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A special case

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AP

Switzerland has always prided itself on its exceptionalism, but there are signs that it is becoming more like other countries. Barbara Beck examines the current state of Swissness

"WE CAN re-grind your skates," says a sign at a key-cutting stall in the main railway station in Bern, Switzerland's capital. How very Swiss, the visitor thinks. It conjures up visions of traditional winter fun in a pristine white landscape. But it also suggests good sense, a certain frugality and concern for the environment: don't throw out something that is still perfectly serviceable.

"Swissness" covers a range of attributes that Switzerland has been using to good effect to sell itself to other countries—and perhaps even to itself. It stands for democracy, fairness, stability, quality, meticulousness, punctuality, thrift, efficiency, openness and all sorts of other desirable things. For the buyer of a Swiss watch, it means clockwork reliability. The rich man will confidently entrust his money to a Swiss bank. The holidaymaker is sure to have a comfortable night, courtesy of Swiss hotel-school training. And Swiss chocolate will be dependably delicious.

In those and all kinds of other ways, Switzerland is special. It is the oldest democracy in the world, with a political system that many foreigners envy. It remains fiercely independent, having stayed out of two world wars by being deadly serious about its armed neutrality. For much of the 20th century, its people were richer, on average, than those of any other country, and it remains close to the top of the wealth league.

It has four official languages (not to mention English, which is understood by at least half the population) and a kaleidoscope of ethnic and religious groups, which makes outsiders wonder how it managed to stick together for so long. It may be a long way from the sea, but last year (with the help of a few New Zealanders) it even won the America's Cup, an international yacht race usually dominated by rich Americans. For a small, landlocked country of 7m people with a difficult geography and no natural resources to speak of, Switzerland has done remarkably well.

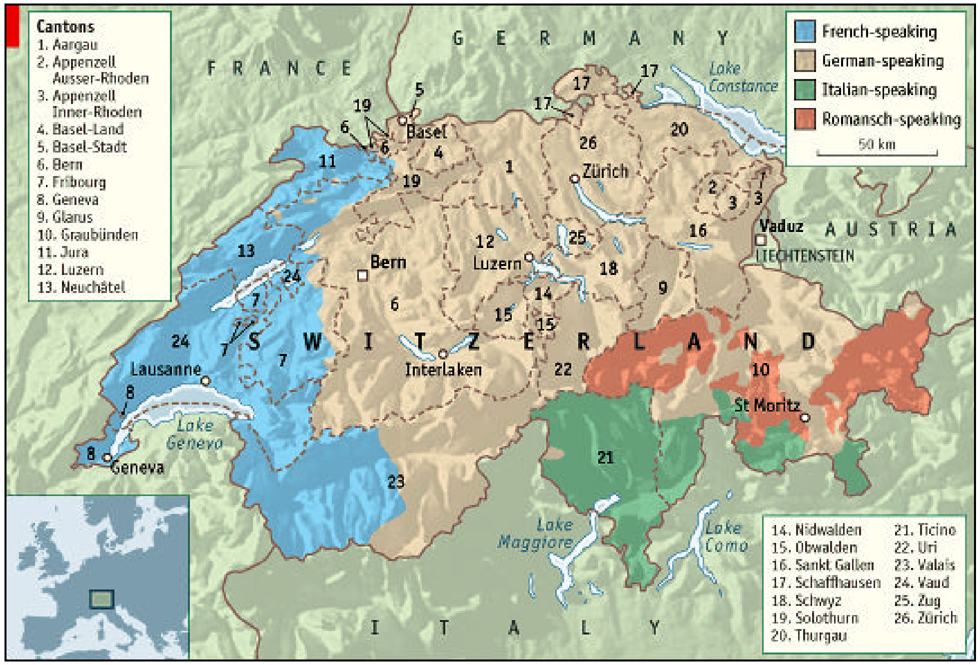
Anni horribiles

However, this survey will argue that the Swiss island of calm is becoming a little more like other countries. In recent years it has found itself battered by a few storms. A fair amount of damage was caused by the revelation that neutral Switzerland had behaved rather less well in the second world war than everybody had wanted to believe. It turned away too many Jewish would-be refugees at its borders; indeed, it has only just got around to pardoning those Swiss citizens who illegally helped Jews to enter the country during the Nazi period. Switzerland also bought great quantities of gold that Nazi Germany had looted from the occupied countries. And, after the war, anxious to preserve its banking secrecy in the face of money-laundering charges, it did not look hard enough for money deposited in Swiss banks by Jews who died during the Holocaust.

In defence of their wartime behaviour the Swiss pointed out, not unreasonably, that if they had antagonised the Nazis too much they might have been invaded too, which would have been worse for everyone. But their squeaky-clean image suffered, particularly in America.

On the business front, too, Switzerland has recently shown itself to be fallible, most spectacularly with the grounding in 2001 of Swissair, the national airline that had been marketing itself as the very essence of Swiss reliability. No sooner had Swissair fallen by the wayside than a new airline, Swiss, was launched to take its place. Outside observers felt that the government, the big banks and other large companies were perhaps a little too ready to help. A few other big Swiss companies also went through a sticky patch, but mostly seem to have recovered now.

What has yet to recover is Swiss economic growth. For a variety of reasons (of which more later), since the early 1990s Switzerland's income per head has been almost static. Many other rich countries have done better in the growth stakes, and several have now overtaken the erstwhile champion. The Swiss economy depends heavily on exports, so it suffered badly when the dotcom bubble burst, stockmarkets collapsed and other economies turned down. And although most Swiss companies that trade internationally are world-class, the domestic sector is much less competitive, and is heavily protected or subsidised.



Switzerland has also faced a huge rise in public expenditure in recent years, much of it because spending on health care and disability pensions has got out of hand. With an ageing population, the next big worry is retirement pensions. The country has always prided itself on small government, but the share of GDP taken up by taxes and deductions is now moving closer to the share elsewhere in Europe, and government borrowing has shot up.

Unemployment is around 4% and shows no sign of coming down. Many other European countries would be delighted with that figure, but by Swiss standards it is worryingly high. People remember that not so long ago Switzerland was importing lots of foreign workers to relieve its labour shortages. A quarter of its labour force are now foreigners, with jobless rates higher than those of the natives.

The Swiss used to be proud of their education system, which appeared to turn out large numbers of skilled and highly employable people. But in 2000 they got a rude shock when an OECD study comparing children's educational attainments in a range of industrial countries revealed that although Swiss kids did well at maths, they were only middling at reading and science. The official explanation was that teaching children several languages from an early age may have caused an overload, but Swiss pride suffered.

Confidence was also dented by a collision in 2001 between two lorries in the St Gotthard tunnel under the Alps that left 11 dead and closed the tunnel for two months, and by a mid-air crash in Swiss-controlled air space in 2002 that killed 71 people. Of course accidents will happen, but the safety-conscious Swiss felt especially troubled.

A paler shade of neutral

However, the news has not been all bad. The end of the cold war made it much less likely that Switzerland will face any external threat, and this has caused the country to re-examine its policy of armed neutrality. It still refuses to join any alliance that will oblige it to take military action in the event of war (which rules out NATO membership), and will still not send soldiers into battle unless the country itself is threatened. But it is now prepared to back UN action against rogue countries. During the war in Bosnia it allowed its airspace to be used to supervise the no-fly zone, and some of its troops even took part in the multinational peacekeeping operation in Kosovo. In a referendum in 2002, after decades of soul-searching, the Swiss people at last agreed to join the UN.

Now that it is surrounded by EU countries on all sides, Switzerland feels less need to be armed to the teeth to repel potential invaders. Since the mid-1990s, it has been reorganising and drastically cutting down the size of its militia army. In future, most men will need to keep their rifles under their beds only up to their late 20s instead of well into middle age.

This will save money and manpower, but in some people's minds it will also make Switzerland a little less special. Traditionally the army was one of the things that helped to define Swiss identity, and enjoyed widespread popular support. It was seen not only as a way of serving the country but also as a social leveller (which it probably wasn't) and a splendid networking opportunity (which it used to be but probably no longer is in the same way).

The relentless spread of the EU all around has not pleased everyone in Switzerland. The country has strong linguistic and cultural ties with the three biggest EU members, Germany, France and Italy, as well as friendly relations with all the other member countries, and most of its foreign trade is done with Europe. But the bigger and more powerful the European club becomes, the more it seems to worry the Swiss. With their decentralised political system and strong direct democracy, they distrust the EU's centralising tendencies, and they dislike the idea of laws made in Brussels rather than in Bern.

