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The impact of the liberalisation of public services on the competitiveness of firms in the Alpine regions of Switzerland¹

1. Introduction

In recent years, public services have undergone a number of radical changes in the wake of a general process of economic transformation: the scope for action by national governments has been restricted by the globalisation of markets, the liberalisation of foreign trade regulations, European integration, technological developments and the public sector's lack of financial resources. The state enterprises, which have to date provided public services, have been subjected to economic pressure. The question of the efficiency and potential of state enterprises,

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discussed within the framework of the theory of policy failure is being intensified under the influence of changing framework conditions (Frey 2000).

The reaction of the state can be summarised by the key word “liberalisation”, i.e. the public sector reacts – in varying degrees – with the introduction of market elements (Hodge 2000; Schedler, Proeller 2000). With a reduction in regulatory intervention, the markets have been opened up to competition. The monopoly situation of state service providers has been relaxed, and hitherto state-run enterprises have been split off from public control or (partially) privatised. Increased competition is supposed to bring cost savings, while at the same time increasing the quality of the services provided (Hodge 2000). Following this market-driven logic, public services are more strongly oriented towards the economic criteria of efficiency and productivity. But changes in the provision of public services cannot be reduced to a purely economic dimension. They are embedded in a national policy debate and the expression of a far-reaching change in the understanding of what the modern state can and must provide. In this context it is possible to speak of a fundamental paradigm change with regard to the relationship between society, state and economy (Ambrosius 2000). But it is not only the aspect of state activities which are under scrutiny, but also the nature of the performance.

The networked infrastructures of the telecommunications, postal services, electricity and transport sectors make up the classic area of public services (Commission of the European Communities 2001). They display a particularly marked tension between efficiency and equalisation considerations. On the one hand, in the case of numerous services, it is fundamentally possible to provide the service under competitive

conditions, thus increasing efficiency. On the other hand, due to their elementary significance for economy and society, they are subject to a particular state responsibility.

In the wake of the opening up of the market, the infrastructure sector is frequently the subject of a functional privatisation, i.e. the performance of public duties is carried out by private contractors, although the responsibility for performance remains with the public authority (Schuppert 1998). This form of privatisation allows room for a wide variety of forms of public-private partnerships. The state concentrates on the formulation of framework conditions to ensure competition between private providers. This development frequently results in a change from the state as provider to the state as guarantor. The operational and political responsibility for the performance remain separate. However, this separation has only been made on an organisational level in some countries, including Switzerland. The enterprises are still wholly or mostly in public ownership, but are also becoming increasingly internationally active (European Commission 2001).

This development also involves a number of critical aspects. The state is increasingly and simultaneously assuming a variety of roles and functions: as owner, regulator or supervisory authority. The superimposition of different roles can lead to conflicts of interest. There is the additional risk that opening up the markets may result in a need for increased regulation. In order to ensure access to and competition within networked infrastructures, additional interventions and institutions such as regulatory authorities are necessary. This tendency thus leads to a contradiction of the original objective of the deregulations. In general, for competition to function properly, an

effective supervision of the competition is needed, which, however, in turn requires public investment in the regulation.

In particular, the state responsibility as guarantor means ensuring a sufficient basic supply of public services. By establishing a universal service, access to established services is guaranteed for all users.

The services that are desirable in the general interest are formulated in a way that is as neutral as possible, with no bias towards any particular solution, and attempts are made to keep the regulatory framework as open as possible (INFRAS 1999).

The European Union thereby sets the rhythm for opening up the markets, which is also of crucial importance for Switzerland. The European Union tries to characterise the central terms such as ‘Services of general economic interest’ or ‘Universal Services’. Exactly what is meant by services that are ‘of general economic interest’ or how ‘Universal services’ can be defined is currently the subject of a broad international debate (Commission of the European Communities 2001; Cox 2001).

Under these circumstances, it is difficult to come up with a concrete definition for basic provision. Specifying the content of the provision is also influenced by society’s changing expectations and can thus ultimately only be decided by way of a normative political approach based on social concepts (Thierstein, Abegg 2001).

2. Public services: the current position of the discussions in Switzerland

In the following examinations we will concentrate on four areas of public services: regional public transport, postal services, telecommunications and electricity. In

making this selection, we have incorporated those services in which attempts to liberalise markets are most advanced and in which initial experience in opening up markets has already been acquired.

The network-based infrastructures form the basis for economic activity. They have hitherto frequently been implemented as important, but frequently not explicitly designated, instruments of economic and regional policy. For this reason, these four sectors are of particular interest from the point of view of the regional economy. But the themes of opening up the market and fundamental provision are also gaining significance in further areas such as health and education.

