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***VIEWS OF THE EFTA COUNTRIES***

***MAKING ECONOMIC GROWTH INCLUSIVE***

**EFTA ECOFIN MEETING**

**7 NOVEMBER 2017**

## **Views and priorities of the EFTA States**

The recovery of the European economy is becoming increasingly resilient and broad. Employment is picking up and unemployment continues to fall gradually. The upswing provides an opportunity to build buffers and implement structural reforms to make growth sustainable and ensure that gains from open markets and technological advancements are spread more broadly. Well-functioning product and labour markets are fundamental to achieve higher output and lower unemployment in the medium and longer term.

The economic situation in the EFTA States is relatively good. Iceland has lifted capital controls and enjoys economic growth of above 7%. The other EFTA States are experiencing moderate growth rates with a positive outlook for the years to come. In Liechtenstein, the latest data signal a return to a gradual recovery path after a slowdown following the strong appreciation of the Swiss franc in 2015, and employment growth has increased since the beginning of 2016. In Switzerland, the export industry has increasingly managed to adapt to the strong currency and the Swiss economy is gradually resuming a stronger growth trajectory. Despite rather weak employment growth in 2016 and in the first half of 2017, a turnaround seems to have been reached, with unemployment rates falling. The Norwegian economy is also improving and unemployment is declining. Targeted fiscal measures and lower interest rates have supported domestic demand, and the depreciation of the krone along with lower wage growth has increased the country's cost competitiveness.

EU and EFTA countries share several important economic challenges. Globalisation and new technologies are changing the nature of work. Digitalisation and automatisaton are seen as a key influence on future labour markets. Demand for labour to do routine and manual tasks will probably decrease, while demand for high-skilled labour will increase. Moreover, new industries and job profiles will arise and some older ones will die, leading to shifts in the labour market. This development implies that the labour market will require different qualifications, which may present challenges for the economy and employees alike. Another challenge stems from the ageing population, which is expected to weigh on economic growth and public finances in many European economies in the coming years. High participation in the labour market is crucial to maintain income equality and to secure public finances, which is a precondition for many policy measures against inequality.

Broader and more efficient use of technology is critical for raising productivity, which in turn is important to income growth in our economies. Smart use of new technology is also key to raising efficiency in the public sector, which is necessary for meeting the challenges that an ageing population poses to the welfare state. The economic potential stemming from digitalisation and, more broadly, the so-called “fourth industrial revolution”, can best be facilitated if private initiatives receive the necessary freedom to exploit the opportunities at hand. Digital transformation should therefore not be limited by unsuitable regulation restraining innovation or protecting traditional technologies or business models. Although technological development brings about opportunities, it also comes with challenges, and some individuals or groups might be adversely affected. Economic policy must therefore aim to reap the gains while also supporting the most vulnerable groups in our societies. Education and skill enhancement are key to successfully confronting these challenges. Modernising and expanding educational systems and lifelong learning programmes, along with enhanced efforts to implement structural reforms to strengthen productivity growth and successful integration of immigrants in the labour market are suited to promote high inclusive growth.

A well-integrated, well-functioning European market is a key element of this approach, as large gains can be derived from further opening up our markets, both regionally and globally. EU and EFTA States share responsibilities and benefits in this respect, as they are all participants in the common market – the EEA EFTA States through the Agreement on the European Economic Area (EEA Agreement) and Switzerland through its bilateral agreements with the European Union. The United Kingdom’s exit from the EU brings a major source of uncertainty to the future European framework. Our aims must be to minimise uncertainty and avoid a build-up of economic barriers, as these will allow Europe to maintain its status as an attractive business location and economic partner. Since the EEA EFTA States will be affected by this change in almost the same way as the remaining EU Member States, it is important for the EEA EFTA States to be closely consulted on the content and process of the withdrawal negotiations, and to have the opportunity to participate in any arrangements relevant to the EEA. Switzerland, for its part, will also have to find new legal arrangements with the UK, as the bilateral agreements with the EU will no longer be applicable to its relations with the UK.

Among the EFTA States, the vast majority of the population has benefited from rising incomes over the past decades, and income inequality is low. Inequality of market income before taxes and transfers is among the lowest in the Organisation for Economic Co-operation

and Development (OECD), especially in Switzerland where redistribution is relatively small. In Iceland and Norway, redistribution is more prominent and income inequality of disposable income relative to other OECD economies is very low. Low inequality and poverty in the EFTA States is largely supported by high employment, a highly skilled labour force, publicly financed education and a generous welfare state.

The EFTA States acknowledge the importance of supporting smart, sustainable and inclusive economic growth delivering high levels of employment, productivity and social cohesion. The EFTA States agree that high employment is both a goal in itself and the most important factor for inclusive growth. Policies should aim at enhancing the integration of workers who are generally less attached to the labour market. Access to vocational training programmes and higher education is crucial to achieving inclusive growth and preparing workers for the rapidly changing demands of the labour market. Policies addressing health inequalities are also important to promote a longer stay in the labour market.

Within the EFTA States, a variety of measures are carried out in order to promote inclusive growth:

- Iceland emphasises gender balance and, despite an already low gender pay gap, companies will be required to be certified for gender pay equality, with the aim of paying the same for all jobs of equal value. Furthermore, men and women have the same rights to parental leave and, therefore, the parental leave policy does not entail built-in impediments for women in the workforce. The VAT tax gap has been reduced significantly and the tax base has been broadened as various tourism-related services are no longer exempt from VAT taxation. Iceland has also introduced a ceiling on payments for healthcare.
- Liechtenstein notes that a solid financial basis is vital for future investments and, thus, has prioritised managing expenditures. All expenditures are continuously reviewed in terms of need and benefit, and costs have been significantly reduced in recent years. Moreover, the government plans on ensuring that high-quality care will be available and affordable for everyone in the future. Liechtenstein sets its focus on digitalisation, and plans on promoting entrepreneurship by enhancing support for entrepreneurial networks and the venture capital market.

- In Norway, every child is entitled to a place in their local kindergarten from the age of one at an affordable price, and recent measures aim at improving the quality of teachers in primary and lower secondary education. Flexible labour market regulations have, together with universal income insurance schemes and active labour market policies, supported the reallocation of labour and reduced the risk of a segmented labour market. Norway also emphasises gender balance and notes that subsidised childcare, working time flexibility and paid parental leave have facilitated the combination of family life and work for both genders.
- Swiss policy aims at mitigating inequality in advance by promoting equal opportunities and labour market participation. Key elements are high quality education, its different pathways between vocational and academic streams, and the dual education system that ensures close links between the education system and the labour market. Furthermore, Switzerland has a flexible labour market and a well-functioning social security system, which sets incentives for participating in the labour market. Finally, large reforms are subject to the approval of the population in Switzerland. This ensures that distributional consequences of such reforms are taken into account when designing the reforms, and in the public discussion.

In the context of financial market policies, the EFTA countries have long supported international efforts to strengthen the regulation and supervision of financial markets and institutions. The EU requirements for financial markets legislation, which also apply in the EFTA pillar in the EEA, constitute the foundation for national legislation. Legal homogeneity and a level playing field are major objectives of the EEA Agreement. The application of the same set of rules promotes stability, predictability and reliability. Regulatory efforts should not foreclose access to markets, market infrastructure and services within Europe. Furthermore, the EFTA States view an environment of financial stability as fundamental to the good functioning of our economies. In order to achieve this, it is important that the requirements at the European level allow national regulations that are suited to secure financial stability in the various jurisdictions. Finally, care needs to be taken so that financial sector regulation does not become overly complex.

