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Autor: Ribi, Rolf / Walser, Rudolf / Gaillard, Serge
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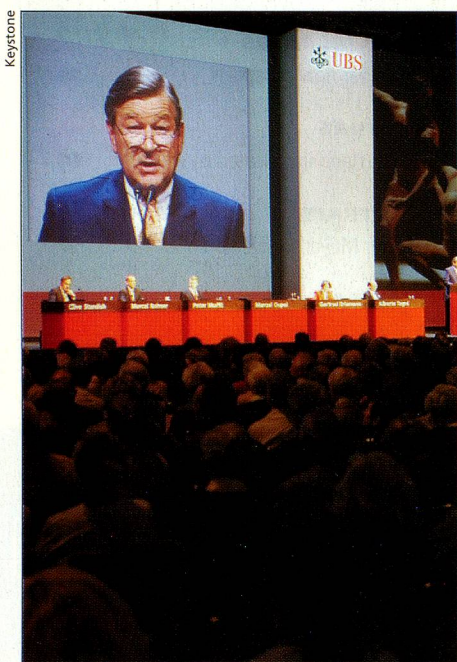
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"Lord, give us the strength to reform"

Where does the Swiss economy rank in the world? Do its virtues still count, or is it on the way to the poorhouse? Six strengths and six weaknesses of Switzerland's economy.

BY ROLF RIBI



Successful: Marcel Ospel, UBS.

"ACCORDING TO A SIMPLE extrapolation, if the Swiss economy continues growing at the same feeble pace as it has since 1980, Switzerland will be one of the poorest countries in Western Europe by 2028." Never before has such a drastic indictment of Swiss economic growth and purchasing power been uttered as in this statement by State Secretary Jean-Daniel Gerber of the Federal Department of Economic Affairs. A similar tone is taken by Economiesuisse, the umbrella organisation representing the Swiss economy: "At the beginning of the 1990s, Switzerland was still a model of good economic policy. Since then it has lost ground dramatically: Its attractiveness as a tax haven has been eroded, public debts are high, economic growth is weak, regulatory intervention is growing, and capital expen-

diture is low," says Rudolf Walser, member of the Executive Board (see page 5).

Are these rather bleak forecasts justifiable, or is the picture being painted deliberately black in order to push through reforms? In terms of international competitiveness the Swiss economy can still hold its own, and as an international business centre, Switzerland remains first-class.

Switzerland in the world

The annual study conducted by the World Economic Forum (WEF) assesses countries on the basis of two competitiveness indicators: The 2004 Growth Competitiveness Index ranked Switzerland eighth among 104 countries (seventh in 2003), with Finland, the USA, Sweden and Taiwan in the top four positions. The second WEF index, which assesses affluence, productivity and the business environment (Business Competitiveness), placed Switzerland even higher at Number 5 (compared to No. 7 in 2003) among 98 countries, behind the USA, Finland, Germany and Sweden.

The annual study conducted by the IMD institute in Lausanne uses data and surveys to determine a country's ability to create a favourable business climate. According to these statistics (World Competitiveness Yearbook), Switzerland came 14th among 104 countries in 2004 (9th in 2003). Top of the list were the USA, Singapore, Canada and Australia.

Switzerland was the most affluent country in the world for decades following the Second World War. Even now, it ranks alongside Luxembourg, Norway, the USA and Ireland as one of the richest of the 30 OECD member states in terms of gross domestic product. And in terms of personal purchas-

ing power (calculated on the basis of national prices and salaries), according to a global survey conducted in 70 countries by the Swiss banking giant UBS, purchasing power in Zurich, Basle, Geneva and Lugano is the highest in the world, followed by Luxembourg, Los Angeles and Miami.

There are other factors that point to our country's high international ranking. Switzerland is one of the most globalised countries in the world, with more globally active conglomerates per capita than any other country. This underpins the international strength of Swiss companies and the attractiveness of Switzerland as a base for foreign enterprises.