The liberalisation endeavours in the various sectors show different stages of progress. This is mainly due to two determining factors: the economic characteristics of the market and the technological opportunities available in each case. Three additional components can also be identified which have a decisive influence on the liberalisation process (Bonde 2002):

- the structure of the political decision-making process,
- the historical context and the market structure arising from it, and
- the traditions and values of the country.

Although the various sectors have different prerequisites, they all have a similar set of questions; these relate, among other things, to the definition of the scope of the basic provision, the financing of loss-making services or the organisation of the regulatory framework. The individual points here should always be considered against the characteristic background of the relevant sector. Below is a brief overview of the

most important themes, representing an outline of the current position of the discussions in Switzerland.

Telecommunications

In Switzerland, liberalisation is most advanced in the telecommunications sector (Bühler 1999). Similarly to the rest of the European Union, in 1998 the telecommunications markets were opened up completely (Zorn 2000). The state postal service and telecommunications enterprise, PTT, was split to form two companies, the Schweizerische Post [Swiss Postal Service] and Swisscom. Swisscom was partially privatised, but the Federal Government is obliged by law to maintain a majority holding of capital and voting rights in the company. As the basic supply concessionary, Swisscom has the task of providing full coverage. The evaluation of the liberalisation has been predominantly positive (WIK-Consult 2002). However, competition has only a limited role, as Swisscom still has a market share of over 70 percent. Shortcomings in the liberalisation arose in particular in the unbundled access to the local loop, where Swisscom still has a monopoly. From a regional perspective the comprehensive supply of broadband services is of particular interest. These are as yet not part of the basic supply, but are fast gaining in significance as efficient communication channels.

Postal services

In contrast to the dynamic, technology-driven developments in telecommunications, liberalisation of the postal services sector is taking place much more slowly. The market for postal services is stagnant. Business activities are shifting from the classic

letter and parcel delivery service to logistics services and electronic forms of communication. The services are divided between a reserved sector, within which only the Schweizerische Post is entitled to operate, and non-reserved services, in which the postal service operates in competition with private providers. With a monopoly limit of 2 kilograms, Switzerland is a long way above the limits of the other European countries. Further opening up of the market is planned. The parcel market should be fully opened up by 2004, and by 2006 the weight limit for reserved letter delivery services should be reduced to 100 grams. Switzerland is behind the schedule of the European Union in this (Swiss Executive National Council [Bundesrat] 2002). Schweizerische Post is a legally independent institution, which also supplies the basic service, and is 100 percent owned by the Federal Government. Despite a far-reaching monopoly protection, it nevertheless has to operate in competition with providers from abroad, in particular in the logistics sector.

However, the political discussions in Switzerland revolve not so much around the scope and quality of the service provided, but rather around the post office network. The closure of post offices – in both peripheral and urban areas – is facing strong resistance from the trade unions and from representatives of peripheral regions and urban districts. The existing postal service law does not specify the number and location of post offices. However, endeavours are under way to secure a change in the law, which will oblige the Schweizerische Post to provide a comprehensive network of post offices. The criteria according to which such a network is to be established have not been fixed. The debate is twofold: firstly, it is clear that the intended division of strategic and operational responsibility has very little foundation in

everyday political affairs. Secondly, the public services appear to have a symbolic significance which extends beyond their actual economic relevance.

Regional public transport

In line with European developments, public transport in Switzerland has been liberalised in certain individual areas. Free access to the networks has been allowed in goods and international passenger transport, although the concession system has been retained for national long-distance passenger transport. However, the revision of the railway law in 1996 and the railway reforms of 1999 led to pioneering changes in regional transport systems (Lundsgaard-Hansen et al. 1999). A core element of the revision of the law was the introduction of the *Commissioning and Payment for Use Principle* to regional public transport. Here, the Federal Government, Cantons and private contractual partners commission and finance the regional public transport services on the basis of service agreements. This model, with a guaranteed minimum service and additional services commissioned according to need, is continually being introduced to the debate as a possible example for other public services. Furthermore, the law allows for individual transport routes to be put up for tender. Although this has led to a change of operator in only a few cases, a culture of competition has emerged, and additional exertions have been made by all parties. A certain lack of clarity of procedures and content has prevented a broad application of this instrument. From an organisational point of view the Swiss railway authority (die Schweizerische Bundesbahnen (SBB) has been disencumbered and transferred to a public limited company formed under special laws. The Federal Government remains the sole shareholder.