## **Annex 1: Iceland**

### **Economic outlook**

The Icelandic economy grew by 7.4% in 2016, which makes it the fastest growing OECD economy. Further robust growth is projected in 2017 as the economy is expected to grow at around 5%. Unlike in previous upswings, the internal and external balance of the economy appears solid. Iceland is running a current account surplus, amounting to almost 8% of Gross Domestic Product (GDP) in 2016, and net capital outflows in connection with the current account surplus and the settlement of the failed financial institutions' estates have improved Iceland's net international investment position markedly. Furthermore, inflation has remained below the Central Bank's target of 2.5% for almost four years.

Investment has grown quickly in recent years. In 2016, it grew by almost 23% year-on-year, on the heels of nearly 17% growth in the two preceding years. The main driver of the increase is business investment, which has grown by an average of almost a quarter per year in the past three years. The increase has been particularly notable in sectors related to transport and tourism. Residential housing investment has also picked up strongly, growing by over a third in 2016. The outlook is for a marked slowdown in investment growth this year, although growth will remain robust.

The exchange rate appreciated rather rapidly in 2016 and early 2017. The appreciation was largely due to growth in tourism, considerably better terms of trade and a substantial improvement in Iceland's external position. Therefore, it is considered to reflect the adjustment of the króna to a higher equilibrium real exchange rate rather than to carry trade-related inflows.

Iceland has experienced a boom in tourism, with tourist numbers growing almost exponentially since the volcanic eruption of Eyjafjallajökull in 2010. The number of foreign visitors increased by almost 40% in 2016, when 1.8 million tourists visited Iceland, and around 2.2 to 2.3 million visitors are expected this year. The surge in tourism has boosted the economy, helping unwind some of the impacts of the financial crisis. New jobs have been created and foreign currency earnings have risen, while the boost to tax revenues has contributed to improved public finances. However, at current growth rates, tourism also brings many challenges with respect to nature, the housing market and overall infrastructure in Iceland.

The Icelandic labour market is flexible. The strictness of employment protection is low, companies can easily adjust their labour force, and labour market needs are fulfilled by large variation in employment through migration flows. At present, the labour market conditions are tight, with very low unemployment and high labour force participation. As a result, many firms are short-staffed. The labour shortage has largely been met with an inflow of foreign workers, thus dampening overheating pressures as domestic firms meet their labour demand by importing labour rather than overbidding wages. Despite the inflow of workers, collective bargaining agreements have led to substantial wage increases in recent years.

In spite of rapidly increasing wages, inflation has remained low due to favourable external conditions and an appreciating exchange rate. Hence, purchasing power of households has increased markedly. Contrary to the expansion a decade ago, both households and firms have taken advantage of favourable economic conditions and paid down debt. As a result, private sector debt stood at around 160% of GDP at the end of 2016, its lowest ratio in the 21st century and substantially lower than the peak of above 350% of GDP in 2008.

Construction of residential properties fell dramatically after the financial crisis. Demand for housing picked up after the economy rebounded, but supply of housing has responded slowly to growing demand. In addition, the inflow of foreign workers and the boom in tourism has further increased demand for housing, resulting in rapidly rising house prices.

The banking system is currently much smaller than before the financial crisis. The commercial banks' assets, which accounted for more than nine times GDP in 2008, today account for around 1.3 times GDP. The banks are well capitalised, with a combined Common Equity Tier 1 (CET1) capital ratio of around 25%. In addition to a strong capital position, the liquidity position of the financial system is sound, and default is low as the borrower's position is good. The banks are therefore well equipped to withstand possible adverse shocks in the future.

### **Inclusive growth – Recent developments**

As a small, resource-based and open economy, Iceland is prone to boom and bust cycles. However, it protects individuals from this volatility with universal healthcare, free education, and well-designed social benefits. As a result, poverty is among the lowest in the OECD and life expectancy among the highest in the world.

Iceland is highly unionised, and collective bargaining plays a key role in wage formation. Even though the procyclical nature of collective bargaining has resulted in large wage awards, particularly during times of economic boom, the strong presence of trade unions has contributed to promoting equality and inclusiveness. The wage distribution is already compressed, but taxes and benefits have further equalising effects, resulting in Iceland being the OECD country with the lowest inequality in disposable income.

Female labour force participation is the highest among OECD countries, and women exit the labour market very late. Iceland tops the Global Gender Gap Index, being a top performer in political empowerment and educational attainment and in the top ten for economic participation and opportunity, due to a high number of women among legislators, senior officials and managers. Furthermore, the gender wage gap has been diminishing rapidly, as women's wages have been catching up with those of men.

### **Policies to support inclusive growth**

Inclusive growth is often defined as economic growth that creates opportunities for all segments of the population and distributes the dividends of increased prosperity fairly across society. In order to achieve this, policies must enable individuals to reach their full potential in the labour market and enhance the integration of workers who are generally less attached to the labour market.

#### *Gender equality*

Overcoming gender inequalities is fundamental to achieving inclusive growth. Key priorities include closing the salary gap and taking measures to enhance women's career advancement to senior posts. By law, for companies with at least 50 employees, boards of more than three members must have a membership of at least 40% of each gender. Moreover, companies with 25 or more employees are required to disclose the number of men and women employed, as well as the number of men and women in management positions. The Icelandic parental leave policy strikes a balance between encouraging both parents to play a significant parental role after childbirth and allowing households some discretion in taking parental leave. Each parent gets three months of parental leave and couples can divide the additional three months between them as they wish. The scheme thus does not entail built-in impediments to women in the workforce. Furthermore, despite an already low gender pay gap, Parliament has passed a law whereby it will be compulsory for all companies with 25 employees or more to obtain



certification for gender pay equality, with the aim of paying the same for all jobs of equal value.

### *Tax reforms*

Broadening tax bases can support inclusive growth as it allows reduced tax rates, thereby reducing deadweight losses from taxation, while also making the tax system more progressive as many tax expenditures benefit those on higher incomes more than others. In order to raise revenues after the financial crisis, various amendments were made to the tax system. Recently, however, focus has shifted towards simplifying the tax system. The VAT tax gap has been reduced from 18.5 to 13 percentage points. Various tourism-related services are no longer exempt from VAT taxation and are currently taxed in the reduced VAT rate. According to the current government's fiscal plan, the VAT tax base will be broadened further by moving accommodation and other tourism-related services from the reduced VAT rate of 11% to the standard VAT rate. Simultaneously, the standard VAT rate will be lowered from 24% to 22.5%. Further tax amendments include abolishing the mid-income tax bracket and repealing customs and excises on industrial products.

### *Fiscal policy and macroprudential measures*

Countercyclical fiscal policy, creating fiscal space for economic downturns, and appropriate macroprudential measures can be effective in increasing the resilience of individuals otherwise hardest hit by economic downturns or recessions.

