

Jean-Pierre Roth: Switzerland and Singapore - small countries as platforms for global business

Keynote address by Mr Jean-Pierre Roth, Chairman of the Governing Board of the Swiss National Bank and Chairman of the Board of Directors of the Bank for International Settlements, at the Swiss Business Association, Singapore, 18 September 2006.

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Once in a while, the Annual Meetings of the International Monetary Fund and the World Bank do not take place in Washington, as usual, but are held somewhere else in the world. The fact that we are meeting in Singapore this time is a welcome opportunity for me to return to the "City of the Lion". I am happy to be with you today and I would like to thank the Swiss Business Association and Ambassador Woker for hosting this Association lunch.

For Swiss people, it is always a pleasure – even a delight – to spend time in this fascinating city. Since Singapore is often referred to as the "Switzerland of Asia" it is particularly interesting for them to make comparisons with their home country. As a matter of fact, I am one of some 50,000 Swiss who visit Singapore each year.¹ Singapore is a unique place with its beautiful skyline, its outstanding location, its pulsating life, and – most of all – its openness to the world. Interestingly, Singapore and Switzerland share many common features. In particular, both of our countries have to deal with surrounding neighbours that are much larger and more powerful. Some believe this must make it harder to succeed in competition of any kind, but in fact the opposite is true. Let me show you why our position needn't be a disadvantage, but, on the contrary, an asset.

Clichés are very hard to overcome. In the case of Switzerland, as you know, we are best known for our banks, watches, chocolate and cheese. Other than this, and despite the strong presence of Swiss multinationals abroad, the world doesn't usually take too much notice of what some regard as a "small village in the heart of Europe". In international surveys, we are largely ignored, and in European statistics we are almost non-existent. Sometimes this can be an advantage. However, in a more and more globalised world, it is rather the opposite. Success depends heavily on your marketing.

So, let me show you some hidden aspects of Switzerland. You will see that modern Switzerland is adjusting rapidly to the changing reality of the world economy. Let's consider a few facts.

A booming economy, at home and abroad

With 7.5 million people, Switzerland is indeed a small country, surrounded by the economically powerful European Union. We have no natural resources, and contrary to Singapore, we do not even have a chance of gaining new territory by raising it out of the surrounding sea. Nevertheless, we have a highly developed economy and a GDP per capita that clearly exceeds the European average. Contrary to the situation among some of our neighbours, our population is still growing, thanks to immigration. Our foreign population now represents more than 20% of the total population and 25% of the labour force. Despite strong immigration, our unemployment rate – 3.1% – is relatively low.

In recent years, our economy has been doing better than its neighbouring countries in terms of growth and employment. At probably close to 3% this year, our economic expansion is above our potential. Obviously, the fact that we are not a member of the European Union is no obstacle to our development. This is good news. However, Switzerland remains a slow-growing country – not only when compared to Singapore and other "East Asian Tigers". Our weak growth performance in the long run is due in part to full employment, the relatively high level of personal income and the limited scope for domestic investment.

Like many other highly developed industrial nations, Switzerland is increasingly a producer of services. The flagship of our service industry is the financial sector, which expanded markedly in the 1990s and now accounts for 15% of our GDP – more than the machine tool industry and the chemical industry together. During the same period, however, the number of banks was reduced by half and the number

¹ Switzerland ranks fifth in terms of European visitor arrivals to Singapore, just behind France and the Netherlands.

of bank employees has remained stable despite expanding financial activities. These figures show that our financial industry has been eager to react swiftly to the challenges posed by globalisation.

Switzerland has a solid balance of payments position. Thanks to a large excess of savings over domestic investment, our current account surplus is constant and substantial. Contrary to popular belief, my country is not an importer of capital, but a net capital exporter. Our current account surplus represents 15% of our GDP, a level which can only be compared to that of some Asian countries like Singapore.

In terms of labour market openness, another step will be achieved next year with the full liberalisation of labour markets between Switzerland and the traditional members of the EU. From our perspective, this is good news. We expect a new impetus to our labour markets. Europe will become even more important as a reservoir of skilled labour for Switzerland. The opening and integration of these markets is putting pressure on the wages in our country, which are traditionally high as compared to other countries.

