Comparative Country Analysis

Switzerland and the United States

Nada Amin
nada.amin@epfl.ch

June 2004

Introduction

I am going to compare the economies of the United States (US) and Switzerland (CH), focusing on the fundamentals.

Switzerland is an open economy. It has the highest rate of exportations per GDP. As such, it is affected by global developments such as the terrorist attacks of September 11, 2001 in the US. In times of crisis, there is a pressure on the demand of its currency, because of its status as a safe haven currency.

By contrast, the US is the leading economy of the world. It has the highest GDP in PPP of the world. Yet, its rate of exportations per GDP is comparatively low. Its currency is the most used in the world.

In this analysis, I will first take a brief look at the main economic indicators of each country. I will then discuss their major policies. Then, I will look into more details at their recent performance: inflation, growth, and current-account balance. Finally, I will discuss a major issue in each country: for the US, it is the current-account deficit; for Switzerland, is it the slow growth of the past two decades.

Main economic indicators

	CH	US
Real GDP growth %	0.1	2.4
Consumer price inflation	0.6	1.5
Current-account balance (US$ bn)	1.56	-503.4
Population (m)	7.3	288.4

Table 1 *Main economic indicators*
2002 estimates (EIU 2003; EIU 2004)

There are two striking discrepancies in **Table 1**: the slow growth of Switzerland and the current-account deficit of the US, which I will discuss later.

The inflation in both Switzerland and the US is low, perhaps showing the success of their monetary policies, which I will explain next.

Policies

Swiss Monetary Policy

The goals of the Swiss National Bank (SNB) are price stability, since 11/1999, and a weak Swiss franc, since 1995.

In 2000, because the GDP growth prospects were seen to improve, the SNB augmented the interest rates. In 2001, after September 11, the growth prospects were weakened and the Swiss franc sharply appreciated, so the SNB lowered the interest rates. The current interest rates are rather low, at 0.25%. (EIU 2004)

Because of its status as a safe haven currency, the Swiss Franc tends to be sharply appreciated in times of crisis. Because this affects exportations, the SNB is quite aggressive in its policy to maintain a weak Swiss Franc.

US Monetary Policy

The top priority of the Federal Reserve is to maintain price stability. Like the SNB, it has been very successful in achieving low inflation in the past decade.

Alan Greenspan, the Chairman of the Federal Reserve, is quite popular and highly respected. He has been credited a lot for creating the economic environment that enabled the boom of the 90's. However, he has been criticized a little for not intervening during the tech bubble.

His non-intervention during the tech bubble can be explained by his philosophy, which tends to *"address the bubble's consequences, rather that the bubble itself"* (Greenspan 2004). For Greenspan, the defining characteristic of the monetary policy landscape is *uncertainty*: uncertainty in the situation, uncertainty of the models, uncertainty of the evaluation of the models, … As such, he compares monetary policy to risk management, and performs a cost-benefit analysis: between

A) a policy with a high probability of a fantastic outcome but a low probability of a disastrous outcome, and
B) a policy with a good probability of a positive (but not fantastic) outcome and a minimal risk of a negative account,

he would choose policy B. But, at the end, because of the uncertainty in the evaluation of the models, he relies on judgment and historical comparison above all. This philosophy explained why Greenspan cautiously limits his interventions and why he tends to avoid preventive interventions. Indeed,

Instead of trying to contain a putative bubble by drastic actions with largely unpredictable consequences, we chose, as we noted in our mid-1999 congressional testimony, to focus on policies "to mitigate the fallout when it occurs and, hopefully, ease the transition to the next expansion." (Greenspan 2004)

Thus, we can understand why reducing the current-account deficit is not a goal in itself (OECD 2004). Rather, the goal is to mitigate the negative effects of the resolution, when it occurs naturally.