In general, the results of the railway reforms have been viewed in a very positive light. Public transport efficiency has been increased. Despite stagnation in public grants, the service has been expanded in many locations. At the moment the second phase of the railway reform is going through the political process. In the context of regional transport the main aim is to rectify existing defects in the tendering process. A comprehensive separation of traffic and infrastructure is not being undertaken in Switzerland. Within the context of a shortage of finance, such a division would be a further draw on public funds. In the opinion of the Federal transport office, funding should mainly be invested in the economically profitable long-distance and conurbation routes. In the peripheral regions it will therefore be a matter of being able to maintain the quality of provision at the present level.

Electricity

The electricity sector has an important role in Switzerland. Switzerland is a hub of the European electricity market. The Swiss producers are dependent on having free access to the European markets. With a share of around 60 percent, hydroelectric power represents the backbone of electricity generation. The resultant water rates provide an additional source of income for the mountain regions. With over 1000 power stations the market structure in Switzerland is oriented towards small local areas and small operators. The opening up of the electricity market has been correspondingly cautious, and late in comparison with the rest of Europe (Bodmer 2001; International Energy Agency 2001). A new law governing the electricity market, which would have provided for a moderate opening up of the market, was rejected in the referendum of 22 September 2002. The rejection of these very

complex proposals was based less on technical considerations than on fundamental principles. The referendum became a vote on liberalisation, resulting in the expression of a general scepticism towards liberalisation among the population at large. The way forward for opening up the market, and the consequences for Switzerland as a hub of electricity production, are at present unclear. Pressure from the European Union is likely to increase, as liberalisation proceeds throughout Europe. With a delay in the original schedule, the intention is to open up the market for commercial customers by 2004 and for private consumers by 2007.

3. Spatial effects of the liberalisation of public services

The endeavour to introduce a liberalisation of public services is a new phenomenon for Switzerland – at least on the present scale and with the current level of dynamics. Consequently, there are also a number of gaps in research when it comes to the academic discussion of public services. In particular, the regional effects of the liberalisation have hitherto been neglected. There is very little basic information available, especially with regard to regional development in outlying and peripheral areas.

Switzerland is characterised by a small-scale pattern of languages and cultures, which in a political context is built on a strong federalist system. In this context the economically oriented considerations increasingly come into conflict with terms such as ‘regional balance’ or ‘national spatial cohesion’, which were strongly embodied in the past economic and political system of Switzerland. The gap between the two poles of international competitiveness and national cohesion continues to increase.

However, the apparent national political debates also serve wider interests. The very indistinct term ‘national spatial cohesion’ can be used to legitimise and help implement particular (regional) interests (rent-seeking behaviour).

The supply of public services is not only a question of efficiency and productivity. Thus consideration of the spatial effects of liberalisation cannot be undertaken from a one-dimensional economic viewpoint. It must take into account the various functions of public services, which should be clearly separated in the analysis. It is helpful to differentiate between supply and demand for public services, as shown Figure 1.

Figure 1: Typology of the functions of public services

		Supply side	
		Range of services	Workforce of the service providers
Demand side	Consumers	<ul style="list-style-type: none"> • Supply function: quality of life • Identity function 	<ul style="list-style-type: none"> • Income function • Stability function
	Companies	<ul style="list-style-type: none"> • Supply function: Quality of location, competition factor • Identity function 	<ul style="list-style-type: none"> • Consumer demand function • Future employment market function (training of apprentices)