In 1992, almost to their own surprise, they narrowly voted against joining the European Economic Area, which was widely seen as a “training camp” for the EU. That may have been because around the same time the federal government of the day, probably unwisely, put in an application to join the EU itself, without much prospect of popular Swiss support. The application has been gathering dust in Brussels ever since. Official government policy still aims for eventual entry, but even enthusiasts acknowledge that this is unlikely to happen for a decade or two. Meanwhile, Switzerland has found a way of living with the EU by negotiating a series of bilateral agreements.

All this helps to explain the large gains made in last October's federal election by the far-right Swiss People's Party (SVP), led by the charismatic Christoph Blocher, who is now minister of justice in the seven-strong Swiss cabinet. The party caused a splash with its rather xenophobic-sounding campaign against illegal asylum-seekers and its attempts to link law-and-order concerns with foreigners. But its biggest attraction to Swiss voters may well have been its policy on the EU, which can be summed up in two words: keep out. At least in that sense, it seems, the Swiss would rather stay special for now.

The Blocher factor

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Swiss politics has moved slightly to the right. But how much difference will it make?

Reuters

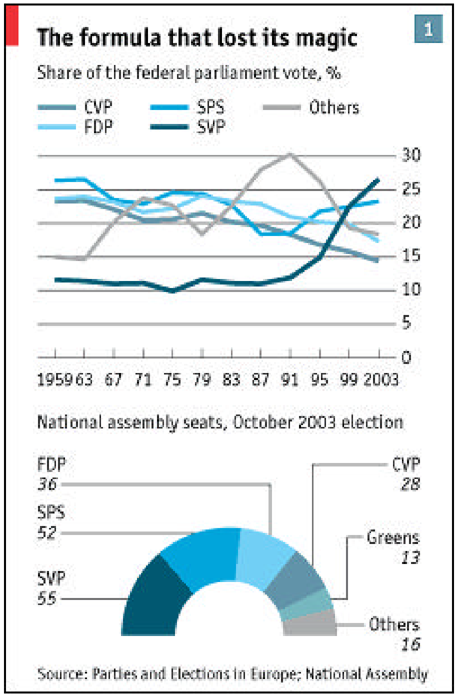
Blocher made it

IMAGINE a political system where the four biggest parties, ranging from fairly far left to fairly far right, form a permanent coalition. After each election, the seven ministerial seats are shared out among them, under a formula set decades ago. This cabinet of disparate politicians is expected to come to unanimous decisions, which it does behind closed doors, so the outside world never (or hardly ever) finds out how its individual members argued on a particular issue.

Ministers take it in turns to serve as president—an office with limited powers—but only for a year at a time, so they don't get too big for their boots. As members of the cabinet, on the other hand, they can usually expect to be re-elected as often as they like, and the longest-serving get first pick at the portfolios. To those brought up in more adversarial political systems, all this sounds pretty rum, even undemocratic. But in Switzerland it seems to work.

Or at least it did, until the most recent federal election on October 19th last year, which delivered a small earthquake. The populist right-wing Swiss People's Party (SVP), led by the controversial Christoph Blocher, increased its share of the vote to 26.6%, up from 22.5% in 1999, at the expense of two centre-right parties, the Free Democrats (FDP) and the Christian People's Party (CVP). The SVP is now the biggest single party in the lower house of parliament, holding 55 of the 200 seats. At the other end of the political spectrum, the Social Democrats and the Greens also gained some ground (see chart 1).

A gain of 4% in the share of the vote may not sound like a seismic shift, but Swiss politics is famous for being boringly static, so this was a big event. Not that it came entirely unannounced. After decades of relative immobility, the party landscape started to shift in the early 1990s, when the SVP gained some ground on its rivals. By 1999 it had overtaken the two big centre parties and drawn level with the Social Democrats, up to then the biggest single party.



The “magic formula” devised in 1959—a gentlemen's agreement that gave two cabinet seats each to the Free Democrats, the Christian People's Party and the Social Democrats respectively, and one to the SVP—began to look inequitable. The SVP demanded a second ministerial seat, but the other parties refused to give way, arguing that such things should not be rushed.

After last October's election, however, in which the SVP made great strides not only in its German-speaking heartland but in French-speaking areas as well, the status quo became impossible to defend. This time the SVP not only asked for two cabinet seats but insisted that one of them must go to Mr Blocher, the head of the party's powerful Zurich branch and to all intents and purposes its national leader. Failing that, the party said, it would go into opposition, whatever that might mean.

So after much huffing, puffing and posturing all round, a “new magic formula” was duly devised and the SVP got its two ministers, including Mr Blocher (even though, unusually, that meant booting out a blameless minister from the Christian People's Party, Ruth Metzler).

From the fuss made about the SVP's election success, both in Switzerland and abroad, you might have thought that a new political force had suddenly popped up from nowhere. In fact the SVP has had a minister in the cabinet since 1959, and Mr Blocher himself first entered the federal parliament as member for Zurich in 1979. What is new is the much more strident nationalist tone his party has recently adopted, and the voters' enthusiastic response to it.

Mr Blocher has been widely compared to far-right leaders in other countries, such as Austria's Jörg Haider and France's Jean-Marie Le Pen, but he himself rejects such comparisons, instead claiming political kinship with Edmund Stoiber, the leader of the Bavarian arm of Germany's Christian Democrats, and—rather more surprisingly—with Italy's prime minister, Silvio Berlusconi.

Like Mr Berlusconi, Mr Blocher is a highly successful businessman. His father and grandfather were ministers in the Protestant church. He wanted to be a farmer, but there was no money to buy a farm. So he trained as a lawyer, acquired and developed his own chemical company, Ems Chemie, and became a multi-millionaire. At the same time he pursued a career in politics (which in Switzerland is a part-time calling except for cabinet members), getting himself elected first at local, then at regional and eventually at federal level. Now that he is in the cabinet, Mr Blocher has complied with strict Swiss rules about conflicts of interest by handing over his business to his four children.

Not one of us

Why does he put so many backs up? Partly it is a question of style. Swiss politicians tend to be sensible, polite and a little grey. Mr Blocher is an outspoken and charismatic maverick. Sometimes his personality has worked against him. When he laid claim to the SVP's one and only cabinet seat in 1999, he was bypassed in favour of his party colleague Samuel Schmid, a much more accommodating figure whom Mr Blocher subsequently branded as “only half an SVP minister”. That helps to explain Mr Blocher's insistence on a cabinet seat after his party's latest election success. At 63, he was already relatively old by the standards of Swiss politics. He simply could not afford to wait any longer.

It is clear that the party owes its present prominence largely to Mr Blocher's leadership, but the substance of the SVP's policies also seems to have struck a chord with the voters. Most eye-catchingly, the party has argued for a more restrictive immigration policy, on the ground that, with foreigners already making up 20% of the population, Switzerland does not have room for any more. It has also claimed that foreigners are to blame for a rise in crime. Some of its posters in the election campaign were downright racist.

The broad message the party is putting over is that Switzerland should batten down the hatches. That goes for relations with the EU as well. The SVP says it is all for European co-operation, but is dead set against EU membership. Technically, Switzerland's EU application is still on the table after a failed attempt to join in 1992, but the party would like to see it removed. Claudio Zanetti, secretary of the SVP's powerful Zurich branch, says a formal withdrawal of the application would have “a useful symbolic value”. The main objection is not practical but ideological: the SVP simply does not feel that membership would be compatible with the country's direct democracy. It wants Switzerland to remain a special case—confident, free, independent and strictly neutral.

On the economic front, the party's policies are closer to the Swiss mainstream. It wants more competition and entrepreneurship, as well as lower taxes and public spending to keep the state small. But it is not so keen on rigorous free-market policies for Switzerland's highly subsidised farmers, who are among its core supporters, and wants the country to be as self-sufficient in food as possible.

Amid all the excitement over the SVP's recent success, it is easy to forget that the party commands little more than a quarter of the popular vote. Party officials blithely predict that in the next federal election in 2007 its share will rise above 30%. Perhaps. But first the voters will want to see how Mr Blocher performs as the team player that every minister must of necessity become. He will have to tread a fine line between getting some of his party's policies put into effect and making a nuisance of himself.

Paradoxically, given the SVP's resistance to European ways, Mr Blocher's entry into the cabinet is likely to make Swiss federal politics a tad more European. Swiss politicians have traditionally resolved their differences through negotiation and compromise. In future the process may become a little more ideological and confrontational. But whatever cabinet or parliament says, the ultimate judge on all big political decisions will still be the one and only Swiss sovereign: the people.