Swiss fiscal policy

The Swiss pension system needs a reform or a financial solution, because of the aging of the population. The US has a similar problem with the baby-boom generation soon reaching the age of retirement. The issue is still open, as the 11th revision of the AVS ("Assurance-vieillesse et survivants") and its financing by the sales tax was rejected by the population in May 2004. (EIU 2004)

In December 2001, the population voted at 85% the debt brake ("frein à l'endettement"), a constitutional commitment to balance the federal budget over the economic cycle. The fiscal rules of the debt brake were amended for the year 2003, because the budget deficit was over 2% of the GDP (OECD 2004). (EIU 2004)

US fiscal policy

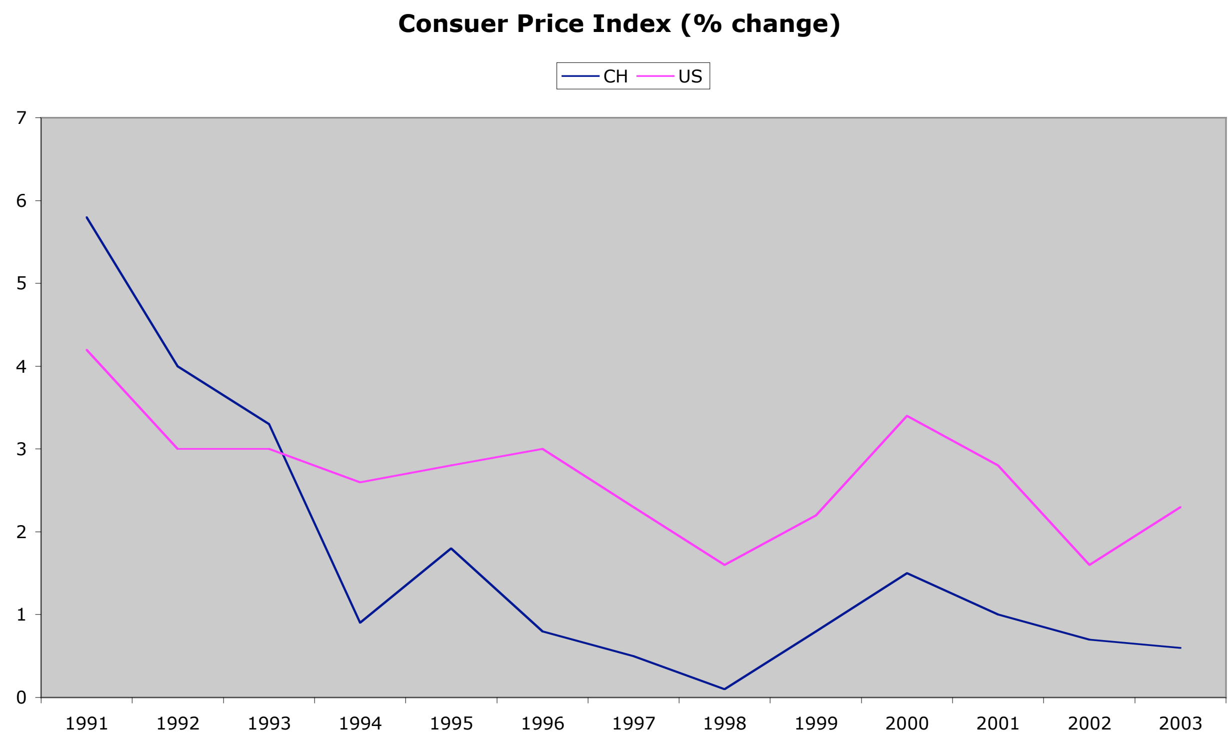
During the Clinton era, tax revenues were up, because of the strength of the economy and a significant augmentation of taxes during the first Clinton term. In addition to the tight expenditure control, this policy brought a budget surplus. (EIU 2003)

The situation has deteriorated during the W. Bush era. Tax revenues went down, because of the downturn in the economy and Bush's tax-cut package, which was approved by Congress in mid-2001. On the other hand, spending increased, notably for defense and homeland security. This combination of less revenues and more spending has brought a budget deficit. (EIU 2003)