Source: own representation

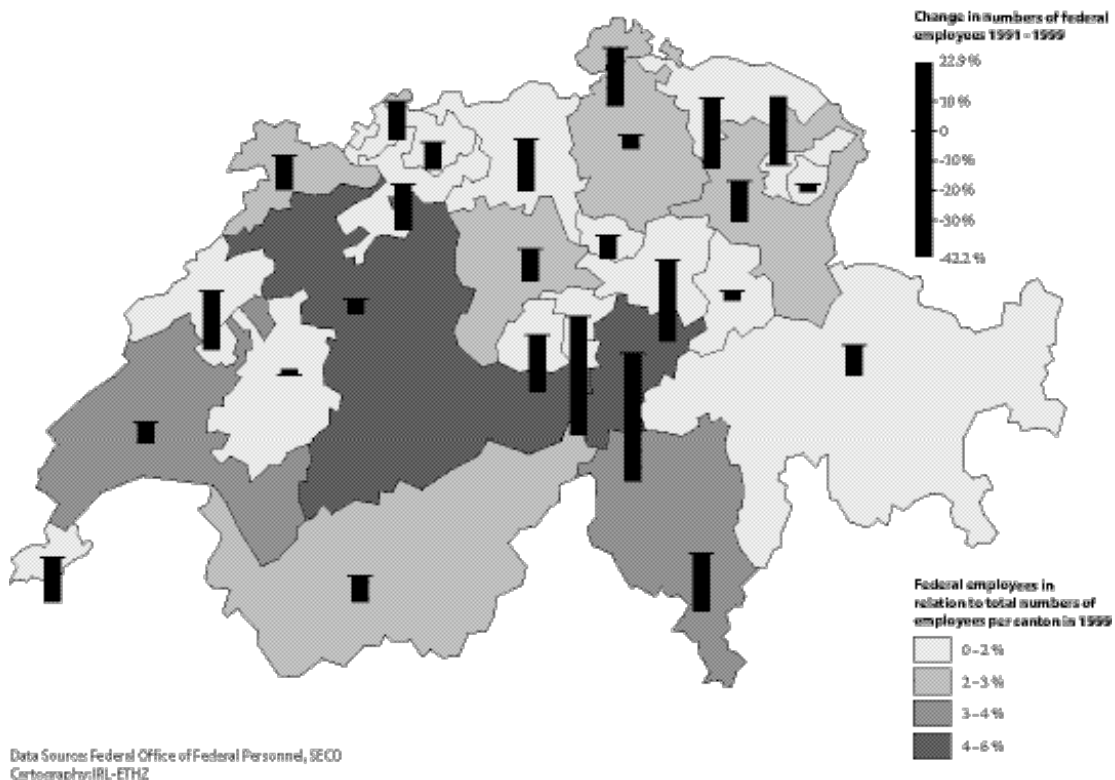
On the supply side, a differentiation should be made between the actual provision of services and the associated workforce of the service providers. On the demand side there are private consumers and companies, which each have different requirements. These functions will be explained below.

3.1 Employment in public services

The public utilities are significant employers and have made a considerable contribution everywhere to regional incomes (income function). As a result of political activities, pressure was (implicitly) brought to bear on the public utilities to provide for a decentralised distribution of their jobs. The additional costs were covered by monopoly revenue. With the separation of operational and political responsibility this kind of indirect influence has largely gone. Thus a gap between the supply of public services and the production of these same services within the peripheral regions seems to be opening up. This leads to a reduction in jobs in some regions which are already structurally weak.

In addition to a loss of income, these structural adjustments have caused further changes in the regions affected, and thus led to associated uncertainty. Especially in the peripheral regions, the public utilities have until now had a stabilising, settlement-oriented function, in that they have provided secure jobs and training places with above-average pay in the regional context (stability function). It can be added in respect of the telecommunications sector that more new jobs have been created in total in the wake of liberalisation (Werder 2000). Jobs provided by the new, private providers are largely concentrated in the Swiss conurbations.

Figure 2: Federal employees per canton, 1991 – 1999



The direct effects on jobs are, at least for the most part of Switzerland, clearly recognisable and can be tackled directly in political terms. The Swiss government has thus introduced a programme giving financial support to those regions that are affected the most by the liberalisation measures already implemented in public services, with 80 million Swiss Francs over a period of four years. The cross-subsidisation of a decentralised provision of services is more or less being replaced by direct regional-political support. Or, in other words: subsidies to individuals are replacing the traditional subsidies for institutions. With the low level of financial resources, the loss of jobs and thus the income function of the public enterprises can to a large extent not be compensated. However, the programme is an essential political indication of the intention of the Federal Government to support the regions

affected by the process of change, and of its continued awareness of the stability function.

3.2 Service Provision

Liberalisation is often only considered in terms of the effects on the jobs provided. But in addition to job changes, the effects also concern the services provided, although these changes are harder to define. The various aspects of the provision, such as availability, quality, price or scope of services are subject to very different change processes. Overall, the public services have an important provision function. For both individual and commercial consumers they are among the elementary basic services. They contribute to the quality of life of a region and also to the quality and attractiveness of a location to companies, and can also have a role in the competitive position of the companies located there. Following liberalisation there is generally an increase in quality and improved customer orientation. The provision is better adapted to suit the demand requirements. Following the logic of the market, supply follows demand, i.e. new services and technologies are first introduced in the conurbations, areas of high demand. Up to now, the costs of comprehensive introduction have only had a subordinate role. Under present conditions, investment in areas of low demand is increasingly being called into question from a business economics point of view.