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Voting as a way of life

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Being a Swiss citizen is hard work. Well, that's democracy

AP

We have 700-odd years of practice

"FORTUNATE events have put me at the head of the French government, but I would consider myself incapable of governing the Swiss," Napoleon Bonaparte told a Swiss delegation in 1802. "The more I think about your country, the more convinced I become that the disparity between its constituent parts makes it impossible to impose a common pattern on it: everything points to federalism."

Napoleon came and went, but the Swiss disparities remained. They culminated in a religious quarrel that led to a civil war in 1847. Fortunately this turned out to be short and not very bloody. The new constitution drafted in 1848 (loosely modelled on the American one), which became the foundation of modern Switzerland, enshrined the principles of a federal system and direct democracy, and was itself ratified by referendum.

Switzerland's federalist past goes back much further, however: to August 1st 1291. After the death of Emperor Rudolf I, a particularly unpopular Habsburg overlord, the people of three small cantons in central Switzerland, Uri, Schwyz and Unterwalden, got together to conclude a co-operation pact, the *Bundesbrief*. In 1315 the three cantons won the battle of Morgarten, prevailing with a tiny band of men against a huge Habsburg army, which encouraged other cantons to join them. In time these voluntary agreements formed the basis of the Swiss *Willensnation*—a nation created by acts of free will by a diverse people.

The Swiss still use that term, albeit with a slight weariness. It takes an act of will, they say, to hold together a country made up of so many disparate elements. Switzerland has four official languages, German (spoken by 64% of the population, mostly in a number of Swiss variations that Germans find hard to understand, though the written version is the same), French (20%), Italian (6%) and Romansch (0.5%), as well as a large foreign population that adds further variety to this mix of tongues.

Superimposed on those divisions are geographical, ethnic and religious ones that do not necessarily coincide with the linguistic ones. Lifestyles in, say, German-speaking Basel, French-speaking Geneva and Italian-speaking Lugano appear to have more in common with those in their respective big neighbours than with each other. It is a wonder that the place has not fallen apart long ago.

For that, the Swiss have their political system to thank. Federalism and direct democracy are not just desirable political features; they are a necessity to keep the country together, says Annemarie Huber-Hotz, Switzerland's federal chancellor and guardian of its political institutions. The key to it all is that old tongue-twister, subsidiarity, meaning that all decisions must be taken at the lowest appropriate level.

Swiss democracy works from the bottom up. Starting at the lowest level, much of the action takes place in Switzerland's 2,800-odd communities. Some of these elect their own parliament, but most have a traditional community assembly (which generally meets indoors these days, though a few still assemble on the village green) where all citizens over 18 can turn up and speak their mind. The communities are responsible for local schools, social services, energy supply, roadbuilding and such like—mostly modest stuff, but people like having a say in such matters. “I feel a lot happier about paying my local taxes if I can see where they are going,” explains a senior banker.

The next tier up consists of the cantons, the original states that in 1848 formed the Swiss federation. There are now 26 of them, and they vary enormously in size and population, from a mere 15,000 people in the smallest, deeply rural Appenzell Inner-Rhoden, to 1.2m in the biggest canton, Zurich. But each of them has its own constitution, parliament, government and courts, and each is responsible for a wide range of services, from education to policing. And even the smallest canton enjoys considerable political power. Each is entitled to at least one seat (the bigger ones get two) in the 46-member upper house of parliament that represents the cantons, and at least one seat in the 200-member lower house of parliament. The small cantons also get a disproportionate say in referendums on important national issues (of which more below).

The top, federal, tier is responsible for such things as foreign and security policy, national legislation, and customs and currency matters. The Swiss have always aimed to keep this tier as small as possible, but have recently found it increasingly hard to control federal expenditure. Very roughly, the breakdown of spending among the different tiers is around 30:40:30. Each tier raises its own taxes, but there are also transfers of funds within and between different levels of government.

Vote early, vote often

So far, so familiar from other federal countries, except that Switzerland devolves more activities and more tax-raising powers than most to lower levels of government. However, the Swiss cast their vote not only in federal, cantonal and communal elections but also in federal referendums on specific issues three or four times a year, as well as in cantonal and communal ones. Adding all these obligations together, this means they may have to pop along to the polling station (or, more likely these days, cast their vote by post) every few weeks to decide on anything from building a local bypass to joining the UN.

All amendments to the constitution and other big changes proposed by parliament must be put to a referendum, and need a double majority, both of voters and of cantons. The Swiss are quite pragmatic about their constitution. The original 1848 constitution was comprehensively revised in 1874, and an entirely new one was approved by referendum in 1999.

For new laws or changes in existing ones, as well as some international treaties, a referendum is optional, and is held only if objectors can collect 50,000 signatures within 100 days. The main effect of an optional referendum is to slow things down. Threatening to mount one can be a useful way of getting a proposal modified before it is passed.

But Swiss voters can do more than pour cold water on other people's schemes. They also have the right to launch initiatives of their own, provided they can collect 100,000 signatures in support of their proposal within 18 months. Such initiatives have a low success rate: typically, only one in ten gets through, whereas proposals put forward by parliament have a one-in-two chance of succeeding. But they provide an airing for grievances, and if they do not succeed their supporters usually accept the people's verdict. Sometimes even the failures are instructive.

When important issues are turned down, they are often put to the vote again after a decent interval, say a decade or two, and sometimes win a majority in the end. Universal voting rights for women, for example, were heavily defeated in 1959 but were passed by a two-thirds majority (of an all-male electorate) in 1971. Likewise, Swiss membership of the United Nations, which was decisively turned down in 1986, was approved in 2002 with a small majority. The creation of the new canton of Jura in 1979 required several referendums, first to separate it from the canton of Bern and then to allow parts of it to make their own arrangements, but it settled local unrest that had turned to violence.

The people's will 2

Selected Swiss referendums

Date	Issue	Outcome (%)
Sep 1990	Moratorium on building nuclear power stations	Yes (54.5)
Mar 1991	Reduce active and passive voting age to 18	Yes (72.7)
May 1992	Join Bretton Woods institutions	Yes (44.2)
May 1992	Permit civilian service for conscientious objectors	Yes (82.5)
Sep 1992	Build new Alpine railway tunnels	Yes (63.6)
Dec 1992	Join European Economic Area	No (50.3)
Sep 1998	Road charges for heavy lorries	Yes (57.2)
Apr 1999	New federal constitution	Yes (59.2)
Jun 1999	New asylum law	Yes (70.6)
Jun 1999	Heroin on prescription	Yes (54.4)
Sep 2000	Control immigration	No (63.8)
Mar 2001	Yes to Europe	No (76.8)
Dec 2001	Abolish army	No (78.1)
Mar 2002	Join United Nations	Yes (54.6)
Mar 2002	Shorten working hours	No (74.6)
Sep 2002	Open electricity markets	No (56.2)

Source: Confoederatio Helvetica

All this direct democracy is hard work for Swiss voters. Ahead of any referendum, they are supposed to read piles of documents to inform themselves about the issue. Some referendum campaigns are sponsored by interest groups that spend a good deal of money on publicising their cause, though a few have been won with very little promotion. Some of the subjects may be of no great interest to particular voters, others may be too technical to be readily understood. A referendum in 2002 to open up Swiss electricity markets to competition was lost even though the proposal seemed to offer a way of bringing down the country's high and locally very variable electricity prices. Its promoters remain convinced that the proposal went above many of the voters' heads.

In recent years Swiss voters have been getting less enthusiastic about doing their civic duty. In federal elections turnout has declined to around 45%, from 80% a century ago, and in federal referendums it is now around 40%, rather than the 50-70% it averaged in the first half of the 20th century. In cantonal and local votes even fewer people turn up.

There are several perfectly reasonable explanations for this. First, the number of referendums has greatly increased as interest groups have learned how to use them as political weapons, leading to growing voter fatigue. Second, the enfranchisement of women in 1971, while doubling the number of voters, noticeably reduced turnout. That is what you would expect: new groups of voters have always been slow to take up their rights. Third, as people work harder, travel more and are busier than they used to be, they seem less inclined to take part in the political process. Participation among the young is especially low, leading to worries that the voting habit may be dying out.