Performance

Inflation

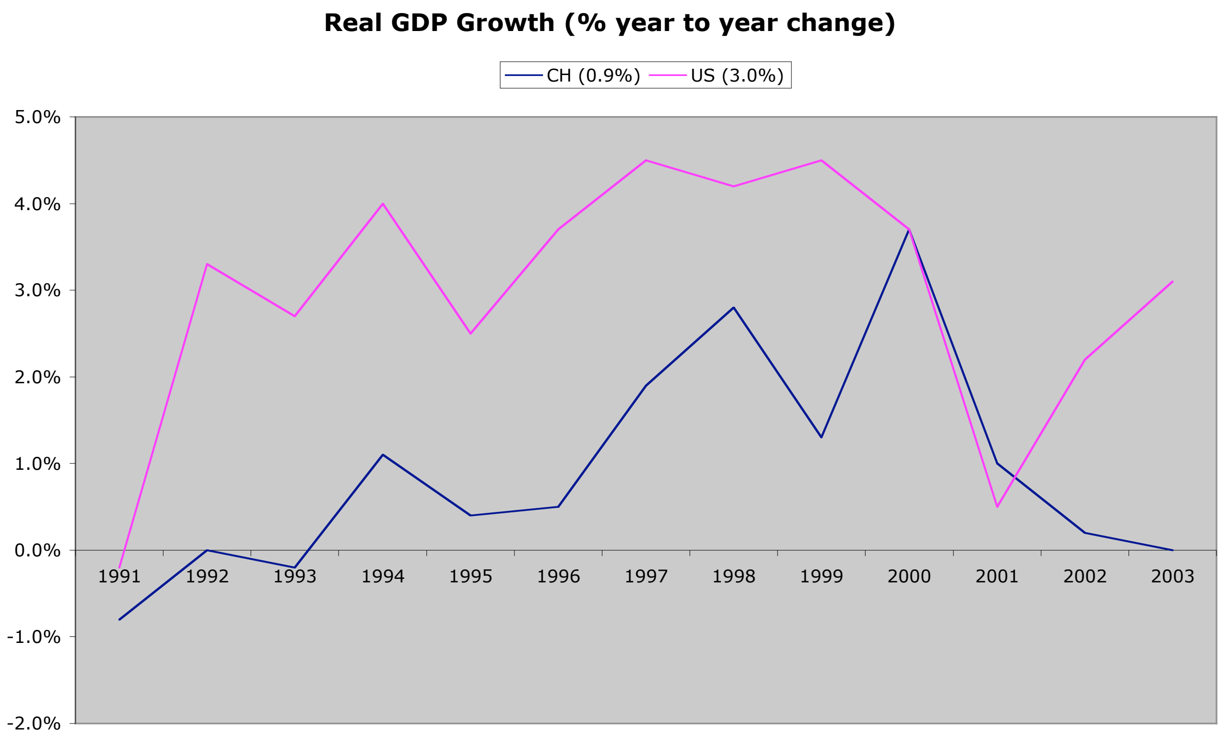
The inflation has been low in Switzerland and the US since the beginning of the 90's, as shown in **Graph 1**.



Graph 1 *Inflation in Switzerland (CH) and the United States (US) 1991 to 2003 (Labor 2004)*

GDP Growth

GDP Growth has been strong in the US but low in Switzerland, in the past decade, as shown in **Graph 2**. The US growth went down in 2001, due to the tech bubble crash in March and the terrorist attacks of September 11, a downward trend that Switzerland followed. However, while the US has moved up, Switzerland has continued to go down. I am later going to discuss the low growth of Switzerland.