The position of Switzerland in Asia

Large Swiss firms invest more money and create more jobs abroad than they do at home. Switzerland has become a major investor not only in Europe, but also here in Asia. Today, there are 4.2 million jobs in Switzerland, while 1.9 million people work abroad for Swiss firms. Apart from Singapore and Hong Kong, there is no other country where foreign investments exert this kind of leverage. This situation is the result of a long tradition of Swiss presence abroad. In Asia, Swiss direct investments amount to 35 billion Swiss francs, and Swiss firms employ 300,000 people, up 20% from 2000. In Singapore, to take an example, Switzerland is among the top European investors, ranking third after the UK and the Netherlands. The 250 Swiss companies here contribute 18% to total European investment in Singapore.

Our trade relations with Singapore have developed rapidly in recent years. Since the late 1990s, total bilateral trade has increased by almost 50% to a new record of 1.9 billion Swiss francs last year. As a consequence of the rapid expansion of our trade with Asia, in general, and Singapore, in particular, the overall significance of Asian trade for us is now of the same magnitude as our trade with the United States. However, taking into account the relative size and the potential in Asia, there is still a lot of leeway for Swiss firms.

A similar picture can be observed with respect to Swiss direct investment on the continent of Asia. Despite an increase of 30% between the late 1990s and 2004, Asia still only accounts for 7.7% of total Swiss investment abroad. Although Singapore commands the lion's share in this regard – 2.5% or 11 billion Swiss francs – it is evident that there is enormous potential for the expansion of bilateral economic relations between our two countries, and even more between Switzerland and other emerging Asian countries.

For both historical and geographical reasons, our country is exposed to a considerable commercial risk in Europe, with 60% of our exports going to European countries. These European markets are no longer the most dynamic, nor will they become so in the future. Clearly, in recent years, the emerging economies in Asia have become one of the vibrant regions of the global economy. This is precisely why globalisation makes sense for an economy open to international markets, such as ours. Therefore, it is essential that we step up the diversification process so as to ensure the expansion of our export sector. It is in our own best interests to further strengthen economic relations with Asia. With our liberal philosophy and sound financial standing we have the necessary tools to pursue a policy of openness and enhance our strong presence abroad.

Our monetary framework

Switzerland is well-known for its stable monetary framework. Average inflation over the last 20 years has been 1.8%, and for the last 13 years, we have had price stability. We have never gone through monetary reforms as many European countries have done over the past few decades.

Our monetary regime has been unchanged since 1973, when the peg to the US dollar was removed. Today, the Swiss franc is freely determined by market forces. As a representative of a country that has had floating exchange rates for over thirty years now, I can only underscore the importance of an exchange rate regime that reflects the realities of the market. During the past three decades, the

Swiss franc has been an essential factor in the development of the Swiss economy. However, it has never been a reason for our exporters to sit back and relax. On the contrary, the Swiss franc has put pressure on them to become more efficient and to specialise in those product areas in which we have a real competitive edge. Consumers have also profited from the strong Swiss franc in that the prices of imported goods have fallen significantly. A currency that is accurately priced enables the economy to benefit from improvements in its terms of trade triggered by productivity increases. That is why Switzerland is a firm believer in flexible exchange rates.

Another advantage of a flexible Swiss franc is that changes in the international monetary system have little bearing on our currency, which is largely determined by economic realities in Switzerland. Consequently, the launch of the euro in 1999 – probably the most important event on the monetary scene in recent years – did not lead to the disappearance or the destabilisation of the franc as feared by some. Though the euro – to all intents and purposes – is accepted as a means of payment in Switzerland, there are not more euros in circulation now than there were French francs, German marks or Italian liras prior to monetary integration. Furthermore, the calm that has characterised the foreign exchange market in Europe since the disappearance of national currencies has mitigated speculative pressures on the franc. When the euro was launched, its exchange rate against the Swiss franc was 1.60; now it is only 1-2 cents below this rate – in other words, almost unchanged. On the whole, the euro has stabilised the monetary scene in Europe, and our currency is therefore less volatile than before.

To be sure, floating rates still mean volatility, especially in the case of market disruption. At times, the Swiss franc has been pushed up to levels no longer compatible with the economic reality of our country's fundamentals. However, these episodes have usually lasted for a limited period only. After September 11 and before the outbreak of the war in Iraq, the safe-haven function of the franc triggered a 10% appreciation in our currency against the euro. As a consequence, we pursued a more aggressive interest rate policy than the ECB in order to lower the attractiveness of our currency and give our economy some room for manoeuvre.