None of this means, though, that the Swiss have gone off the whole idea of direct democracy. Considering how often they are expected to cast their vote, an average turnout of 40% still seems pretty remarkable. Most people appear to put a high value on their right to influence specific political decisions, even if they do not exercise it every time.

The system ensures that all big issues are thoroughly aired, and that the decisions eventually reached are generally sensible and command widespread support. It may be slow; it may sometimes get hijacked by special interests; and it may need a little tweaking. But it still seems to work a lot better than anything else.

Split personality

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There is not just one Swiss economy, but several. Some are more impressive than others

AFTER more than half a century as the richest country in the world, Switzerland has lost the crown. To be sure, the windows in Zurich's Bahnhofstrasse are still full of furs and jewellery too grand to display price tickets. But measured by GDP per head at purchasing-power parity, the Luxembourgers, the Norwegians and the Americans are now richer than the Swiss, and others are close behind (see chart 3). What went wrong?

The first thing to note is that the Swiss are not actually getting poorer; it is just that other countries are getting richer faster. Switzerland started with a huge advantage after the second world war because almost all its infrastructure had remained in one piece. But as other countries started rebuilding their economies, the advantage gradually diminished. According to figures calculated by Angus Maddison, an economic historian, Switzerland's income per head in 1950 was 80% above the European average. But by 1998, its GDP per head at purchasing-power parity was only 14% above the European average.

Certainly, Switzerland's recent growth rate seems to have been exceptionally slow. Average annual growth in GDP for the past two decades has been 1¼%, less than half the OECD average. During the 1990s, real GDP per head remained absolutely flat, whereas in Britain and America it grew by around 2%. This has caused some Helvetic puzzlement. After all, the country continues to feel comfortably and increasingly wealthy. The economists got to work, and concluded that things were not as bad as they looked.

The low growth of the past two decades is "something of an optical illusion", says Ulrich Kohli, chief economist at the Swiss National Bank. In a recent paper, he argues that it is partly explained by a huge improvement in Switzerland's terms of trade, of 34% between 1980 and 1996. Better terms of trade allow a country to export less for any given quantity of imports, or import more for any given quantity of exports. The resulting current-account surplus is solid enough, but by definition it does not show up in the real gross domestic product. It is, however, reflected in gross national income figures, which show that real annual growth over those 16 years has on average been 0.6% higher than reflected in the GDP figures.

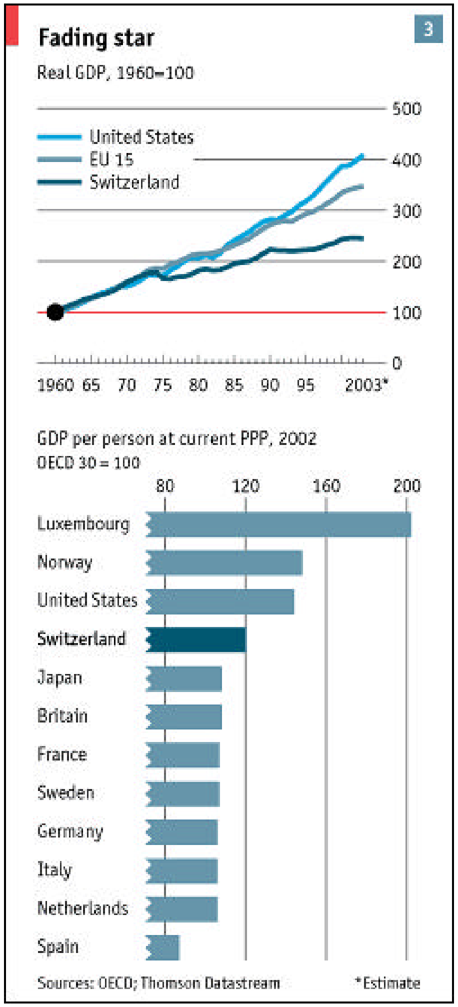
The true figure may be even more cheerful than that. Bernd Schips, an economics professor at the Swiss Federal Institute of Technology in Zurich, says that recent changes in the way the GDP figures are calculated, and incomplete labour-force figures, may have been another factor in making the figure for GDP growth per person look lower than it is.

Besides, Switzerland's growth paradox is anything but new. As Mr Kohli points out, the country's average real growth per person lagged behind that of most other countries for the whole of the 20th century. Yet even though Switzerland in the 19th century was poor compared with most of its neighbours, it ended up very rich half a century later. It seems to be the tortoise that always wins the race.

This time, however, even if some of the lack of growth can be explained away by technicalities, there remains plenty of cause for concern. Last year the economy probably shrank a little, and this year it will do well to grow by 1¼%, according to the OECD's latest report on Switzerland. Unemployment, at 4% and rising, is high by Swiss standards. Unhelpfully, the economic cycle in the financial-services industry, which usually runs to a different timetable from the rest of the economy, has coincided with everyone else's this time.

There is only so much the Swiss can do to help themselves. One Swiss franc in two is earned abroad (from exports of goods and services, income from direct investment and so on), and if most of the countries they trade with are doing badly, they cannot expect to do much better. Some 60% of Swiss exports go to members of the EU, and much the biggest chunk of that to Germany, which has had plenty of its own problems of late.

But not all of Switzerland's economic troubles come from abroad. One big home-made problem is a steep rise in recent years in public spending at all levels of government—federal, cantonal and communal—which has pushed up the public-sector deficit. The country has always prided itself on its small government, and state spending as a proportion of GDP is still smaller than in other European countries, but the gap is narrowing (see chart 4).

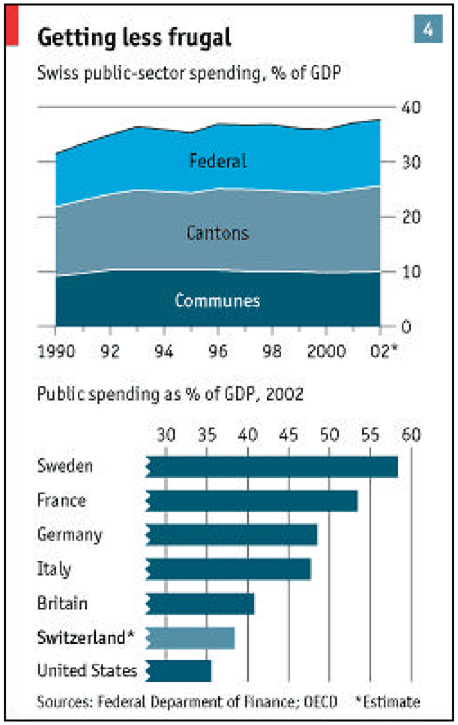


The main culprit has been an alarming increase in social-security spending. The outlay on health care, for example, is now well over 10% of GDP, double its level 30 years ago. At the same time a lot more money is going on disability pensions, probably not because the health of the Swiss has suddenly taken a turn for the worse but because definitions have been relaxed. Spending on retirement pensions too is going up, with worse to come in the decades ahead as the population ages.

Labour productivity has grown very slowly in recent years. This is partly because interest rates are low and capital is cheap, so most of the obvious productivity-raising investments have already been made; and partly because in so rich a society much of the growth in demand is not for goods but for services, many of which cannot easily be rationalised.

Critics say there is not just one Swiss economy but at least two: the efficient export sector, dominated by large, internationally competitive companies, and the inefficient domestic sector that survives only because it is highly protected. Thomas Held, who runs Avenir Suisse, a think-tank financed by Swiss multinationals, lists no fewer than four different Swiss economies: the global companies based in Switzerland that create much of the country's wealth; the competitive and innovative small and medium-sized outfits that live on exports; the state-owned or semi-privatised sector, such as the post office, the telecommunications operator (Swisscom) and the electricity industry; and the plethora of small domestic enterprises with lowish productivity in retailing, construction, tourism, farming and so on.

The cream of Switzerland



The first, big and international, sector of the economy is impressive by any standards. For a country of its size, Switzerland has an unusual number of large multinational companies. The list includes big banks such as UBS and Credit Suisse; big insurance companies such as Zurich and Swiss Re; Nestlé, a huge multinational food company that grew from small beginnings in Vevey on Lake Geneva more than 130 years ago; Novartis and Roche, two world-class pharmaceutical companies; and Swatch, the company that resuscitated the Swiss watch industry after a nearly terminal assault by cheap quartz watches from East Asia in the 1980s. A few big companies have been accused of oligopolistic practices, and some have had their troubles, but most are now doing well.