Graph 2 *Real GDP growths of Switzerland (CH) and the United States (US) from 1991 to 2003 (Bureau of Economic Analysis and Swiss Federal Statistical Office)*

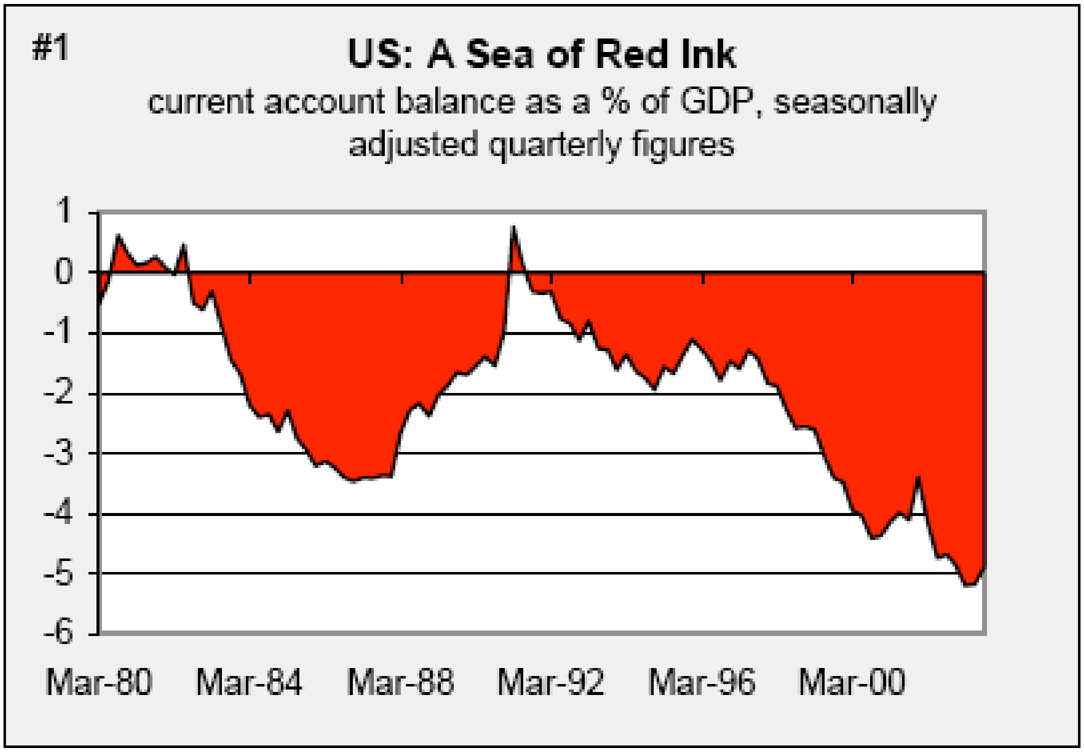
Swiss external sector

The balance of trades in goods is traditionally in deficit for Switzerland. This is because Switzerland is a net importer of food and almost all its energy. It exports high-value-added goods, notably in the pharmaceutical and chemical industries. Its major trading partners are in the European Union, the most important one being Germany. Given that, would Switzerland benefit from being a member of the European Union?

Despite its trade deficit, Switzerland has a high current-account surplus, which reached a peak of 14.3% of the GDP in 2000. This surplus is boosted by Switzerland's banking and insurance activities. Switzerland holds a lot of foreign assets, which have a comparative better yield than the Swiss assets and thus contribute to the surplus. (EIU 2004)

US external sector

The US has a huge current-account deficit. I will devote an entire discussion to it later.



Graph 3 *Recent US history of current account balance as % of GDP (Franck 2003)*

Discussions

US deficit: good or bad?

The accounting identity `CA` *`(current account)`* `+ FA` *`(financial account)`* `= 0` implies that `CA < 0 → FA > 0`. In words, a current-account deficit implies high foreign investments.

So are high foreign investments a good thing? It depends on whether these investments are short-term and highly speculative – like they were in Thailand before the crisis of 1997 – or long-term, in which case it is not a problem.

What is certain, however, is that a current-account deficit cannot be sustained indefinitely (Mann 2002). Indeed, foreign investments will saturate at some point. If the resolution is sudden, then it can lead to a crisis with terrible consequences like in Thailand. If the resolution is progressive, then it can be benign.

The US current-account deficit boosts the economy of the partners that benefit from more exportation, notably China, Japan and to a lesser extent the European Union. If the US deficit is resolved, who will be the next booster?

