland’s accession to the European Economic Area in 1992. Agreements in seven sectors have been in force since mid-2002; a further eight agreements were signed by the EU and Switzerland just three weeks ago. These now need to be approved by parliament or, if necessary, by the people.

Opening up the Swiss labour market vis-à-vis the EU is of particular importance. For our country, the enlargement of the workforce through the immigration of foreign nationals has long been crucial, given its own limited labour potential. Earlier arrangements were customised to suit the needs of certain sectors, notably the construction, tourism and agricultural industries. However, since the bilateral agreement on the free movement of persons entered into force two years ago, the Swiss labour market has been open to EU citizens. And vice-versa - Swiss nationals seeking employment are free to work anywhere in the European Union. There are, however, still quotas in place. These will be removed in 2007. In June of this year, the preference clause favouring Swiss employees was abolished. A company in Switzerland may now employ EU nationals without first having to prove that an equally qualified person could not be found for the position in the country.

Thanks to the agreement on the free movement of persons between Switzerland and the EU, Switzerland now has access to an extensive highly-trained workforce. It has not yet been possible to estimate just how much of this potential will be used. Up until now, there has been no major influx of people into Switzerland, although this may be attributable in part to the weak labour demand, which in turn is due to the current economic situation. In the medium term, we expect the proportion of labour coming from the EU to Switzerland to increase.

However, opening up the Swiss labour market also gives rise to fears. People are concerned that Swiss salary levels will come under pressure and that employment conditions will deteriorate. In an effort to counteract any serious repercussions on the Swiss labour market, the authorities have implemented a number of accompanying measures. These, however, will not be able to completely prevent competitive pressures in Switzerland from intensifying. The attempt to avert any wage adjustments by introducing minimum wages across the board, for instance, would be counterproductive. Switzerland would be unable to benefit from the opportunities that this opening up presents. The Swiss labour market would become less flexible, and the country would lose one of its most crucial locational advantages. It is more important to ensure that the goods markets also adjust and the inflated price level drops - this can be achieved by systematically promoting competition and by reducing state regulations.

The eastward enlargement of the EU inevitably begs the question as to whether the rocky bilateral road on which Switzerland has set out will also be a fit for the challenges of the future. Accession to the EU is currently not an issue, however. Reasons for the scepticism of the Swiss people in this regard are manifold. For instance, Switzerland would have to give up the Swiss franc if it joined. This in turn would mean a higher interest rate level and an end to our autonomous monetary policy.

It was precisely in the past three difficult years, that the possibility of conducting an independent monetary policy proved advantageous. At the beginning of 2001, the Swiss National Bank relaxed its monetary policy before the European Central Bank and, in the following months, also cut its short-term interest rates more drastically than the ECB. In March 2003, we lowered our key rate, the three-month Libor rate, to almost zero. This was in reaction to the deflationary risk in the wake of the strong appreciation of the Swiss franc. We have, in the meantime, pushed our interest rates back up slightly. Our economy has now returned to its growth path and the risk of deflation has been overcome; so there is no longer any reason to keep the short-term interest rate level so close to zero.

The sharp decrease in interest rates certainly helped to bolster domestic demand and thus avoid an even worse downturn. It was nevertheless not possible to completely escape an economic slump. It goes to show, yet again, just how close Switzerland's ties are with the EU and the global economy - both in good times and in bad.

3. Switzerland as a global player

Switzerland does not only feel the winds of change in Europe. As a small and open country, it is also strongly exposed to globalisation. Foreign trade - measured as the sum of exports and imports in relation to the gross domestic product - has risen further in the past ten years. At the same time, the export and import structure has become more diverse. While the old EU countries have lost some ground, the emerging countries in Eastern Europe and Asia have gained substantial shares.

Globalisation brings with it an increase in competition for the most attractive business locations. In recent years, Swiss companies have founded or taken over companies outside Europe on a significant scale - partly to cut costs, but in many instances also to be closer to the markets. To what extent Switzerland has already become a global player is reflected by the impressive development of direct investments. These are investments through which an investor participates with at least 10 percent in a company abroad or establishes a subsidiary or branch abroad. In 2002, the stock of Swiss direct investment abroad amounted to almost 100 percent of Switzerland's GDP, as against only 29 percent in 1990. Compared with other industrialised nations, Switzerland is in the top league.

In the financial sector, globalisation has manifested itself particularly clearly. In the past few years, Swiss banks have seriously boosted their investment abroad, mainly by taking over foreign financial institutions. At the same time, however, the Swiss banking sector has undergone an intensive process of concentration, which partly resulted from domestic problems, but also came as a reaction to fierce international competition. The total number of banks halved from roughly *600* institutions at the beginning of the nineties to less than *300* institutions today. Of the four big banks, only two remain.