They are there because Switzerland has plenty to offer such firms: political and economic stability; an attractive tax and regulatory regime; well-developed capital markets; good communications; an educated and flexible workforce; and an excellent quality of life. They make a huge contribution to the economy but a much smaller one to domestic employment, accounting for well under 10% of Swiss jobs, because much of their business is abroad.

The second category covers small, nimble companies in sectors such as engineering, biotechnology, medical instruments and watchmaking that spend a lot on R&D and export most of their output. Again, their share of domestic employment is relatively small, but their economic contribution is significant.

The third group, state-owned or semi-privatised enterprises, which account for about a quarter of all jobs, could probably be reinvigorated by further privatisation, but is unlikely to display great dynamism.

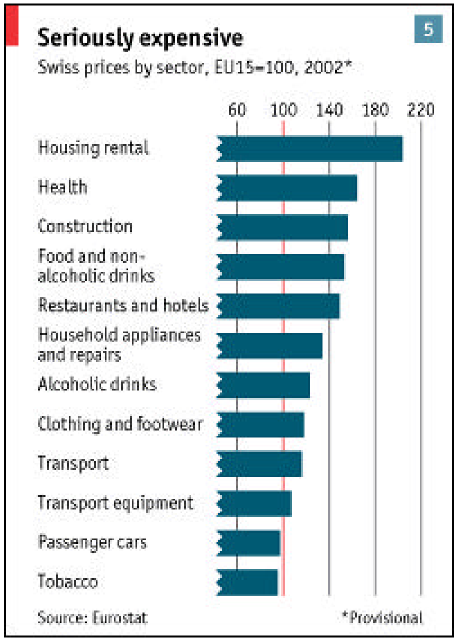
The bulk of Swiss employment, around 60%, is in the fourth economy: small and medium-sized builders, craftsmen, retailers, hoteliers, restaurateurs, consultants and so on. They are safe not only from international competition, but often from rivals nearer home too. The Swiss federal government has been trying for decades to create a truly integrated domestic market, with mixed results. Swiss doctors and lawyers are now able to move freely from canton to canton, but plenty of restrictions remain elsewhere. Chimneysweeps and plumbers, for example, operate cantonal cartels. If you try to engage a plumber from another canton, he will refer you to a list of approved operators for your own canton—who will do a fine job, but charge you a packet.

To a foreigner, almost everything in Switzerland is hair-raisingly expensive. According to the central bank, this is not because the Swiss franc is overvalued, but because the domestic cost base is high. The high wages paid by the internationally competitive sector of the economy filter down to other, less efficient companies. Food costs a lot because Swiss farmers are not large enough to operate at optimum efficiency, and Switzerland's tariffs on imports of agricultural goods average around 50%. Tariffs on manufactured goods are low, but technical barriers can be pretty effective at keeping out imports. A basic washing machine, for example, costs two or three times as much in Switzerland as it does in France or Germany.

Measured by a standardised basket of goods and services, prices in Switzerland are nearly 40% higher than the OECD average, whereas in neighbouring France and Germany they are only 10% higher and in Italy 10% lower. In a small country with fairly open borders, that encourages a lot of Swiss families to nip across the border to buy their groceries more cheaply.

Chart 5 shows how Swiss price levels in particular sectors compare with the EU average. It is a textbook illustration of economic forces at work. Where Swiss taxation is below that in other countries (eg, tobacco, cars, fuel), prices are lower than in the EU. Where international competition is strong and there is no special tax treatment (eg, clothes and shoes), prices are much the same. But where there is no international competition (health-care services, rents), strong protection (food) and/or a high labour content (construction, hotels, restaurants), prices are much higher.

The least market-oriented sector of the Swiss economy is agriculture. Some of this is a hangover of the second world war, when Switzerland wanted to be as self-sufficient in food as possible. It still produces three-fifths of its own food. That may reassure its citizens about the reliability and quality of supplies, but it is not the most cost-effective way of feeding them.



Still, the farmers are not just there to produce food. They are also paid to look after the countryside. Where it is not picturesquely wild and mountainous, the Swiss countryside does indeed look manicured. However, the average Swiss farm is too small to be economic. The agriculture ministry reckons that the minimum herd for making a decent living is 60 cows, but the average Swiss farmer keeps only half that number. The life is hard, and when farmers get too old for it they often find that their children do not want to take over. Between 1985 and 2000 the number of people working in agriculture declined by 32%, to 200,000, and the number of farms dropped by 29%, to 70,000.

The Swiss government subsidises agriculture and forestry even more extravagantly than does the EU with its famously profligate agricultural policy. But some progress is being made. Milk quotas will be gradually phased out between 2006 and 2009, and farmers are now being paid directly for non-commercial activities such as caring for the environment, instead of indirectly through farm prices. But these reforms will do little to bring down consumer prices.

High domestic prices hurt some of Switzerland's export industries, particularly tourism. The economics ministry recently commissioned a study comparing the cost of a standard skiing holiday in a medium-class hotel in Switzerland with the same sort of thing in Austria, and found that the Austrian package was one-third cheaper. That sort of price differential must put many people off.

But at least prices are stable. The Swiss central bank's inflation target, defined as a range of 0-2%, has been met every year since the mid-1990s, after a scary period in the early 1990s when inflation topped 6½%. Prices actually turned down for a brief period in 1998, causing worries about Japanese-style deflation. But, in contrast to Japan, Swiss demand held up well, and those deflationary fears have now passed.

Switzerland's biggest competitive advantage is its people, who are well-educated, sensible, conscientious and hard-working. Labour-market participation is among the highest in the world, around 90% of those of working age (though this includes many part-timers, particularly among women). Swiss workers put in long hours, if not as long as in America, and take shortish holidays. A proposal for a 36-hour week was turned down in a referendum in 2002. Moreover, in contrast to neighbouring countries, where early retirement is widespread, most people work right up to pension age.

Swiss workers also hardly ever go on strike. Ever since the two sides of industry reached a peace agreement in the 1930s, the number of days lost through labour disputes has been negligible. And pay increases in recent years have been modest, reflecting the tougher economic environment: nominal wages in 2001 went up by 2.5% and in 2002 by only 1.8%.

So far as employers are concerned, another good thing about Swiss workers is that they can be fired when necessary. They will get unemployment pay, but not for very long, and they have to show that they are genuinely looking for work. Left-of-centre politicians such as Andreas Gross, a Social Democrat MP, describe the system as “brutal”. But it may help to explain why unemployment is around 4% and not 10%, as in France or Germany.

There is no doubt that the Swiss are an industrious people. Yet note, too, that a fifth of the population and a quarter of the labour force are foreigners, who seem to be working every bit as hard as the natives. Despite all the scaremongering about asylum-seekers from far-flung parts of the world, more than half of these foreign workers come from EU countries (and another quarter or so from former Yugoslavia). Under a bilateral agreement negotiated with the EU, from the middle of this year all European citizens will be entitled to work in Switzerland. Nobody is expecting a rush, but this change will make the country a little less special still.

Trouble in the air

Feb 12th 2004
From The Economist print edition

Does Switzerland need a flag-carrier?

FOR an airline that had sold itself on the very Swiss characteristics of punctuality and reliability, it was an awful way to go. The grounding of Swissair, Switzerland's flag-carrier, in October 2001 left thousands of passengers stranded all over the world. With hindsight, it was clear that Swissair's strategy of rapid expansion by taking stakes in smaller airlines had been misguided. But many felt that if help—from the government and/or the banks—had been forthcoming after September 11th, the collapse could have been avoided altogether, and with it a perceived failure of Switzerland Inc.

This meant an awkward start for the airline's successor, Swiss, formed from the remnants of Swissair plus Crossair, a regional carrier. Moreover, Swiss was launched straight into the huge slump in the world's aviation industry caused by the terrorist attacks on America. In its first year of operation the newcomer lost nearly SFr1 billion. Last June it embarked on a round of savage cost-cutting, and last September it joined the oneworld alliance, a consortium led by British Airways and American Airlines, which made it look a little less exposed. But its future still seems anything but secure.

Does Switzerland need a flag-carrying airline at all? The country's government, its big banks and some of its big multinationals clearly thought so, because they all chipped in to get Swiss off the ground. They argued that the heavily export-oriented Swiss economy needed frequent international air connections. Critics say that a competitive market would have provided such connections anyway if they were profitable—and, if not, there was no point in subsidising them.