A new Organic Budget Law entered into force in early 2016. The main objective of the law is to strengthen the fiscal framework and strategic planning in public finances by coordinating the central government, local authorities and their corporations. It also enhances a more effective application of fiscal policy in order to promote stability for households and corporations. According to the law, the overall balance of the general government must be positive over a five-year period, annual deficit shall always be below 2.5% of GDP and net debt<sup>1</sup> must be lower than 30% of GDP. If the debt ratio is higher, then the part in excess shall be reduced in every three-year period by at least 5% on average per year. With the law, gender budgeting, which has proven to be a relevant and important tool enhancing gender equality, has been incorporated into the budget cycle.

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<sup>1</sup> Net debt is defined as general government debt, excluding pension liabilities, accounts payable, currency and bank deposits.

In light of the favourable state of the economy, Iceland is paying down debt and running a primary balance surplus of around 4% of GDP. However, despite rapidly declining public debt, interest expenditures remain a substantial burden.

In July 2017, the Icelandic Financial Supervisory Authority issued rules limiting maximum loan-to-value ratios on new residential mortgages to 85% of a property's market price. First-time home buyers may be granted loans of up to 90% of the market price. The purpose of the rules is to maintain financial stability in light of rapidly increasing housing prices and to strengthen the resilience of both lenders and borrowers in the event of an adverse shock.

### **Challenges to maintain inclusive growth**

#### *Globalisation and digitalisation*

Demographic shifts, globalisation and new technologies are changing the nature of work globally. Digitalisation and automation, in particular, are seen as a key influence on future labour markets. This development implies that the labour market will require different qualifications, which may present challenges for the economy and employees alike. Economic policy must aim at supporting the most vulnerable citizens, while also reaping the gains from new technologies. In Iceland, the rights agreed during collective bargaining are automatically extended to all workers, including temporary agency workers. Only self-employed are excluded, but they are, by law, still covered by unemployment insurance and the occupational pension system. This has protected workers from changes in work organisation and other consequences of new technologies. The fourth industrial revolution will probably increase non-standard employment, i.e. temporary, part-time and self-employed workers. However, regulation and policy measures such as statutory working hours, minimum wages and unemployment insurances are largely modelled on the notion of traditional employment.

### *Tax evasion*

Tax avoidance and evasion are major challenges to achieving inclusive growth. Iceland has placed emphasis on strengthening its system of information exchange for tax purposes, and is currently working on implementing the Base Erosion and Profit Shifting (BEPS) recommendations in order to tackle tax avoidance strategies that exploit gaps and mismatches in tax regulation to artificially shift profits to low or no-tax locations.

### *Demographic trends and healthcare*

One of the main future fiscal challenges for Iceland is the rapidly ageing population. Due to demographic trends, spending on healthcare is expected to increase in the coming years and decades. Making health services accessible and affordable is not only a health issue as it is also suited to promote inclusive growth. However, this might be much easier said than done due to the expected expenditure increase to healthcare and overall care for the elderly. In May 2017, Iceland implemented a new cost participation system in healthcare. The new system aims at reducing the costs for those who frequently need to seek medical assistance by introducing a ceiling on payments.

### **Lifting capital controls – Capital flow management measure**

Capital controls were introduced in 2008 after Iceland was struck by a severe banking crisis that created a risk of excessive capital outflows and a sharp depreciation of the exchange rate, which had already fallen steeply. In March 2017, capital controls on individuals, businesses and pension funds were finally lifted. Some restrictions on capital mobility remain, but they are minimal and affect few. They mainly consist of measures to prevent excessive capital inflows due to carry trading.

The capital account liberalisation in March did not affect the remaining offshore króna assets, which remain subject to special restrictions. Furthermore, the Central Bank adopted a capital flow management measure (CFM) in June 2016. The CFM is intended to reduce the risk that could accompany excessive capital inflows and contribute to macroeconomic and financial stability by affecting the composition of foreign currency inflows. Under the measure, 40% of new inflow into bonds and high-yielding deposits are deposited at the Central Bank for a year at zero interest rates. The Icelandic government does not view the CFM as an active long-term policy instrument, but rather as a third line of defence to supplement conventional macroeconomic policy and macroprudential tools if needed.

After the capital controls were lifted in March, Fitch and Standard & Poor's raised Iceland's sovereign credit rating. Furthermore, Moody's noted that the elimination of capital controls was credit positive for the sovereign and the financial sector.

### Key figures for the Icelandic economy (%)

	2016	2017	2018	2019
Private consumption growth	7.1	7.8	5.3	3.6
Public consumption growth	1.9	2.2	1.3	1.3
Gross fix capital formation	22.8	8.8	3.1	2.9
Export growth	10.9	7.7	4.3	3.3
Import growth	14.5	12.5	6.2	3.3
GDP growth	7.4	4.9	3.1	2.6
Consumer price inflation (annual rate)	1.7	1.8	2.9	2.6
Unemployment rate (annual average)	3.0	2.7	3.0	3.8
Current account balance (% of GDP)	7.8	5.5	3.9	3.8

*Source: Statistics Iceland, October 2017, Ministry of Finance and Economic Affairs*

## **Annex 2: Liechtenstein**

### **General economic situation**

After the economic slowdown in 2015 in light of the Swiss National Bank's (SNB's) decision to abolish the exchange rate cap of the Swiss franc to the euro, latest data signal that the Liechtenstein economy has returned to a gradual recovery path. Employment growth accelerated from 0.2% to 1.9% in 2016, and early indicators point to a further improving outlook in 2017. For the next few years, Liechtenstein expects stable economic growth, although the outlook remains heavily dependent on the external environment and thus the global recovery.

Liechtenstein is an important industry hub, with around 40% of the workforce employed in manufacturing. The most important economic activities in manufacturing are: mechanical engineering, electrical machinery, dental technology, vehicle components, food products and construction equipment. The country is also well known as a stable, highly specialised financial centre with strong international links.

Liechtenstein's export sector was heavily affected by the abandonment of the exchange rate cap of the Swiss franc to the euro in 2015. The strong Swiss franc has also put downward pressure on import prices, leading to increased pricing pressures for domestic products. Due to its small domestic market, Liechtenstein's economy is heavily reliant on exports. Around 60% of all direct exports of goods are exported to EEA countries. The economic outlook thus also crucially depends on whether the currency returns to a fair valuation in the near future, although the recent depreciation vis-à-vis the euro has reduced the overvaluation of the Swiss franc in the past few weeks to some extent. In 2015, direct exports of goods decreased by 6.9% and direct imports of goods by 6.1%. Liechtenstein's industry sector has implemented various measures to stay competitive in recent years, including the reduction in personnel expenses through hiring freezes or staff reductions, the expansion of part-time work, the cancelling or postponement of new investments. Export growth returned to positive growth rates in 2016, and latest data point to a further improved outlook for Liechtenstein's external demand.

The financial sector has traditionally played an important role for the Liechtenstein economy as well, contributing about 25% to the country's gross value added. In a very demanding economic environment with low interest rates and high regulatory pressure, the banking sector

managed to generate higher earnings and net new money inflows in 2016. The assets under the management of Liechtenstein banks, on a consolidated basis, including subsidiaries and branches in foreign countries, reached a record high last year (CHF 234.8 billion). The assets under the management of Liechtenstein banks in Liechtenstein rose by 3.9% on an annual basis, and asset management companies also slightly increased assets under management. In a similar vein, the net assets under management in investment undertakings (funds) also grew slightly. In contrast, premium income in the insurance sector fell slightly in 2016 compared with the previous year. Financial market players continue to operate under high regulatory pressure and in an environment characterised by challenging market conditions. The balance sheet total of the banks in Liechtenstein, including foreign group companies, rose by 1.3% compared to last year. Consolidated across all banks, liabilities to clients amounted to 78.3% of the balance sheet total. On a consolidated basis, the core capital ratio (Tier 1 ratio) amounted to 21.6% at the end of 2016 (previous year: 21.3%), with all banks reporting a Tier 1 ratio exceeding 16%, thus significantly exceeding the international average. The high equity backing ensures a stable financial centre and security for banking clients. The number of jobs at banks, including group companies, rose significantly by 10.9% in 2016 over the previous year.