And where is the greatest economic freedom to be found? According to the reputable Cato Institute in Washington, it is to be found in Hong Kong, Singapore and the USA. Switzerland is in a respectable ninth position. The factors that determine this ranking are freedom of competition, protection of property and person, freedom of choice in economic matters, the independence of courts and the government's influence on the economy.

Let's now turn to a non-economic factor: quality of life. The findings of the British Economist Intelligence Unit are based on satisfaction surveys using nine indicators such as income, health, freedom, employment level, family life, political stability and security. And where is the quality of life at its best? In Ireland, closely followed by Switzerland!

The strengths...

What are the concrete strengths and weaknesses of the Swiss economy at present? There are six major strengths:

Boundary conditions: Swiss businesses and foreign companies based in Switzerland “benefit from national conditions that are key to sustainable development and differ significantly from foreign conditions,” wrote Professor Georg von Krogh of the University of St. Gallen. He believes that Switzerland has “a political environment that is more business-friendly than other countries,” and that the country’s political and social stability favour long-term business strategies.

Production centre: Many Swiss export companies are international leaders in their sector. Household names such as Nestlé, Credit Suisse, UBS and Novartis are among the hundred highest-earning companies in the world. Others are also important global players in their market, e.g. Adecco (recruitment), Swatch Group (watches), Holcim (construction materials), Schindler (lifts) and Roche (pharmaceuticals).

“We have a good base for a healthy production sector in Switzerland,” says Rolf Schaumann, Chairman of technology giant ABB Switzerland. His arguments: highly skilled personnel, good social partnership, highly developed public infrastructure and “by far the highest productivity in Europe”.

The strength of Switzerland as a business centre is reflected in the fact that more and more foreign companies are setting up bases in Switzerland: “more than in comparable countries such as the Netherlands, Sweden, Austria, Denmark and Finland,” emphasizes

Rudolf Walser of Economiesuisse. Moreover, Switzerland is popular among foreign companies not only as a head office location and because of its service sector, but also as a production centre.

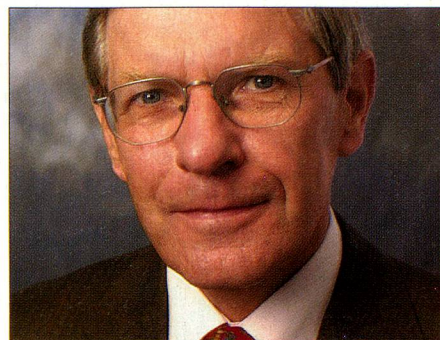
Some 600 American companies alone have created tens of thousands of jobs in our country in recent years. “I enjoy being an entrepreneur in Switzerland,” says American manager Manfred W. Herr. He cites the “very high productivity, motivated employees, the good level of education, and a business-friendly taxation system.”

In recent months alone, well-known names like Google (Internet), Zimmer (medical technology), Ebay (Internet), General Mills (foods), Ralph Lauren (fashion), Gillette (body care), Procter&Gamble (consumer goods) and Starbucks (coffee) have moved their headquarters, European base, production or research centres to Switzerland. A large number of Japanese and German companies are following suit.

The job market: When it comes to the job market, other countries look on us with envy. Low unemployment (currently 3.8 percent), a very high activity rate (80 percent of all persons of working age are in employment), top of the league in terms of the number of hours worked, low unemployment among the young, high employment among women and older professionals, and freedom to resign, make our job market highly attractive.

“The good level of education is an important advantage for Switzerland,” stresses ABB manager Rolf Schaumann. Nowadays the level of education obtained at universities and technical colleges as well as among tradesmen and apprentices is “very good”. Business leaders are also awarded good marks. In a study by the IMD in Lausanne, Swiss managers were found to have the most international experience. The study points to the cosmopolitan attitude of Swiss managers, their linguistic skills and extensive network of contacts abroad.

Research centre: For a country without any natural resources, it is vital to boost innovation through investment in research. “We must be not just technology leaders, but global technology leaders”, urges Rolf Staumann of ABB. Switzerland ranks high when it comes to spending on research and development, and is Number 1 in certain key fields of research. Incidentally, three quarters of all research projects are funded by the private sector.