One unspoken reason for investing in Swiss was that, without a national airline to feed it, Zurich airport would look a much less convincing international hub. The airport is in the middle of a SFr2.2 billion revamp, approved by a cantonal referendum in 1995, when international aviation was still booming. Over the next few years the airport is due to expand its capacity to 30m-40m passengers a year, double the present number. If Swiss came to grief, so would Zurich airport, and with it many of the 100,000 jobs that, directly or indirectly, depend on it.

As it happens, the airport is already preoccupied with a more local problem that has raised a lot of hackles. The most heavily used approach route for incoming aircraft has always been from the north, over a thinly populated part of Germany, but three years ago the Germans cancelled a bilateral agreement on the use of that route, made in 1984. A compromise was turned down by the Swiss parliament, so after much toing and froing the Germans last October unilaterally imposed restrictions on early-morning flights over German soil.

Except in poor weather, incoming aircraft now have to take the southern approach over the densely populated Lake Zurich area, rousing tens of thousands of good Swiss burghers from their sleep. Many of these early-morning arrivals are Swiss's intercontinental flights from East Asia, South Africa and Latin America, which the airline can ill afford to lose.

The Swiss residents have threatened legal action, but the Germans refuse to backtrack, and there is no quick end in sight. A team of mediators has been appointed, but is expected to take at least two years to finish its work. Alain Thierstein, a professor of planning at the Swiss Federal Institute of Technology in Zurich, thinks the row could have been avoided if those most affected by the noise, including Germans, had been paid compensation early on; and that if Switzerland had been a member of the EU, the problem would have been solved long ago.

Economist.com RESEARCH TOOLS SURVEYS

The world's piggybank

Feb 12th 2004
From The Economist print edition

Filthy lucre is out, clean lucre is in

AP

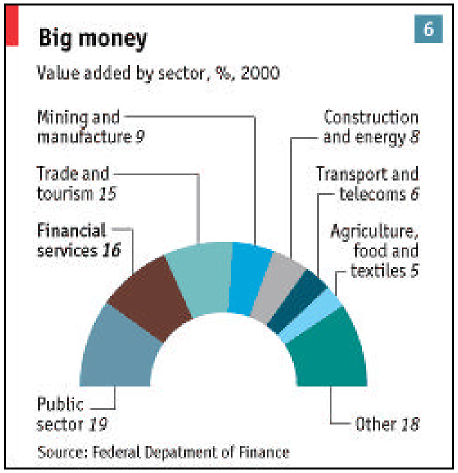
Money matters

IF A man from Mars were to visit Switzerland, he might conclude that its inhabitants were obsessed with money. Banks are everywhere, not just in the main financial centres—Zurich, Geneva and, on a smaller scale, Lugano—but up and down every high street. These temples to mammon tend to be suitably marbled, display some fine indoor plants and attract a steady stream of customers. Little knots of people gather in front of the screens displaying the latest share prices. Most of them look comfortably ordinary rather than loaded, but you never know: the Swiss frown on conspicuous displays of wealth, and even the rich and famous travel by tram.

If the Martian were to consult the statistics, he would find his impression vindicated. They show that the money business forms the most important single component of the Swiss economy. In the country as a whole, the financial-services industry makes up about 11% of GDP (and more than twice that in Zurich and Geneva). Draw the definition a little wider to include insurance and pension funds, and you get to a 16% share of GDP, ahead of commerce and tourism at 15% and engineering at 9% (see chart 6). The financial sector employs about 220,000 people in Switzerland itself and a further 190,000 in other countries, mostly in high-quality, well-paid jobs.

The recent economic downturn has caused some downsizing, but insiders say there is still plenty of capacity, indeed rather too much of it. The giants of the industry, UBS and Credit Suisse, are doing all right, and some small niche operators too are making a comfortable living, but those in the middle are increasingly getting squeezed. Customers have become more demanding, more concerned about performance and more risk-averse, so their banks are having to work harder for them.

The number of banks has shrunk from 495 in 1990 to 356 at the end of 2002, and further consolidation, particularly among medium-sized operators, looks certain. Big banks are opening more branches abroad, offering their foreign customers a choice between their services in Switzerland ("offshore") and in their home country ("onshore"). Well over half of all banking business in Switzerland comes from outside the country.



The country's traditional strength has been, and remains, in private banking. “Nothing really changes here,” says Ivan Pictet of the eponymous private bank in Geneva. “There are 60 or 70 countries with surplus money, and six or seven financial centres with expertise in wealth management.” But he concedes that new money has recently been coming in more slowly.

Private banking is for the rich, not for the merely comfortably off. Providing a tailor-made service is labour-intensive and expensive. Mr Pictet's bank regards an investment of SFr1m-2m as the minimum to allow proper diversification of a portfolio, and its bread-and-butter clients are in the SFr2m-5m range. Add a couple of noughts, and any of the posh Swiss private banks will provide you with a personal service from another age, setting up a family office for you, making your travel and hotel arrangements, even laying on art experts if that is what takes your fancy. And whether you are a big or a small investor, a Swiss private bank will always handle your affairs with the utmost discretion.

For a small country, Switzerland attracts a huge share of international wealth. Swiss banks look after about a third of all private financial assets invested across borders, much more than any other financial centre anywhere. This generates large tax revenues, which helps to keep down taxation elsewhere in the economy. It also contributes about a third of Switzerland's consistently huge current-account surplus.

Switzerland's enduring charm as a home for the world's money rests on a combination of factors. One big attraction for foreign investors is the low probability of nasty surprises. The country is politically and economically stable, its currency is rock-solid, it has not imposed any capital controls in living memory and it has a well-functioning legal system and regulatory framework. It also has plenty of experience of looking after other people's money, which rich clients find reassuring.

Can you keep a secret?

But probably the most important competitive advantage Swiss financial institutions have to offer is banking secrecy. This dates back to 1934, when Nazi Germany started snooping around for money that German Jews had deposited abroad. The Swiss headed off unwelcome inquiries by making it illegal for banks and their employees to provide information about their clients' financial affairs, and soon found that the anonymity of a numbered Swiss bank account attracted other foreigners too.

Swiss banking secrecy came under attack after the second world war when the allies asked for German assets to be handed over. This covered not only money deposited by German Jews in Swiss banks that was never reclaimed, but also bullion of doubtful origin that the Swiss National Bank had bought from the German Reichsbank during the war. In 1946 Switzerland reluctantly agreed to hand back some 50 tonnes of gold.

As for the unclaimed Jewish funds, most of the owners had probably perished in the Holocaust, and many of their heirs were either not aware of the accounts or lacked the papers to prove their claim. The banks looked for the money, but did not seem to find much. After a lot of outside pressure, mainly from America, in 1998 they agreed on a $1.25 billion settlement to compensate the victims or their heirs. But the processing of claims has proved slow.

In recent years criticism of banking secrecy has centred on the risk of money laundering, the practice of disguising funds from illegal sources by passing them through secret accounts until their origins can no longer be traced. A federal law passed in 1997 made money laundering, and abetting it, a criminal offence. The banks were not overjoyed, because this in effect did away with banking secrecy in such cases, but it proved to be a turning point. The Swiss Federal Banking Commission, the body responsible for banking supervision, had been critical of various banks' efforts to search for funds suspected of involvement in money laundering, but concedes that procedures have since been tightened up.

Switzerland is a founder-member of the Financial Action Task Force on Money Laundering (FATF), an international body set up by the G7 group of big industrial countries in 1989. FATF has drawn up a list of measures to combat the laundering of money obtained from crime and corruption, which after September 11th was widened to include terrorism as well. In 2002 the IMF, in the most recent of its periodic reports on Switzerland's financial sector, said that Swiss anti-money-laundering measures met the highest international standards, and that the sector's regulation and supervision were effective and solid.

The Federal Banking Commission is in the middle of a reorganisation that will make it more independent of government. Following recent problems at several big Swiss insurance companies, the commission will also take charge of the insurance sector, as well as keeping a tighter watch on the performance of audit firms, some of which it feels have been getting too close to their clients.

Swiss banks are careful to say that they can never be 100% sure of keeping out undesirable customers, but insist that it has become much harder for such people to park their money in Switzerland. “There has been no money arriving in suitcases for at least ten years,” says a senior executive at one of the big banks. “But we need to be seen to be cleaner than clean.”

Faced with that business imperative, the Swiss have changed their ways. These days a numbered Swiss bank account is not what it was. When someone opens an account, the bank has to satisfy itself that he is who he says he is. If the money comes from one of a list of high-risk countries, or amounts to more than SFr10m, the bank must exercise due diligence and cross-check information. If there are suspicions that the money is connected to a crime, the bank has to co-operate with law-enforcement authorities at home and abroad. Swiss bankers claim that their rules are now tighter than those of many of their competitors abroad, including Britain and the United States.