For 2016, the average unemployment rate settled at 2.3%, with the unemployment rate of persons under the age of 25 standing slightly higher at 3.1%. In July 2017, the unemployment rate dropped to 1.7%. A specificity of the Liechtenstein labour market is that 54% of the Liechtenstein workforce lives abroad (mainly in Switzerland (54% of inward commuters) and Austria (42%)). A total of 38% of the workforce is employed in the industrial sector.

The government's goal of balancing the budget before the end of the legislative period has been achieved. Following a budget deficit in 2013, the national budget has achieved a surplus since 2014 and the forecast for 2017 is also positive. Current government consolidation efforts are related to the full implementation of cost-cutting and revenue-increasing measures. Various important structural reforms were taken during this legislature for this purpose: revenues and expenditures have been balanced since 2014, stabilisation of the public pension fund, reform of the Health Insurance Act and the Pension Fund Act. The results of the reforms are positive. Net assets of social insurance are growing and pension funds are on solid ground.

## **Making economic growth inclusive**

Different measures are being taken in order to better integrate the imperatives of boosting economic growth and ensuring that its benefits are shared fairly across society. In order to make economic growth inclusive in Liechtenstein, the Liechtenstein government defined the following priorities in its government programme (2017-2021):

### *Prudent management of public finances and making public administration more customer-oriented*

With the conclusion of the consolidation measures in 2016, the goal of a balanced national budget was achieved, thus creating a solid basis for the future. Budget discipline and stability guarantee the ability to act and shape the future over the long run. Only a solid financial basis makes the necessary investments in the future possible. Managing the expenditure side of the national budget continues to be the top priority. All expenses will be reviewed continuously in terms of need and benefit. This also applies to contributions, grants, and expenditures for the administration itself. Costs have already been reduced significantly in recent years, and personnel costs have been kept significantly below their budgeted levels. Liechtenstein has a customer-friendly, competent and high-performing public administration. The government's goal is to steadily optimise the efficiency of processes and to design services in an increasingly customer-friendly way. This applies both to processes within the public administration and to interaction with the concerns and needs of the population, enterprises, and other stakeholder groups. Over the course of this legislative term, a series of measures is to be implemented to strengthen the national administration's service, with a special focus on electronic communication technologies. However, due to various developments (demographics, regulation, implementation of international standards, etc.), an increase in spending is expected in the future.

### *Intergenerational cohesion and sustainable cost growth*

Due to the consequences of demographic developments, the government will take measures in the healthcare system to ensure supply and financial feasibility. Access to necessary medical care must be ensured for everyone in our society. At the same time, attention must be paid to the future affordability of these services. Future demand requires integrated and efficient organisational and supply models that involve all medical professions. The increasing demand for health services must be met with even better cooperation and division of labour. The aim is to ensure that high-quality supply also remains affordable for future generations. High-quality care must continue to be available and affordable for everyone.

In the field of elderly care and nursing, the goal of the government is to prepare and expand the systems in view of the foreseeable growth of the population eligible for care. For this reason, permanent monitoring of the need and supply of inpatient and outpatient care and nursing capacity is necessary. It is also important to consider new residential and living models in old age and possibly to accompany the development of those measures.

### *Education*

Liechtenstein has a smooth-functioning and proven education system. With social transformation and the changes of professional and family structures, however, the education system must always continue to develop. The STEM disciplines (science, technology, engineering and mathematics) play a key role in conjunction with digitalisation. The opportunities and attractiveness of dual professional training must be made more visible. The STEM disciplines will strengthen further. WLAN access at all public schools will be secured. Information and communication technologies will be integrated better into class instruction. Compatibility of family and work is to be promoted by implementing expanded childcare offerings.

### *Labour market policy*

Access to skilled labour and a well-functioning labour market are major competitive advantages for Liechtenstein. Providing high quality education is essential in building human capital. High labour force participation and low unemployment rates are key policy goals of the Liechtenstein government. Innovation in work processes and stronger efforts to include as many as possible in active employment are necessary in order to combat unemployment, especially among the youth, and to prepare for an older workforce. Furthermore, more will be done to promote entrepreneurship, by enhancing support for entrepreneurial networks and the venture capital market. Structural policies that aim to make labour and product markets more flexible could help increase employment, boost economic growth and strengthen public finances in the years ahead. An increase in the child allowance is being considered to facilitate the compatibility of family and work. The needs of young families will be assessed through a survey, and measures to promote families will be derived.

### *Promoting an internationally competitive industrial sector and a strong services sector*

Liechtenstein's economy is particularly characterised by its broad diversification. The predominantly export-oriented enterprises have to assert themselves against global



competition. Enterprises are competitive mainly thanks to innovation, requiring leadership in terms of technology and quality. The strengths of the business location must be preserved and optimised where possible, especially when promoting innovation in existing and new enterprises. Regulation and bureaucracy should be reduced where feasible. The system of dual professional training should be further strengthened.

In the context of financial market policies it is necessary to keep an eye on the competitiveness of the European financial sector in an international context, and on the risks of overburdening it with excessive rules and regulations. In this international context, there is a need to guarantee a level and fair playing field for EEA market participants. Competitiveness needs to be achieved within a stable financial environment. The specificities of financial markets of individual countries need to be taken into account when applying supervisory requirements. Furthermore, effective financial supervision needs to be risk based, and regulation should reflect that. Otherwise, the regulatory burden runs the risk of evolving into an important entry barrier for start-ups and an impediment to business innovation, with negative consequences for the wider economy.

Especially in financial markets, the timely application of the same set of rules is decisive for achieving stability, predictability and reliability. In order to ensure a level playing field for all operators and consumers and market access to financial services in the EEA, having successfully incorporated the EU's legal acts regarding the European Financial Supervisory Authorities (ESAs) into the EEA Agreement it is essential to incorporate those governing the actual provision of financial services as soon as possible. Clarity, predictability of regulatory developments and legal certainty are crucial for decisions of financial market participants on the location of their businesses. Liechtenstein calls upon its EEA partners to speed up as much as possible the process of incorporation of the remaining EU legal acts, while taking into account the concerns and the priorities of the EEA market participants.