Also, in the current business cycle, with a rapidly growing Swiss economy, we started lifting interest rates earlier than – and independently of – the ECB. In the last two years, we have already increased interest rates on six occasions. Contrary to the pessimistic assumption that the Swiss National Bank would be forced to shadow the policy of the European Central Bank, we have been able to set interest rates according to the needs of the Swiss economy. And we will continue to do so. Summing up, we are as happy as central bankers can be with the outcome of the test imposed by the change in the European monetary system.

Why joining the EU and the euro is not a realistic option

And what about the European issue? As you know, we are not a member of the European Union, nor do I foresee Switzerland joining the EU in the near future. The Swiss people remain sceptical about the efficiency of the Union and are very aware of what they stand to lose in terms of political rights and economic freedom in the event of integration. But our relationship with the EU is of key importance, since Europe accounts for two-thirds of our foreign trade, as I mentioned before. In order to secure our access to the European market and to avoid discrimination, we have concluded two packages of bilateral agreements with the Union – one in 2002 and one in 2004. The present situation – with free movement of goods, capital and labour, but without monetary and fiscal integration – is probably the best solution for us. In short, our relationship to Europe is well organised and established.

At this point, one specific question often arises: If we are so well integrated, why don't we peg the franc to the euro instead of pursuing an independent monetary policy? Wouldn't this help eliminate the exchange rate risk, without giving up monetary flexibility entirely?

The answer is that there is no certainty that a peg would engender the foreign exchange stability that exporters sometimes dream of. We have learned from our experience with flexible exchange rates that any explicit foreign exchange target stimulates the appetite of speculators instead of calming the situation. And this would be especially true if our pegging decision were to be taken unilaterally, without the prospect of a full and permanent integration into the euro area. Today, with global markets and global speculation, it is an illusion to believe that a central bank can defend a specific exchange rate target. The only exception would be if the economy whose currency serves as the peg were strongly convergent with the domestic economy.

Furthermore, a nominal peg against the euro would do little to stabilise the real value of the Swiss franc – the only thing that matters for the international competitiveness of the Swiss economy – or to stabilise the franc vis-à-vis third currencies, especially the US dollar.

Last but not least, Switzerland enjoys the lowest interest rates in Europe. This situation has nothing to do with the appeal of our bank secrecy, as many believe, but with the abundance of savings and the high degree of price stability. Since the introduction of the euro in 1999, the average interest rate on three-month Swiss franc deposits – 1.4% – has been less than half the rate for euro deposits.

If Switzerland were to give up its monetary independence by pegging the franc to the euro or by joining the euro area, Swiss interest rates would increase to European levels. Since higher interest rates mean lower asset prices, lower levels of investment, and also higher mortgage rates, the Swiss are, understandably, not keen on giving up their national currency. A major decision of this kind would have to be approved in a public referendum in Switzerland; the prospect of EU and euro membership in the near future is thus highly unlikely.

Conclusion

Having chosen the option of free trade and free movement of capital, Switzerland is, in many respects, better prepared than others to take advantage of the greater opening of borders brought about by globalisation. To be sure, this is no easy ride, as international competition always necessitates painful adjustments, and Switzerland is no exception in this respect. Given our openness, we are immediately affected by a slowdown of the world economy. On the other hand, as in the current circumstances, we can take full advantage if worldwide business activity is healthy.

When we take stock of the last few years, the bottom line looks favourable. However, we would certainly be in an even better position now if we had built up a stronger presence in emerging economies. Contrary to what some people believe, I am fully convinced that globalisation is not the cause of weak growth and unemployment in Switzerland; indeed the opposite is true. Foreign trade is the engine driving our economy. It has expanded in recent years in step with the global economy. By contrast, our domestic market has been much less dynamic and has registered only limited gains in productivity.

In comparing Switzerland to Singapore the many similarities are evident. As small countries, both of us have simply no choice but to trade with the rest of the world, if we want to prosper. In many respects, we also face the same challenges: We have to adjust to a rapidly changing world, we have to remain competitive with our high technology products as well as our world-class services, and we have to focus on niche policies. In other words, we have no choice but to opt for excellence.