Better tax than snoop

But the real issue in Swiss banking secrecy is taxation, says Daniel Zuberbühler, the Federal Banking Commission's director. This is of no concern to domestic investors, who already have a 35% withholding tax deducted from their interest and dividend payments. But foreign holders, so far, are paying no tax, and whether they report their Swiss income to their own tax authorities is up to them.

This looks like an opportunity to get round the taxman, and the Swiss are unrepentant about offering it, although they insist that they would not aid and abet anything illegal. In their own country, tax fraud involving forging documents and making false statements is a criminal offence punishable by jail, and if the Swiss authorities receive inquiries from abroad about such offences they will co-operate. But simply omitting to tell the taxman about income received is another matter. In Switzerland this is punishable only by a fine and carries little moral opprobrium.

So far as anyone can tell, the Swiss themselves are pretty honest about filling in their tax returns, but they do not see it as their business to enforce other countries' tax codes. After all, muses one senior official at the finance ministry, the tax regime in a foreign investor's home country may be iniquitous, or designed to enrich corrupt officials. Better not to get involved.

This argument has not gone down well with the EU, which for the past 14 years has been trying to persuade Switzerland to adopt a proposed pan-European system of sharing information about foreign interest payments. That plan would blow Swiss banking secrecy out of the water. But the EU has been very insistent, so last summer Switzerland agreed on another solution, along with Belgium, Luxembourg and Austria, which also wanted special deals.

From the start of next year, such interest payments are due to become subject to a withholding tax, starting at 15% and rising to 35% by 2011. Three-quarters of the money thus collected will be remitted to the tax authorities of the investor's home country. If the investor feels he has been taxed too much, he is free to provide his own tax authorities with the relevant information and claim some of the tax back.

Problem solved? Not quite. For a start, the deal was negotiated as part of a package of bilateral agreements between Switzerland and the EU which has yet to be tied up. But even if it goes through as intended, it may not deliver all it promises. This is because it covers only interest payments, not dividends, and only natural persons, not companies. Any Swiss bank worth its salt should be able to devise instruments that offer a way round the new rules.

How would Switzerland's financial-services industry fare if the country ever joined the EU? Bankers are generally unenthusiastic about membership. For a start, it would probably mean the end of the Swiss franc, which offers an alternative to investors who would rather not keep all their eggs in one euro basket. The Swiss franc is now the world's fifth most important currency for international loan issues, after the dollar, the euro, the yen and sterling. Equally important, ultra-low Swiss interest rates (three-month LIBOR, the rate at which banks lend to each other, is currently 0.25%) would have to rise to European levels, increasing the cost of capital.

When a group of top Swiss bankers recently studied the impact of the euro on their industry, they concluded appreciatively that the new European currency had made life easier and more transparent for Swiss banks. But they also came down strongly against Switzerland joining.

Economist.com RESEARCH TOOLS SURVEYS

Splendid isolation

Feb 12th 2004
From The Economist print edition

The Swiss still prefer to go it alone

Reuters

A shrinking band

"I WANT you to understand that Switzerland is not an island," says Micheline Calmy-Rey, the Swiss foreign minister, and starts to reel off a list of her country's recent foreign-policy activities: entry into the UN, narrowly approved in a referendum in 2002 (and now, according to the opinion polls, supported by 80% of the population); a busy programme of bilateral negotiations with the European Union; assistance provided in the Balkans; even financial and logistical support for a privately negotiated peace plan in the Middle East known as the "Geneva Accord".

As a small, independent and neutral country, with no historical baggage or hidden agenda, Switzerland is well placed to act as an intermediary and provide good offices to other countries. The same qualities, however, also oblige it to keep a low profile in foreign policy. From a distance, the country can be almost invisible. Dieter Ruloff at Zurich University, one of only a handful of Swiss professors of foreign relations, notes that many Americans tend to confuse Switzerland with Sweden. That may say more about Americans' knowledge of foreign affairs than about the respective qualities of those two countries, but it gives pause for thought.

When the iron curtain was dismantled in 1989, Switzerland had to decide whether armed neutrality, its main foreign-policy plank, still made sense. It had served the country well for the best part of 400 years, and had proved a life-saver in the 20th century by keeping it out of two world wars—and keeping it in one piece. If Switzerland had taken sides in those world wars, the Swiss reckon, it might well have split up along cultural and language lines.

The benefits of remaining neutral in two world wars were obvious: while there was devastation all around, in Switzerland hardly anybody got killed, and the country's infrastructure remained largely intact. During the cold war, neutrality also seemed to offer some protection, but the benefits were less clear-cut, because the whole of western Europe also emerged unharmed. And now that many central and eastern European countries are about to join the EU, armed conflict in the heart of Europe looks increasingly unlikely.

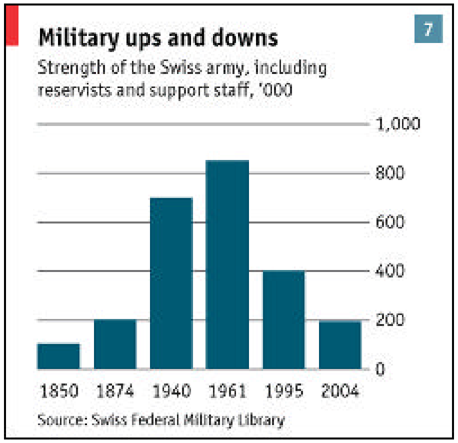
To adjust to the new circumstances, Switzerland has shifted its definition of neutrality a little. It still insists that it cannot join any alliance in peacetime that would prevent it remaining neutral in the event of war, or give military support to any party to an armed conflict. But it is now prepared to take part in any UN-backed action against those who “endanger world peace”. For example, it joined in the UN sanctions imposed on Iraq after the first Gulf war and then on Serbia, and gave the international peace force in Bosnia access over its territory. And although it has absolutely no plans for joining NATO, it is taking part in the Partnership for Peace programme to help stabilise conflict areas, and is working with other countries to combat international terrorism.

Flexible response

All this has caused a big rethink of Switzerland's defence needs. In the past, as a neutral country sitting astride important transit routes in the middle of Europe, it has felt the need to be well armed to discourage invasion, and apart from a brief period of French domination around 1800 its determination achieved its purpose. In 1874 Switzerland was able to mobilise 200,000 people. By the early 1960s, a growing population had pushed the number above 800,000—but a few decades later the external threat receded out of sight.

Sensibly, Switzerland introduced reforms in 1995 that cut the number to less than half. In another round of rationalisation now in progress, the size of the army is about to be roughly halved again. The new forces will be more flexible, more mobile, better trained and better equipped. In due course they might also become cheaper. In the transition phase, however, the cost will remain much the same, about SFr4.3 billion a year.

Switzerland gets a lot of bang for its buck by having a militia army. In principle, every Swiss man over 18 has to do military service (women get a choice), starting with a basic training period of a few months and continuing with annual refresher courses into his 40s or 50s. Soldiers still keep their uniform, their gun and their army knife at home to allow instant mobilisation. The latest reforms will make military service considerably less onerous: for most soldiers it will be all over by the time they are 26.



That is just as well, because enthusiasm for army service is waning. It used to be considered a useful tool of social integration, because recruits from all social classes trained side by side, as well as an opportunity for professional networking among the officers, who also serve part-time but for longer periods. For bankers in particular, their army contacts often proved invaluable in lining up their next job. But in the past decade or two employers have become less keen on staff being away for military training, and the networking advantages have lessened.

Because the state needs fewer soldiers, dodging the draft has also become easier. Lots of young men now claim to be physically or mentally unfit, and get away with it. The Swiss are not ready to abolish their army yet, as a couple of referendums in recent years have shown, but their support is no longer as wholehearted as it was.

But even though Switzerland's immediate neighbours no longer present a military threat, that does not mean it feels entirely relaxed about them. To be sure, they are all friends as well as indispensable trade partners. But every one of them belongs to a dynamic and evolving club of which Switzerland is not a member, and about which it is deeply ambivalent. It did put in an application to join the EU in 1992, which remains on the table in Brussels, but a Swiss referendum in the same year on membership of the European Economic Area—a sort of antechamber to the EU, inhabited by the few European countries that remain outside—was narrowly lost, and another referendum in 2001 on an immediate resumption of entry negotiations was defeated ignominiously.