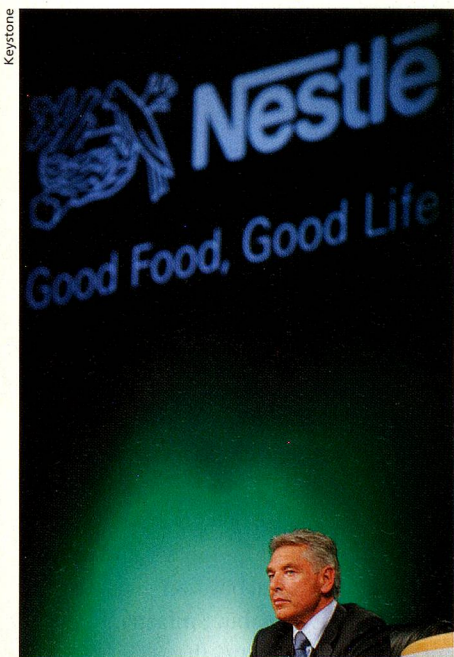
Rudolf Walser talks about Switzerland’s business climate

The strengths: In principle, Switzerland still holds a few trumps in terms of its competitiveness as an international centre of business: The strength of the export economy, the good position held by Swiss universities in the international knowledge and innovation league, a tax climate that continues to be favourable, the proven three-pillar system for pensions, and the fact that more international companies are based here than in other comparable countries. Finally, the surplus of income over expenditure corresponding to 13 percent of gross domestic product is indicative of a competitive economy.

The weaknesses: At the beginning of the 1990s, Switzerland was still a much-admired model of good economic policy. Few public debts, low unemployment, average economic growth, secure social mechanisms. Since then our country has lost a great deal of ground: Its attractiveness as a tax haven is eroding, public debts are high, growth is weak, state regulation is on the rise, and spending on investment is low.

The solution: Politicians and the business sector must work together to identify ways of enhancing global competitiveness, boosting growth and creating jobs, and act decisively to bring about change. Reforms for a more market-driven economy, more competition, solid state finances and an economically viable social security system call for consistent leadership, particularly on the part of the Federal Council.

Rudolf Walser, Member of the Board of Economiesuisse



Successful: Peter Brabeck, Nestlé.



Successful: Emch, Hayek jun., Swatch.

Other factors point to a high level of innovation: Our country produces the largest number of scientific and technical publications in the world (per capita), registers the most patents and boasts a disproportionately high number of Nobel laureates. "If we continue investing in research, we can remain a leader in the world league," explains Charles Kleiber, State Secretary for Education and Research.

Capital market: In the financial hub that is Switzerland, banks manage and invest some CHF 4 trillion for the wealthy of this world. Private banking is one of Switzerland's strengths, and our banks are in a position to finance capital-intensive productions (though reticent when it comes to risk capital).

The monetary and currency policy practised by the Swiss National Bank ensures sufficient liquidity, unbeatable low interest rates and capital costs, extremely low inflation and a strong franc. Without a doubt, the banks and capital market reinforce Switzerland's status as a financial and business centre.

Tax haven: Company taxation in Switzerland is "much lower than anywhere else in Europe", according to Professor Georg von Krogh. At 29.6 percent, the fiscal ratio (taxes and obligatory social security contributions relative to gross domestic product) for 2003 is still low compared to other countries. But the tax burden on the economy has recently increased, primarily due to un-

employment insurance. "Switzerland must maintain its rank among the top players in terms of fiscal policy," urges *Economiesuisse*, "otherwise it risks relegation to a lower league." St.Gallen Professor Heinz Hauser believes that a reform of corporate taxation is a key criterion for Switzerland's competitiveness.

...and the weaknesses

What are the concrete weaknesses of the Swiss economy? Lack of competition, high prices, failure to implement innovations, growing state intervention, political isolation, and our mentality are among the main deficiencies.