## Key figures for the Liechtenstein economy

(% volume change from previous year)

	2013	2014	2015	2016
Direct exports of goods	0.0	1.9	-6.9	4.3
Direct imports of goods	2.6	6.9	- 6.1	3.4
GDP, million CHF	5 925	6 105	5 988*	-
GDP change from previous year	4.7	3.0	-1.9*	-
Consumer price inflation	-0.2	0.0	- 1.1	-0.4
Employment growth	1.1	1.3	0.2	1.9
Persons employed by economic sectors, as % of total employment:				
- Agriculture and forestry	0.8	0.8	0.8	0.7
- Manufacturing	39.3	38.8	38.3	37.9
- Services	59.9	60.4	60.9	61.4
Unemployment, as % of labour force	2.5	2.4	2.4	2.3
Unemployed persons under 25, as % of labour force 15-24 years old	2.8	2.9	3.0	3.1
Public Surplus/Deficit (+/-), million CHF	-60	142	227	-
Public Surplus/Deficit (+/-), as % of GDP	-1.1	2.7	3.8	-
Public expenditure quota, as % of GDP	22.4	20.8	20.9	-

Estimate\*

Sources: Office of Statistics, Liechtenstein

## Annex 3: Norway

### General economic situation

The oil price decline three years ago spurred a major economic setback. This has now turned into a recovery that is gradually strengthening. Businesses across the country are reporting an increase in production. Households have also become more optimistic over the last year. Thus far this year, GDP growth has outpaced expectations. Low interest rates, a distinct improvement in competitiveness and expansionary fiscal policy have been important drivers.

Improved household purchasing power and higher petroleum investments will serve to strengthen economic growth over the next couple of years. Mainland<sup>2</sup> businesses may at the same time realise higher exports and investments as the competitiveness improvements continue to filter through. For next year, we expect the non-oil economy to outpace trend growth, capacity utilisation to increase and the labour market improvements to continue.

Overall, mainland Norway GDP<sup>1</sup> growth is forecast at 2.0% in 2017, which is 0.4 percentage points higher than forecasted last spring. For the next two years, growth is expected to increase to around 2.5%, well above trend growth in the economy.

The labour market is improving. Registered unemployment declined for the ninth month in a row in August, and represented 2.6% of the labour force (seasonally adjusted) in September. The unemployment figure, based on Statistics Norway's labour force survey, was 4.2% in July, down from 4.7% in 2016. Unemployment is falling all over the country, including in Southern and Western Norway. Employment developments were weak for a long time but have improved this year, according to national accounts. Labour market improvements are expected to continue as economic growth picks up.

The employment rate in Norway (15-64 years) was 74.3% in 2016, almost eight percentage points higher than the EU average. The employment rate for young people is also higher in Norway than the EU average. The employment rate has declined since its peak in 2008, which is not surprising in periods of slow economic growth, such as in the wake of the financial crisis and after the fall in oil prices. An ageing population also contributes to this figure. The

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<sup>2</sup> Excluding petroleum production and shipping.

decline seems to have stopped over the past months. Going forward, we expect employment to grow faster than the population, so that the employment rate may increase.

Inflation has generally come down since last summer, as the depreciation of the Norwegian krone following the oil price fall is no longer pushing up prices on imported goods. Moderate wage growth has also contributed to lower inflation. Growth in the Consumer Price Index (CPI) has decreased from a peak of 4.4 in July 2016, to 1.6% in September 2017 (year-on-year). Core inflation (CPI adjusted for tax changes and excluding energy products) was 1.0% in September this year, down from a peak of 3.7% in July 2016.

House prices have declined in recent months following strong growth in the previous two years. Year-to-year growth in August 2017 was 3.1%, down from a peak of 13.1% in February. The house price development reflects developments on the supply side, with low growth in new homes last year and high growth this year. Household debt continues to rise faster than income.

### **Macroeconomic policies**

The Norwegian fiscal policy framework is designed to underpin stability in an economy with large and fluctuating oil revenues. By transferring all government revenues from petroleum activities to the Government Pension Fund Global (GPF) and over time aligning withdrawals with the expected real return on the Fund (estimated at 3%), the fiscal budget is better protected from fluctuations in petroleum revenues. It also ensures that current spending of petroleum income over the budget can be sustained.

The fiscal guidelines place much emphasis on stabilising economic fluctuations. Importantly, the automatic stabilisers are allowed to function, since petroleum revenue spending is measured by means of the structural, rather than actual, non-oil deficit. The guidelines also allow the fiscal budget to be used actively to stabilise the economy. In any given year, fiscal policy shall be tailored to the cyclical situation, and spending of petroleum revenue can thereby deviate from 3% of the Fund's value. Further, the guidelines specify that the petroleum revenue spending impact of major changes to the Fund capital or the structural deficit shall be evened out over several years.

Measured as the change in the structural, non-oil budget deficit as a share of trend GDP for mainland Norway, the fiscal impulse in 2018 is estimated at less than 0.1%. Spending of

petroleum revenues over public budgets in 2018 is estimated at 7.7% of mainland GDP and corresponds to 2.9% of the Fund's capital. Real growth in underlying expenditures from 2017 to 2018 is estimated at 1.0%.

The operational target of monetary policy is annual consumer price inflation of close to 2.5% over time. Norges Bank operates a flexible inflation targeting regime, so that weight is given to both variability in inflation and variability in output and employment. Norges Bank's key policy rate is currently 0.5%.

In the government's proposal for 2018, the corporate tax rate is reduced from 24 to 23% as part of the tax reform currently being implemented (see paragraph below). In addition, the personal income tax rate is reduced slightly to increase the supply of labour.

### **Policies to support inclusive growth**

The vast majority of the population in Norway has benefited from rising incomes over the past decades. Income inequality is low, both along social and regional dimensions and compared to other countries. Social mobility is relatively high, meaning that the income distribution today is less dependent on the income distribution of the parent generation than in many other countries. High rates of employment, a compressed wage structure and a generous welfare state with universal minimum benefits and public financed education and healthcare, are core to Norway's low rates of poverty and inequality. There are several mechanisms at play in the Norwegian socioeconomic model:

#### *Income policy cooperation – collective wage bargaining and universal working rights*

One characteristic feature of the Norwegian model is the collective risk sharing and wage bargaining. The high level of coordination has helped to maintain relatively small wage differences and a competitive business sector, where operating surplus as a share of factor income is a central indicator of profitability and of the distribution of value added. The social partners are responsible for bargaining collective agreements, where the framework for wage settlements are decided. The authorities are responsible for institutional arrangements to support the coordination. There are twice-yearly coordination meetings between the government and the social partners, and a Technical Calculation Committee for Wage Settlements, where experts from the authorities and social partners<sup>3</sup> agree on basic statistics.

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<sup>3</sup> Trade unions and employers' organisations.

We have experienced that these activities have become important to generate a broad consensus on the basis for the annual bargaining rounds.

The tripartite cooperation between labour unions, employer associations and government is one of the fundamental principles of Norway's incomes policy and a tool for securing working rights. This dialogue is important to deal with structural issues and challenges from a constantly changing working life. In times of crisis, the tripartite cooperation has paved the way for wage restraint and active measures against unemployment.

#### *Features of the tax system*

The main role of taxes is to fund public goods in the most effective manner. The principles of broad tax bases, low rates and equal treatment of different investments, financing forms and organisational forms are important guidelines for tax design in Norway. A tax system based on these principles will minimise efficiency loss and not needlessly weaken incentives to save, invest and work. Taxes are also a tool for redistribution. Broad tax bases, covering all types of income, are a prerequisite for the equal taxation of persons with equal income. This will imply that the progressivity of tax rates will produce an income distribution after tax that is more equal.