Officially, the Swiss federal government is still in favour of entry, though some of its component parts, particularly the Swiss People's Party, are strongly against. For the past 15 years, Switzerland has been keeping a careful eye on EU legislation that might impinge on it, making its own legislation "euro-compatible" so that it would not get in the way of eventual EU entry. In the past few years it has gone much further by negotiating a set of bilateral agreements with the EU. These have put relations on a formal footing, obliging all levels of government to comply.

The first round of these negotiations ("Bilaterals I"), covering the free movement of people, air and land transport, agriculture, technical barriers to trade, public procurement and research, was approved by a two-to-one majority in a referendum in 2000. However, that left the prospect of continuously having to update the agreements already reached. For example, will the provisions negotiated for the free movement of people across borders also apply to the new EU members due to join in May this year?

It also left a range of subjects yet to be dealt with, so a second round ("Bilaterals II") started in 2001 to tackle the remaining items and get to work on a few more. Some of these are particularly contentious, such as the proposed withholding tax on interest paid to EU citizens with Swiss bank accounts, and Swiss participation in the EU's arrangements for fighting crime and for asylum policy (known, respectively, as the Schengen and Dublin agreements). These new negotiations have proved sticky.

It is clear that the bilateral route is slow and cumbersome, and will prove a never-ending labour as the EU evolves and changes. Up to now the Europeans have assumed that Switzerland will join eventually, but if they conclude that it may never do so they could become increasingly unwilling to make concessions. A recent Swiss government report acknowledges that the EU's negotiating position is now so strong that Switzerland "ultimately could be blackmailed".

Wait and see

The Swiss government is now playing a waiting game. It says it wants to see how the bilateral agreements work out, and to spend more time assessing the likely effects of EU membership on matters dear to Swiss hearts, such as federalism, financial regulation, foreign nationals, agriculture and security policy. It also accepts that any renewed application to join must enjoy broad domestic support, because entry will have to be approved by a referendum.

That is likely to prove the biggest hurdle of all. The opinion polls yo-yo a lot, but even at the best of times only half of Swiss voters seem to favour EU membership, and often far fewer. The success of Mr Blocher's virulently anti-EU party in last October's election suggests that EU support is currently on a downward swing.

Even Swiss industry is far from uniformly enthusiastic about membership, despite the lure of the single market. Economiesuisse, an umbrella organisation for Switzerland's large export-oriented industries, has concluded that in economic terms EU entry will make little difference. Switzerland's economy is already closely integrated with the rest of Europe, it says, so any talk about Swiss isolation is largely about politics. In the end, the decision on membership will be a political one.

Swiss worries about EU membership are mainly about three things. The first is that Switzerland would be a small fish in a big pond. With 7m people in a total EU population about to rise to 450m, it might not get much attention. It has already noted that the EU tends to ride roughshod over smaller member countries, and frets that its special interests, such as banking and farming, would get less consideration inside the EU than outside.

Second, as a rich country coming in late, Switzerland suspects it would have to pay over the odds. Government estimates of the annual cost of membership range from SFr3.1 billion to SFr3.9 billion a year, almost as much as the country's entire defence budget. Some private calculations put the figure at nearly twice that.

But the biggest concern is over the effect of EU membership on Switzerland's political system. Were it to sign on the dotted line, the country would have to accept the EU's entire *acquis communautaire*, the body of European laws that holds the Union together, as it stands. None of this would have been put to a Swiss referendum, and none of it could be changed to suit the Swiss.

As for the future, experts say that referendums on 80-90% of the subjects they would previously have covered would still be possible. But that leaves 10-20% on which the Swiss people would have to take instructions from abroad. They may simply not be willing to do that.

Something to be proud of

Feb 12th 2004
From The Economist print edition

Switzerland is not as special as it was—except for its political system

Alamy

Lonely as a cloud

“WHY SWITZERLAND?”, asked an excellent book by Jonathan Steinberg, an academic at Britain's Cambridge University, first published several decades ago and since updated. It is still a good question, and not as straightforward as it appears at first sight. It can be read, among other things, as asking how Switzerland has become the way it is; whether its ancient and peculiar political and economic arrangements still make sense today; and, if they do, whether other countries might have anything to learn from them.

The answer to the first question is shrouded in history. As for the second, this survey has argued that in an interconnected world, even a small country determined to go its own way cannot escape geopolitical changes and global economic trends. This has meant that in recent years Switzerland has in many ways become less of a special case.

Its reputation as a shining beacon of rectitude was somewhat tarnished as details of its behaviour during and after the second world war emerged. Its politics, although still consensus-based, has become rougher and more adversarial. Its government has become bigger than many of its citizens would like—but this is partly in response to demands for a modern welfare state, which is not easy to reconcile with small government.

Its economy has proved as vulnerable as any other to the ups and downs of the business cycle, and not as uniformly efficient as the Swiss themselves like to believe. Although the country is still rich, others are catching up fast. Some of its big companies have proved fallible, and its banks have sometimes been a little greedy. Its foreign-policy platform of strict neutrality has become less appropriate in the post-cold-war world order, and its refusal to move closer to the EU has forced it to adopt complex solutions to living with the European neighbours that surround it.

One persistently special thing about Switzerland, however, is its political system. Its mix of federalism and direct democracy makes it different from any other country in the world, and affects every other aspect of life. Not that the system is perfect: too much federalism can be bad for business if it gets in the way of the internal market, and too many referendums launched by special-interest groups can be bad for voter morale, contributing to a gradual decline in turnout.

But in substance the system is alive and well, and is still delivering results. It stops politicians from assuming that they can impose decisions over the voters' heads, and it encourages citizens to keep themselves well informed on international, national and local affairs so that they can cast their ballot in a sensible way. There can be few other places where political information is so readily accessible, so well presented and so balanced.

The emphasis on consensus and popular endorsement means that politics in Switzerland can afford to be less short-term than it is in other countries. There is little scope for quick political fixes because all the parties in government have to agree, and if an issue is controversial it is likely to be put to a referendum anyway. As a result, policies that require a long-term approach can be planned without always keeping an eye on the next election.

One example is transport. Swiss public transport is a source of wonder to visitors. The trains run frequently and on time, all the timetables are co-ordinated, and getting anywhere in the country is easy. The system may be heavily subsidised, but the same is true in many other countries, usually with much poorer results.

Congested trunk roads are more of a problem, but the Swiss are trying to do something about them. Among other things, they are investing around SFr30 billion in their main north-south rail routes, partly to speed up rail passenger traffic and partly to move all transit freight traffic from road to rail to stop an endless procession of noisy, polluting lorries through their valleys. This involves the construction of two new rail tunnels under the Lötschberg and Gotthard mountain ranges, as well as other upgrades. The plan proved controversial, but a referendum in 1992 produced a respectable majority in favour. The tunnels are now well under way.

The disadvantage of the Swiss political system is that it grinds very slowly. It also builds a conservative bias into most decisions, because most Swiss people are not gung-ho innovators. They did not agree to give women the vote in federal elections until 1971, much later than in most other rich countries. They did not join the UN until 2002, after several abortive attempts. They have put EU membership firmly on ice for the foreseeable future and may not defrost it for decades, if ever.

The Swiss tend to be apologetic about the slow pace of their political process, but argue that the results are worth waiting for: after exhaustive debate, once a decision has been made on an issue, it has been legitimised and is widely accepted.

Clearly, for the Swiss the system works. It may even help to account for the fact that they seem so content. Of course being affluent is a good start. International surveys show time and again that economic well-being and satisfaction with life are strongly correlated. Having a job, in particular, is a big factor in keeping people at ease with themselves.

Happiness is a voice in politics

But recent work by two Swiss economists provides strong evidence that a country's political system also plays a part in people's sense of contentment. In a book entitled “Happiness and Economics”, published in 2002, Bruno Frey and Alois Stutzer of the University of Zurich examined the relationship between the satisfaction Swiss residents expressed with their lives and the amount of political control they were able to exercise. Switzerland provided the perfect laboratory because different cantons practise different degrees of direct democracy. The authors concluded that the more direct political power people have, the happier they seem to be.

That may help to answer the third question raised above: whether the rest of the world has anything to learn from Switzerland. So far as its political system is concerned, the answer is clearly yes. True, the Swiss sort of direct democracy takes many years of practice. It may also be more appropriate for smaller than for larger countries. But at a time when representative democracies everywhere are suffering from disillusionment with politics, it is well worth thinking about alternatives.