The domestic market: Switzerland has a growth problem. Between 1980 and the present, the Swiss economy grew at a slower rate than most other industrialised countries. Economic growth is fuelled by two factors: the number of hours worked and production per working hour (productivity). While Switzerland is the world leader in terms of working hours, the problem lies in its productivity – more precisely, productivity in the domestic market.

The findings can be applied across the board: "Switzerland's current weakness is the lack of competition, particularly in the domestic sector," explains Federal Councillor Joseph Deiss. "Switzerland needs more competition. We must gear ourselves to competition. If we don't, we will lose out on growth and wealth," says Philipp M. Hilde-

brand, Member of the Board of the Swiss National Bank. "It is competition that spurs on managers and employees to perform better and to innovate," explains State Secretary Jean-Daniel Gerber.

What needs to be done? Fewer state monopolies and private-sector agreements (cartels), more competition in areas such as healthcare, agriculture and the electricity market, and fewer state regulations are called for. "Switzerland is a small market that is state-regulated to a high degree, for instance in terms of zoning and construction, environmental protection and product regulations," criticises St.Gallen Professor Heinz Hauser.

High prices: As a consequence of the lack of competition in many sectors of the domestic economy, Switzerland is an expensive country. We pay on average twenty percent more than Germany for imported goods. "There is no reason why prices in Switzerland should be significantly higher than in the USA or Luxembourg," says Aymo Brunetti, Chief Economist of the State Secretariat for Economic Affairs, laying the blame on the "severe constraints on competition in many sectors".

The high price level is certainly remarkable, given that value added tax (only 7.6 percent as opposed to some 15 percent in the European Union), the strong franc (making imports cheaper) and low interest rates should combat high prices. The areas where prices need to come down are obvious: monopolies in electricity, postal services, telecommunications and natural gas, "official" exclusive importers of cars and other goods, as well as foodstuffs, rents and healthcare.

Application of innovation: Over the past decade, Swiss science and technology have gained a leading edge in many fields. But while new technologies and applications have been created, the country lags behind in marketing these innovations. "Switzerland pays homage to supply and neglects demand," says the *Avenir Suisse* Institute. There are also still too many inhibitions when it comes to exchanging ideas between university research institutions and business.

Given the status of its research into telecommunications, Switzerland would have been in an ideal position to play a leading role in this field, but Switzerland missed out on the opportunities that were leveraged elsewhere by Ericsson in Sweden and Nokia

in Finland. When the Scandinavian companies were feeling the effects of global market pressure, telecoms was still a state-run industry in Switzerland.

Public-sector share of GDP: The "high public-sector share of GDP" is often blamed for the sluggish Swiss economy and cited as a risk to the country's status as a business centre. Yet by comparison with other countries, the public sector's 39.4 percent share of Gross Domestic Product (spending by all public households and obligatory social security contributions relative to GDP) for 2004 (and 38.8 percent the previous year) is very good. Only Japan and the USA score better than Switzerland in this respect.

But the public-sector share of GDP has undergone a sharp rise since 1990. "The increase is attributable to the recession and associated increases in spending on unemployment insurance," explains the Federal Statistical Office. "We are among the countries with a relatively low public-sector share of GDP," confirms Federal Councillor Joseph Deiss. St.Gallen economist Gebhard Kirchgässner adds: "Countries like Denmark or Sweden with a high public-sector share of GDP experienced stronger economic growth than Switzerland."

Nevertheless, stabilisation of the public-sector share of GDP is a declared political and economic objective.

Political isolation: One of Switzerland's weaknesses is the lack of integration in the European Union. Our economy can only

participate in the dynamics of the world's largest internal market to a limited extent. "From an economic standpoint, Switzerland's vote in 1992 against joining the European Economic Area (EEA) was a mistake," says Professor Heinz Hauser. Federal Councillor Deiss also talks of an "ill-informed decision": "The consequences are severe, and we have not implemented the requisite reforms."


The facts speak for themselves: Economic performance in the EU member state of Austria grew by 18 percent between 1995 and 2003, as did productivity, whereas in non-EU Switzerland the former grew by only 12 percent and the latter by a mere 6 percent.