#### *Investment in education and skills*

A well-performing education system is vital for productivity growth, labour market participation and inclusion. The Norwegian government aims at improving the quality in every step of the education system. In spite of some progress in its Programme for International Student Assessment (PISA) results, the Norwegian performance in international tests is only middle ranking and we have experienced a longstanding concern of high rates of drop out from vocational education. Recently, efforts have been directed towards improving the quality of teachers in primary and lower secondary education, and the government has taken initiatives encouraging employers to offer more apprenticeships. Attendants in Norwegian kindergartens are voluntary, yet every child is entitled to a place in kindergarten from the age of one. The fee is subsidised and differentiated in order to give all families a real option of sending their children to kindergarten. Primary and lower secondary education is free and mandatory. Upper secondary education is voluntary and free of charge, and everyone who completes mandatory education is entitled to receive upper secondary education. Higher education is also free of charge, and every student is entitled to receive loans and scholarships from the government to cover life expenditures.

### *Active labour market policies and a flexible labour market*

One of the main goals of the Norwegian labour market policy is to include as many as possible in working life. Flexible labour market regulations have reduced the risk of segmented labour markets. Together with universal income insurance schemes and active labour market policies, this flexibility has supported reallocation of labour. In particular, to stimulate participation, the government has put an emphasis on activity measures.

The share of young people dropping out of secondary education and an increasing number of young people on disability benefits, often diagnosed with mental problems, is a huge challenge. A revised activity plan will be offered to young unemployed people under the age of 30, who do not have a job offer and do not attend school or other activities eight weeks after being registered at a public employment office. The aim is to ensure appropriate follow-up and promotion of jobs, education or other activities, including labour market training and vocational training. From this year on, local government is also obliged to set conditions of activity for recipients of its social assistance who are younger than 30 years old.

Sickness and disability support schemes with a longer time horizon have a risk of leading to permanent inactivity. Early intervention and activation strategies are important to reduce the number of people outside the labour market. The government has recently tightened certain entrance criteria for these schemes and put more emphasis on close follow-up of individuals and activity requirements.

Since 2001, there have been agreements between the government, employers and unions aiming at an inclusive work life in Norway. The basis is a shared acknowledgement that activity through work promotes good health, and that early implementation of active measures could prevent withdrawal from work.

### *Gender and family policies*

Norway's employment rate among women, a little below 75%, is some 15 percentage points above the OECD average and just a few percentage points below that of men. In particular, three important factors have contributed to this high level of gender equality. First, increasing educational attainment among women: The share of women who have higher education has increased, and passed men already in 2001. In this respect, free public higher education and financial support for students have been important measures. Second, a family-friendly

working life for both mothers and fathers: Parental leave is generous (49 weeks of paid leave), there is a statutory right to paid leave to take care of sick children, and many workers enjoy flexible working hours. Third, increasing access to affordable day care: Over 90% of pre-school children are in kindergartens. Subsidies and a maximum price system make kindergartens affordable.

However, there are areas where Norway still lags behind. For example, more than twice as many women as men work part time. The labour market is also largely divided along gender lines in that men and women have different occupations and participate in different industries and sectors. To help women gain more influence in important parts of the business sector, gender quotas for corporate boards have been an important tool. Through legislation, we have reached 40% female representation on the boards of publicly listed companies. Norway has been a pioneer in using such a measure.

Going forward, there are several challenges that have to be addressed in order to maintain economic growth and equality:

#### *Ageing population*

A sustainable welfare state is dependent on maintaining a balance between the number of people contributing to the system and the number receiving benefits. In the coming years, an ageing population means that a smaller share of the population will carry the burden of supporting the welfare state unless the retirement age increases. Keeping labour force participation high is therefore key. The tax and welfare benefit system must make it beneficial to work. Higher immigration can amplify or mitigate these challenges depending on how well immigrants are integrated into the labour market. It is crucial that health problems, language difficulties or the lack of a relevant and updated skillset do not prevent people from participating in the labour market.



### *Technological change*

Broader and more efficient use of technology is critical for raising productivity. Automatisation and artificial intelligence render some jobs superfluous, but at the same time create opportunities for the creation of new jobs, new investments and innovation. Education and skill enhancement is key to confronting these challenges successfully. Access to vocational training programmes and higher education is also crucial.

### *Challenges to the tax base*

Globalisation has been accompanied by increased profit shifting within international corporations and the use of tax havens, which reduces the possibilities for the government to tax mobile capital income. A well-functioning tax system is crucial to promote growth and to ensure sustainable welfare systems and a reasonable distribution of disposable income. With global markets and multinational companies, international tax cooperation plays an important role. Digitalisation of the economy makes such cooperation even more important.

### **Financial stability and financial market policy**

Norwegian financial institutions are generally profitable and sound. Several years with good results have enabled Norwegian banks to build up equity capital through profit retention. Norwegian banks are well capitalised compared to banks in other European countries. From year-end 2008 to the end of Q1 2017, Norwegian banks' CET1 capital ratio increased from just over 7% to just under 16%. The CET1 leverage ratio (the CET1 capital relative to aggregate total assets) for Norwegian banks was 7.3% at the end of Q1 2017.

Norwegian insurers generally maintain a sound margin to current solvency requirements. The main part of Norwegian life insurers' activity is related to various tax-favoured pension products. The general low interest rate environment makes it difficult to achieve sufficient returns on guaranteed pension assets, and increased longevity for individuals covered by defined pension benefits requires insurers to increase their provisions. There is a general market shift from defined benefit to defined contribution pension schemes. Premium income related to defined contribution schemes as part of total pension premium income is now about 60%. For non-life insurers, the combined ratio has been well under 100% for the last 13 years.

Household debt is high, and has for some time grown faster than household incomes. Many households would be vulnerable in the event of an income decline, higher interest rates or a fall in house prices. In the International Monetary Fund's statement of 15 June 2017

following this year's Article IV consultations, it was pointed out that "(v)ulnerabilities in the financial system have increased in the context of high and rising property prices and elevated household debt. While bank balance sheets are strong and significant progress has been made to address key risks, continued vigilance and further measures are needed."

While risks in the residential mortgage loan market have increased, banks' model-based risk weights for residential mortgage loans have been lowered in recent years. Norwegian authorities have taken measures to promote more prudent risk estimates and higher risk weights. In December 2016, the relevant authorities established Memoranda of Understanding on significant branches in the banking sector, with the purpose of subjecting such branches to the same macroprudential measures as domestic banks in Denmark, Finland, Norway and Sweden.

Norwegian financial market regulation has been developed in line with new EU requirements. A comprehensive Act on Financial Institutions and Financial Groups entered into force on 1 January 2016. It contains inter alia legislation on capital requirements for banks in line with those of the Capital Requirements Directive IV (CRD IV) / Capital Requirements Regulation (CRR) and a framework for capital requirements for insurers in line with the EU Solvency II requirements. New capital requirements for banks based on the Basel III recommendations were introduced and increased somewhat earlier than the EU requirements. The counter-cyclical buffer requirement for banks has been increased to 2% with effect from 31 December 2017.

In December 2016, a CET1 leverage ratio requirement for credit institutions of minimum 3%, with an additional buffer requirement of 2%, was adopted. For systemically important banks, the buffer requirement is 3%.