Apart from this restructuring process, a number of other challenges have arisen over the past few years. Notably the clean-up of the legacy from World War II, the participation in the combat of money laundering, and also the protection of our interests vis-à-vis the EU, particularly with regard to banking secrecy and the taxation of savings income. Lastly, the stock market slump in 2001/2002 put the earning power of the financial industry to the test.

The Swiss financial sector proved it could tackle these challenges. It was able to consolidate its position as a significant international financial centre, and thus remains an important pillar of Switzerland's economy. Stiff global competition, meanwhile, is still forcing the financial sector to increase its efficiency and lower costs. The days when banks and insurance companies were reliable job machines are gone and will probably not return in the foreseeable future.

The challenges I mentioned - from securing the social security institutions to standing our ground in a global environment - will be major issues for the Swiss economy, politics and the public in the coming years, and they will put Switzerland's adaptability to the test. Allow me now to comment briefly on a few of these challenges.

4. Current challenges

As in most industrialised countries, demographics create a need for action in Switzerland, too. The population is steadily aging and grows only slowly. It is thanks to immigration that it is rising at all. We will therefore face a massive increase in social security expenditure in the decades ahead. At the same time, economic growth in Switzerland is weak. This constellation threatens to destabilise public finances. There are solutions, yet none of them come for free.

The first two solutions, i.e. cutting back social benefits and/or increasing social contributions, are not very popular. In the first instance, the people are opposed to such measures. As to the second solution, it does not make economic sense to further increase the already heavy tax burden. This leaves a third alternative - that is to boost income through stronger economic growth. A majority of people favour this solution, yet there is no consensus as to how it might be realised. Some support stimulating demand, especially with a view toward monetary policy. Others put the emphasis on supporting the market forces by deregulation and liberalisation. However, these same people will often shy away from drastic measures as soon as their own interests are concerned.

The National Bank can support economic growth with its monetary policy as long as the goal of price stability is not jeopardised. This is the case when economic growth reaches capacity limits. However, monetary policy cannot increase the growth potential. To achieve this, measures are needed that provide more room for manoeuvre and foster initiative and readiness for innovation on the part of individuals and corporations.

In recent years, Switzerland has seen a number of reforms that head in the right direction and - in some cases - that have proven to be successful. For instance, the telecommunications sector and the hotel and restaurant industry have been liberalised, the cartel laws revised and - last but not least - labour market policies have seen changes as a result of the free movement of persons between the EU and Switzerland. Admittedly, some of these reforms have been implemented only half-heartedly and - what's more - under pressure from outside. This is not surprising given the fact that the level of prosperity in Switzerland is still high and that we are not in an acute crisis situation. I am confident that the reform process will accelerate in the next few years, with the European domestic market and globalisation being important driving forces. In order to remain competitive and attractive as a production centre, Switzerland will have to break new ground in many areas.

The National Bank is also confronted with some challenges. One change, which initially caused us considerable concern, has turned out to be a big advantage: the creation of the European currency area.

Prior to the launch of the euro, there was a great deal of concern at the SNB. We could not exclude the possibility that the euro would destabilise the franc, that it would replace it as a means of payment, and that the expectation of the Swiss franc being pegged to the euro would mean a convergence of the lower domestic interest rate level with the higher interest level in the euro area.

None of these scenarios have become a reality. On the contrary - the euro stabilised the exchange rates to a degree that we would not have thought possible ten years ago. The franc continues to be the means of payment in Switzerland, and the usual interest rate differential vis-à-vis the euro area remained. As I have already mentioned, this enabled us to conduct a monetary policy in the heart of the euro area that is suited to the needs of Switzerland.

And that brings me to my concluding remarks.

5. Conclusion

Switzerland is a small, open country, with few natural resources, which in many ways has become global. The export industry and the financial sector have adjusted well to the new structures and have become global players. The domestic economy and the political structures, however, are straining to make the equivalent adjustments because changes in those areas would often affect vested interests and future claims on the social security system. Nor has there been sufficient pressure to act. However, in order for Switzerland to stand the test in a dynamic global environment, it must ensure that the reform process currently under way will be continued and accelerated.

By now, some observers have come to question Switzerland's ability to make comprehensive reforms altogether and assert that the country has become a problem case because of its inability to make changes. I do not share this pessimistic view. On the contrary, I am convinced that the understanding for the necessity of reforms, and with it the willingness to temporarily accept disadvantages, will grow. What ultimately gives me cause for optimism are Switzerland's sense of realism and its wealth of experience. We are aware that neither the European environment nor globalisation will take our national feelings into account. However, we have also discovered that a small country can indeed exist in a globalised world provided that it considers its comparative strengths.