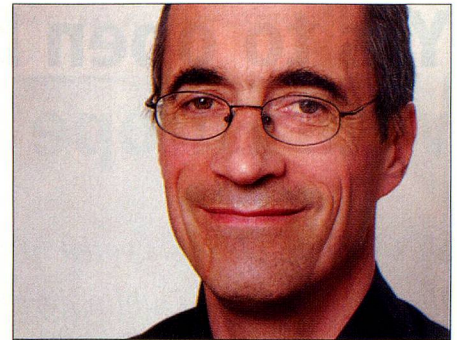
Our national mentality: There are also psychological reasons why the Swiss economy is struggling: "The country is fearful of the future. Every adjustment to international rules of engagement is rejected. The Swiss system has become torpid" (FDP Leader Fulvio Pelli). "In a country that has achieved a high standard of living, people are more concerned about maintaining the status quo" (Federal Councillor Joseph Deiss). "We are no longer performance-driven. We are content with one percent economic growth." (ex-Federal Councillor Adolf Ogi).

According to another opinion leader, "There is no major poverty in Switzerland. From an objective viewpoint, the Swiss are still doing well and the standard of living is still very high. But the relative position is changing," says Beatrice Weder di Mauro, Professor and member of the German Council of Economic Experts.

"Lord, give us strength"

Will Switzerland become a poorhouse, as the State Secretariat for Economic Affairs warns? According to St.Gallen economist Gebhard Kirchgässner, "Switzerland will certainly not become a poorhouse. But a glance across the border shows that it could well lose its leading position: economic performance is higher today in the Austrian state of Vorarlberg than it is in Eastern Switzerland."

"Lord, give us the strength to reform. But not yet." This fervent Swiss prayer will not be enough to ensure the country's future economic success. 



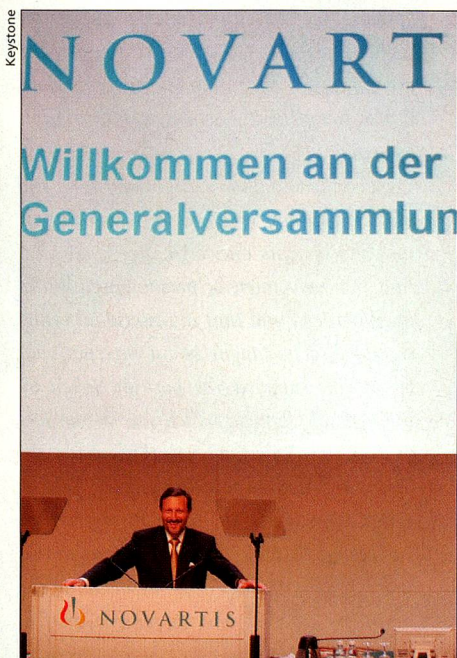
Serge Gaillard talks about Switzerland's business climate:

The strengths: Switzerland boasts a large number of highly productive and innovative enterprises in many sectors. These companies are used to responding rapidly to changing conditions on the world's markets. This is true, for example, of the chemical industry, the mechanical engineering and watch industry, as well as the financial services sector. Switzerland has highly skilled workers, relatively good universities and a reliable infrastructure. The public sector functions efficiently. Compared to other countries, the tax and social security burden on citizens is still reasonable, even though it has gone up in recent years.

The weaknesses: Unlike several Scandinavian countries, Switzerland has not managed to ensure stable resource utilisation by means of a skilful monetary and financial policy. Under-employment has increased sharply. The export industry has suffered, in some cases severely, from adverse currency exchange rates. The resultant increase in unemployment led to a rapid rise in social security costs. At the same time, Switzerland has a costly agricultural sector and one of the most expensive healthcare systems in the world.

The solution: As a small country, Switzerland is dependent on open markets, for which stable relations with the European Union are of paramount importance. It is essential for Switzerland to keep pace with EU countries and also extend free movement of persons to the new EU member states.

Serge Gaillard is Chief Economist of the Swiss Trade Union Association



Successful: Daniel Vasella, Novartis.

Translated from German.