US deficit: Why?

The US has a higher tendency to import per income. This means that at similar growth rate, the US will have a deficit. In the 60-70's, the US partners had a lower growth than the US, enough so that there was no deficit. However, in the 80's, the partners had a similar growth to the US, and thus, the US was in deficit. (Greenspan 2003)

In the 90's, the US deficit is due to a gap between the domestic investments and savings. From 1995 to 2000, this gap was mostly due to the lack of savings in the private sector. However, in 2002, the budget deficit aggravated the trend. (Greenspan 2003)

Because of their monetary policies, China and Japan purchase a lot of US assets. Indeed, the Japanese and Chinese companies exchange the US dollars from exportations to local currencies. These exchanges create a pressure on the demand of the local currencies. In order to maintain the exchange rate between the local currencies and the dollar, the national banks of Japan and China create more money with which they buy dollars. They then invest these dollars in the US. (Greenspan 2004)

Recently, when the US dollar got depreciated relatively to the Euro, the EU partners absorbed some of the shock, thus not significantly reducing their exportations to the US. (Greenspan 2004)

US deficit: Greenspan's confidence

In his speech of November 20 (Greenspan 2003), Greenspan hopes for a benign resolution of the US deficit and puts forward the following arguments:

1. The peak of 1986 diffused benignly.
2. The institutional strengths of the US – like that of other developed countries – is a guarantee against the sort of sudden loss of investors' confidence that destabilizes emergent countries, like Thailand.
3. The US has a higher capacity to incur foreign debt because it is able to finance its deficit in reserve currency.
4. As the euro becomes more widely use as a reserve currency, the dollar price will weaken, thus helping US exportation. (Currently, the use of US dollar in reserve currency is 65% while the use of euro, which seconds it, is only of 15%.)
5. The increase in globalization and flexibility will favor a benign resolution. *"Indeed, the example of the fifty states of the United States suggests that, with full flexibility in the movement of labor and capital, adjustments to cross-border imbalances can occur even without an exchange rate adjustment."* Greenspan is absolutely opposed to protectionism, which he blames for the sterling crisis in Great Britain's early post-World War II.

Not everyone is convinced by these arguments. Some are concerned by the growing dependence between the US and China. Indeed, as explained before, China holds a lot of US assets and it has the potential to destabilize the US. Right now, China has no interest to destabilize the US economy, as it will fall with it too. But will this always be the case? What if China diversifies its exportation and political tensions between the two countries weaken the cooperation?

Swiss low growth: Why?

Putting aside conjectural reasons, the low growth of the Swiss economy in the past two decades is mainly attributed to a lack of competition in the internal market (Brunetti 2003). The productivity of the Swiss companies goes at two speeds: on the one hand, companies who export are very productive, on the other hand, companies who operate mainly in the internal market are not productive.

The lack of competition in the internal market is reflected in the price of goods, which is on average 40% higher than in the US. Compared to the 15 of the European Union, the top uncompetitive markets are rent, health, public spending (>60%), public transportation and food (>40%). Interestingly, these markets are mostly influenced by the State. These differences in price are too significant to be explained by mere qualitative or income differences. (Brunetti 2003)

There are two fundamental reasons why competition influences growth:

1) prices go down, which benefits both consumers and companies, who pay less for their raw materials, and
2) innovation increases, as companies try to surpass their competitors.

Swiss low growth: agenda

Having identified the lack of competition as the main reason for slow growth, Switzerland recently modified its competition policy with the law on cartels, voted in the summer of 2003, which, among others, improves the anti-monopoly legislation.