In December 2016, the Ministry of Finance also adopted a new regulation on requirements for residential mortgage loans. The cap on the loan-to-value ratio on residential mortgage loans was kept at 85%. For secondary homes in the capital, however, the maximum loan-to-value ratio is 60%. The amortisation requirement under the new regulation applies to all loans with a loan-to-value ratio above 60%, compared to above 70% under the previous regulation. The provision that allows for a certain amount of a lender's approved loans to be loans that do not meet all requirements, was retained. Outside of Oslo this quota is still 10% of the volume of a lender's approved loans per quarter. In Oslo the quota is reduced to 8%.

Work is progressing on the inclusion of new EU financial services acquis into the EEA Agreement. The Joint Committee Decisions of September 2016 establishing the necessary EEA adaptations to the ESAs Regulations have opened up for the incorporation of outstanding financial services acquis into the EEA Agreement. National implementation work is also a high priority.

**Key figures for the Norwegian economy**  
(% volume change from previous year)

	2016 <sup>1</sup> NOK bn	2016	2017	2018
Private consumption	1 418.7	1.5	2.3	3.2
Public consumption	757.6	2.1	1.7	1.7
Gross fixed investments	750.5	-0,2	3.9	2.5
Petroleum sector	164.9	-16.9	-6.5	2.2
Non-oil business sector	237.9	4.1	4.9	5.6
Exports	1 064.1	-1.8	1.1	0.9
Crude oil and natural gas	373.4	4.3	0.9	-4.8
Traditional goods	355.7	-8.2	1.7	3.8
Imports	1 037.1	2.3	3.2	3.3
GDP	3 117.0	1.1	1.9	1.5
GDP mainland Norway <sup>2</sup>	2 717.3	1.0	2.0	2.5
Consumer price inflation (CPI)		3.6	1.9	1.6
Underlying inflation (CPI-ATE)		3.0	1.6	1.8
Wage growth		1.7	2.4	3.0
Employment growth <sup>3</sup>		0.3	0.6	0.9
Unemployment rate (LFS) <sup>4</sup>		4.7	4.3	4.0
Crude oil per barrel, NOK, current prices		379	438	438
General government net lending <sup>5</sup>	126.1	4.0	5.0	3.9
Structural, non-oil fiscal deficit <sup>6</sup>	198.7	7.2	7.7	7.7

<sup>1</sup> Current prices

<sup>2</sup> Excluding petroleum production and shipping

<sup>3</sup> % change in the number of employed persons

<sup>4</sup> % of workforce

<sup>5</sup> as % of GDP

<sup>6</sup> as % of mainland trend GDP

Sources: Statistics Norway and Ministry of Finance (National Budget 2018, October 2017)

## **Annex 4: Switzerland**

### **General economic situation**

More than two years have passed since the abandonment of the exchange rate floor by the SNB on 15 January 2015. The subsequent appreciation of the Swiss franc against the euro has curbed economic growth in Switzerland. While structural change may have been accelerated to some extent, the period of strong appreciation did not lead to a recession. In 2015, Swiss GDP grew by 1.2%, which meant a substantial slowdown compared to the 2.0% of the previous year. In 2016, economic growth recovered somewhat at a pace of 1.4%.

Nevertheless, the Swiss economy is only gradually resuming a stronger growth trajectory. In the first half of 2017, GDP growth again fell short of expectations, following even a slight decrease in the final quarter of 2016. In the second quarter of 2017, the growth rate was 0.3%. In particular, development across sectors remains heterogeneous. Although in both the manufacturing and hotel and catering industries the recovery from the slump of the last few years continues, this recovery has been offset by sluggish growth in most other service sectors. Aside from this, recent GDP figures and Swiss sentiment indicators still suggest that the economy is continuing its moderate recovery.

Although the Swiss franc is still considered to be overvalued, recent surveys show that the Swiss export industry has increasingly managed to adapt to the strong currency (again with heterogeneous development within the export sector). With respect to the labour market, employment growth was weak in 2016 and the first half of 2017. However, the turnaround seems to have been reached, with unemployment falling and employment not decreasing any further.

In its September forecast, the federal group of experts expected GDP growth to accelerate (by 0.9% in 2017 and 2.0% in 2018), thanks to the dynamic global economy and the recent moderate devaluation of the Swiss franc. Supported by oil prices, inflation in Switzerland is returning to positive territory in 2017 (0.5%). In 2018, inflation will grow at a slower pace of 0.2%, as the recent reduction in the reference interest rate will reduce rent inflation. Concerning the labour market, unemployment is expected to decrease and employment to accelerate, particularly in the service sectors.

Overall, the foreign forecast risks are more balanced than in previous years. The recent growth recovery in the eurozone and increasing world trade activity are expected to have a positive impact on Swiss exports and economic activity. On the downside, geopolitical risks and possible negative effects of monetary policy normalisation could be a drag on Swiss GDP growth. Domestically, there is a risk of a further slowdown in construction activity. Particularly with respect to residential construction, signs of saturation are becoming more apparent. Also, a permanent source of risk stems from changes in the value of the Swiss franc, with corresponding effects on the real economy.

### **Economic policy**

The implementation of the new constitutional provision to better manage immigration (Article 121a), adopted on 9 February 2014, has advanced significantly. In December 2016, the Swiss Parliament adopted a law implementing the Article, which is in line with the bilateral Agreement on the Free Movement of Persons (AFMP) with the EU and the EFTA. The centrepiece of the law is the obligation for firms to announce vacancies in professions with high unemployment rates to the public employment services. These vacancies have to be open to jobseekers registered at a Swiss public employment service centre – be they of Swiss or foreign nationality – for some time, before the vacancy can be announced publicly. The Federal Council will decide on the more specific ordinances on its implementation, presumably at the beginning of 2018 once the results of a public consultation have been evaluated.

After the rejection of the Corporate Tax Reform III by Swiss voters in February 2017, the Federal Council launched a follow-up reform – the Tax Proposal 17. Its major aim is to boost Switzerland's appeal as a business location while complying with international taxation standards. Furthermore, it takes account of the referendum outcome by guaranteeing an appropriate financial and social balance. At the beginning of September 2017, the Federal Council presented the main points of the new proposal and opened a three-month public consultation process. The main provisions are the elimination of taxation privileges based on the legal form of companies, and the encouragement of investments in innovation through the introduction of a mandatory patent box in accordance with international standards, as well as additional R&D deductions at cantonal level. Additional corporate income tax reductions in some cantons are expected. In order to minimise the financial impact, there is a ceiling for a maximum tax relief by these measures and an increase in dividend taxation. Furthermore,

child and education allowances are to be increased. It is expected that the Federal Council will submit draft legislation to Parliament in spring 2018.

In September 2017, Swiss voters rejected a comprehensive reform of the pension scheme. Some of the main elements of the reform proposal would have included increasing the retirement age of women to 65, more flexibility regarding the timing of retirement and changes in the financing of the pension scheme. Nevertheless, the reform would have guaranteed sustainability only until 2030. The aim of the reform – which was to achieve sustainability regarding the financing of the pension scheme in the long run – was barely contested. It is expected that a new reform proposal will be prepared and presented to the public in the coming years.

In January 2017, the Swiss Federal Council published a report on the digital economy. The report analyses the consequences of digitalisation for the economy in Switzerland. The report notes that entrepreneurial freedom is a prerequisite for companies to exploit the opportunities of digitalisation. The economic potential can be best reached if private initiatives receive the necessary freedom to exploit the opportunities at hand. Digital transformation should therefore not be limited by premature and unsuitable regulation. In particular, regulation should not restrain innovation, or protect or favour traditional technologies and/or business models. Industrial policy programmes (such as the explicit promotion of certain industries, sectors, companies or the technologies they use) are not helpful in supporting this dynamic. Specific issues of the report include the concept of the sharing economy, the prospects of the labour market in the light of digitalisation, new business forms in FinTech, the adequacy of current competition and antitrust laws, and finally the impact of the EU Digital Single Market on the Swiss economy. The following economic policy conditions have been identified as enabling the digital economy: freedom of entrepreneurship, the principle of legal certainty, a flexible labour market, highly developed infrastructures, a sustainable fiscal policy, a relatively moderate tax burden, a strong foundation in education and research, and a high standard of living.

In order to identify regulation that may be no longer be necessary or should be adapted to simplify the digital change, the Federal Council decided to carry out a “digitalisation test”, namely a questionnaire sent to entities affected by digitalisation. It examines whether current legislation unnecessarily hinders digitalisation, or if (and where) it has been made redundant

by digital development. To this purpose various national federations, trade unions and employer associations were consulted. The input received is currently being analysed.

### **Recent development of inclusive growth**

Regarding the distribution of market income, inequality in Switzerland is remarkably low (as measured by the Gini coefficient, before taxes and transfers). Within the OECD, Switzerland ranks second, just behind Korea. Redistribution is relatively small in Switzerland. This results in moderate income distribution after taxes and transfers, slightly outperforming the OECD average. Over time, Switzerland has not encountered rising income inequality as compared to many other countries. Data from national statistics show that the distribution of market income was very stable between 1998 and 2013. Over the same time period, both the median disposable income and median market income increased.

In contrast to many other developed economies, Switzerland has not observed a declining labour share of national income in the past decades. Some explaining factors are the prevalence of highly skilled labour in Switzerland, which tends to be complementary to capital, the structure of the Swiss economy with a focus on knowledge-intensive and hence skilled-labour-intensive industries, and finally the labour shortage, which has increased employees' bargaining power and favoured wage growth. Nevertheless, the link between distribution and economic growth has gained some importance in the public discussion.

Regarding wealth distribution, it can be concluded that wealth inequality is more pronounced in Switzerland than income inequality. However, the availability of data on the distribution of wealth in Switzerland is limited. Furthermore, wealth inequality has slightly increased over the last 30 years. There are two caveats, however. First, private pension plans are not included in wealth statistics, which would otherwise reveal significantly lower wealth inequality. The reason is that the importance of private pension plans has increased over the last decades. Second, real estate values are not included in wealth statistics at market prices but only at a lower, taxable value. About 40% of all households are homeowners and real estate prices have increased substantially over the last 15 years. Finally, the immigration of a few very wealthy individuals has contributed to the increase in wealth inequality.

## **Policies taken to support and promote inclusive growth**

As mentioned above, public redistribution measures in Switzerland are limited, and related policies focus on the distribution of income before taxes and transfers. Redistribution in Switzerland, as measured by the difference between market income and disposable income, is small. Governmental taxes, social security contributions and transfers have a slightly progressive impact on the overall distribution. However, mandatory contributions to private social security (second pillar pension contributions) or to health insurance have a slightly regressive impact on distribution.

The focus of Swiss policy is to mitigate inequality in advance, which refers to the so-called “predistribution” policy measures. The underlying idea is to promote equal opportunities and to set incentives for active labour market participation. Increased spending on education and training is expected to expand equality of opportunity. A key element is the dual education system in Switzerland, which ensures close links between the education system and the labour market. The second key element is the flexible labour market and the well-functioning social security system, which ensures incentives for participating in the labour market. The high qualification of the labour force in Switzerland, its low unemployment rate and record high participation rate in the labour market reveal the results of these predistribution policy measures. These findings are also confirmed by international literature, which explains the historic evolution of inequality by labour market regulation and education, and also tax policy and demographic developments.

Finally, the role of political institutions should not be underestimated. Given the direct democracy in Switzerland, larger reform projects are subject to approval by the population. This political participation ensures that the distributional consequences of such reform projects are taken into account when designing the reforms, and in the public discussion. The rejection of the Pension Reform 2020 and of the Corporate Tax Reform III show the importance of distributional effects in the public debate. In general, stronger integration of the population into the political process through direct democratic elements may lead to more equal policy results.

## **Challenges to maintain inclusive growth**

Important factors potentially having an impact on inequality are demographic developments and technological factors, as well as the resulting structural change.



The high labour market participation rate in Switzerland results, among others, from its active labour market policy. The ageing population challenges not only the structure of today's labour market, but also the sustainability of the Swiss pension scheme. While it is expected that the ageing population is going to weigh on living standards in the long term, especially if low productivity growth continues, high immigration in the past years has partly postponed this process. However, the integration of these differing groups into the labour market has to be ensured and potentially improved, especially in the context of digitalisation.

Technical progress and digitalisation have changed and will further change the employment structure in the Swiss labour market. First, there has been a shift of employment from the manufacturing to the service sector. While jobs in the agricultural and industrial sectors have disappeared, the service sector has seen a large increase in employment, which has more than made up for the decrease in the other sectors. It is therefore likely that employment will keep shifting into new areas rather than being reduced in a long-term perspective. This development implies that the labour market will require different qualifications, which again may present a challenge for the economy and employees alike. One key element to meeting these challenges successfully is education and the way it responds to the skills required in the future. To this effect, the Federal Council passed on its action plan as part of the report "Challenges of Digitalisation for Education and Research in Switzerland", which was published on 5 July 2017. Furthermore, a report on the implications of digitalisation and automatisisation on the labour market is expected to be published by the Federal Council later this year.

Focusing on predistribution policies means ensuring and promoting equal opportunities. In this regard, and given the current context of rising protectionism, preserving an open economy is central. This applies to different areas, such as trade in goods and services, investment and migration, and also regulation in general. Switzerland is aware of these challenges and is therefore prioritising ensuring open markets with the EU based on its bilateral agreements, as well as with third countries by concluding free trade agreements and broadening cooperation.

## Key figures and forecasts for Switzerland

(% volume change from previous year)

	<b>2016<sup>1</sup></b> <b>CHF bn</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Private consumption*	354.5	1.8	1.5	1.3	1.4
Public consumption*	79.4	1.2	1.6	1.3	1.2
Construction investments*	61.6	1.6	0.9	1.4	1.2
Equipment investments*	98.7	2.6	4.5	2.3	2.3
Exports*	354.9	2.2	6.8	3.0	4.2
Imports*	270.9	3.2	4.7	3.4	4.1
<b>GDP*</b>	<b>662.7</b>	<b>1.2</b>	<b>1.4</b>	<b>0.9</b>	<b>2.0</b>
Inflation (Consumer Price Index)	-	-1.1	-0.4	0.5	0.2
Unemployment rate (ILO definition), % of labour force	-	4.8	4.9	n.a.	n.a.
Financial balance of the government sector, as % of GDP	-	0.6	0.3	0.3	0.4
Government debt, as % of GDP	-	30.0	29.2	29.6	28.8

\* National accounting data are expressed as the year-to-year percentage change in prices of the preceding year (real values)

<sup>1</sup> Level at current prices

Sources: State Secretariat for Economic Affairs (SECO), Federal Statistical Office (FSO), Federal Department of Finance (FDF). The grey shaded values are forecasts.