The other territory of attack is to diminish prices. Possible reforms include the introduction of competition in the health sector, the deregulation of the public infrastructure, the liberalization of the agricultural sector – on its way with the "Politique agricole 2007", more transparency in the public markets at all state levels, the liberalization of the external trade – on its way with the various bi/multi-lateral agreements. (Brunetti 2003)

Swiss slow pace of reforms

The structure of power in Switzerland induces a slow pace of reforms. For the executive branch, powers of the federal government are weak, as cantons have a high degree of autonomy. Thus, it is difficult to lead a coherent and centered action. For the legislative branch, the Swiss system of direct democracy, in which the population can vote on the ongoing legislation, means that a lot of legislative process are slowed down if not totally blocked when a referendum is opposed.

Concluding Remarks

Key points

Both US and Switzerland have high living standards: their GDP per capita in PPP in 2002 is the second and seventh, respectively (CIA 2003). Switzerland was at the top a decade ago, but because of the slow relative growth of the past two decades, the others countries have caught up and even some, like the US, have surpassed it. The US high rank must be tempered by the marked and rising inequality in income distribution, which is further aggravated by W. Bush tax-cut package.

Each economy has its worries: for the US, these are the *resolution* of the current-account deficit and its related growing dependence on China; for Switzerland, the slow growth and the parallel aging of the population.

Would I invest in Switzerland or the US?

US seem too high-risk, Switzerland too low-yield – so none. Still, given that the US deficit resolution might weaken the dollar eventually, I keep most of my savings in Swiss francs – the safe haven currency after all.

Would I create a startup company in Switzerland or the US?

Both the US and Switzerland have great expertise in engineering, and are leaders in some technology-related fields. Sure, overall, the growth of the Swiss economy is stagnating, but the export sector – with its myriads of high-value-added company – is doing comparatively well. If I didn't doubt the success of the enterprise, I would base it in Switzerland – for the comfort of being at home. But is there an innovative company that was ever started without risk?

If the opportunity arose, I would probably choose to create a start-up company in the US, in California or New York, for the same reason I chose to pursue my university studies in the US instead of Switzerland. When I was 17 and a junior in high school, I worked at a start-up company in Cambridge, Massachusetts, during the dot-com boom. The CEO of the then very successful company was 36 years old and he had already started six companies – and buried three. Impressed by the resilience, I realized how liberating it would be to study and work in an atmosphere where failure would not be stigmatized but turned into a rebound to success. When you're not afraid of failing, you can risk being more ambitious.

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Appendix: detailed performance data

	USA	Switzerland	Sources
Economic			
GDP (PPP US dollar billions)	$10,446.3	$233.4	2002 est. (CIA 2003)
GDP per capita (PPP US dollars)	$36,300	$32,000	
GDP by expenditure (% of GDP)			2002 est. (EIU 2003; EIU 2004)
Private consumption	69.90%	60.60%	
Government consumption	18.90%	15.20%	
Gross fixed investment	15.20%	18.90%	
Stockbuilding	0%	-1.50%	
Exports of goods & services	9.70%	42.20%	
Imports of goods & services	13.80%	35.50%	
Lending **interest rate**	4.7%	3.9%	
Deposit interest rate	1.7%	0.9%	
Money-market interest rate	1.7%	1.1%	
Long-term bond yield	4.6%	2.4%	
real GDP **growth** rate (% change year on year)	2.4%	-0.1%	
Inflation rate - Consumer prices	1.6%	0.5%	2002 est. (CIA 2003)
Unemployment rate	5.8%	1.9%	
Central **government debt**			Bureau of the public debt
(US dollar or CHF billions)	$7,216.37	CHF 123.71	Swiss Federal Office of Statistics
(% of GDP)	60%	30%	(for CH, does not include cantons & communes)
Social			
Income distribution			
GINI Index	40.8	33.1	1997 est. for US, 1992 est. for CH (WorldBank 2002)
% of income by top 10%	30.5%	25.2%	
% of income by bottom 10%	1.8%	2.6%	
Fertility rate (children born/woman)	2.07	1.48	CIA (2003 est.)
Net migration rate (migrants/1,000 population)	3.52	1.37	
International			
Balance of payments			
Current-account balance (US dollar billions)	-503.4	26.0	EIU (2002 est.)
(% of GDP)	-4.82%	11.14%	