The vehemence of some of the discussions about the liberalisation of public services cannot be explained merely by the economic relevance of individual services. In addition to the provision aspect, public services also have an important regional-

cultural identity function. We can distinguish three dimensions of regional identity: strategic, functional and cultural identity of a region (van Houtum, Lagendijk 2001). In Switzerland, with its linguistic, cultural and spatial variety, they form a bond of national cohesion. Infrastructures represent the perceptible symbol of the identity function. A deterioration in the provision in the individual regions therefore also has an effect on a symbolic level of perception. The regions affected are often already fighting against economic problems, job losses and outward migration of the population. The psychological effects increase this negative spiral and give an area the image of a “forgotten region”, abandoned even by the public authorities. The general scepticism towards liberalisation in peripheral regions is correspondingly great.

While the location of jobs is increasingly decoupled from public decisions, the definitions of the provision of public services on the other hand are still the immediate responsibility of the Federal government and the legislative bodies. However, due to the very vague definition of minimum standards for each of the public services, differentiation is to a large extent at the discretion of the respective public utility.

The territory-wide basic provision in outlying regions is closely linked with settlement trends. In particular the Alpine towns and villages are finding it increasingly difficult to escape the pull forces of the peri-Alpine conurbations (Perlik et al. 2001). As a result of the increasing cost of infrastructure in rural areas, there is a move to concentrate development incentives and strengthen municipal systems in the Alps. In the Swiss Alpine regions – with their dispersed settlement pattern, low

density of population and mainly small-business-based structures – there is a risk that the supply of public services, which is an important element for controlling settlement trends, will be reduced. Against this background, the effects of liberalisation in the different Alpine regions are expected to be highly specific to the particular region.

4. Impact of the liberalisation on the competitiveness of firms

Within the public service functions described, we will concentrate below on the provision function for companies (see Figure 1) and the conditions for competitiveness. The notion of competitiveness applies on different levels: those of firms, regions and national economies. A company has to face up to the competition and win market shares for export, and earn income for purchasing necessary production factors. Competitiveness means the capability for developing new products and processes and thereby creating positive effects on employment and income.

The impact of the liberalisation of public services on the competitiveness of firms can be characterised by three dimensions:

- The relative importance of public services as location factors
- The direct or indirect impact on the production process
- The capacity of firms for innovation and adaptation to a changing economic context.

4.1 The relative importance of public services as location factors

With the increasing international competition between locations, discussions about the importance of location factors have also been intensified (Borner et al. 1991; Porter 1998). In the past, due to their relatively homogeneous regional distribution, public services were of only minor significance as a locational factor for companies (Koellreuter, Kübler 1995). Due to the changed basic economic conditions this will change significantly. As shown in Section 3, the spatial differentiation of the provision of public services will increase. Public services thereby become a differentiating factor of the competition between locations. This applies both to Switzerland as a whole and to the individual regions. The regional advantages and disadvantages must be reconsidered under these changed circumstances.

However, the public services are only one element in a broad range of locational factors. The vehemence of the public debate should not distort the view of their actual significance. Competitiveness cannot be reduced simply to the provision of public services. Essentially, there is a shift in the relative significance of the locational factors relevant to the innovative provision of services. Generalisations are definitely out of place here. The significance of services to the individual company is in the first place dependent on the sector and the size of the company. Secondly, the specific context of the company's activities (embeddedness) also has an important role. Long-established companies with a strong tradition have different decision-making processes and criteria than recently-founded companies (Grabow et al. 1995). In addition, the mistake should not be made of considering individual public services in isolation, exclusively on the basis of their provision function. Based on the identity

function, the public services may also be perceived in an overlapping, mutually strengthening context.

4.2 Impact on the production process

Public services are directly or indirectly part of a firm's production process. We argue that the companies based in outlying regions are affected in two respects by the changes in public services.

On the one hand, the changed provision of public services is becoming more significant for businesses as a hard locational factor and can have a negative effect on production processes. Because of spatial differentiation of the service provision, firms in peripheral regions are discriminated against, in comparison with others. Examples of possible disadvantages include increased electricity prices, fewer or more infrequent public transport connections and reduced quality of postal services.

On the other hand, public services work as soft, person-centred locational factors that make a major contribution to the quality of life a location has to offer (Grabow et al. 1995). A deterioration in services means that outlying regions become less attractive as a place to live and consequently it becomes more difficult for companies based there to recruit well-qualified employees. Companies are being forced to react to the dynamic environment and to develop corresponding response strategies.

With stagnation or even a reduction in the population, the sales market for locally-active companies also becomes increasingly smaller. Following the logic of a

demand-oriented system a downward spiral is thus initiated which can only be halted with difficulty.

4.3 Capacity for innovation and adaptation

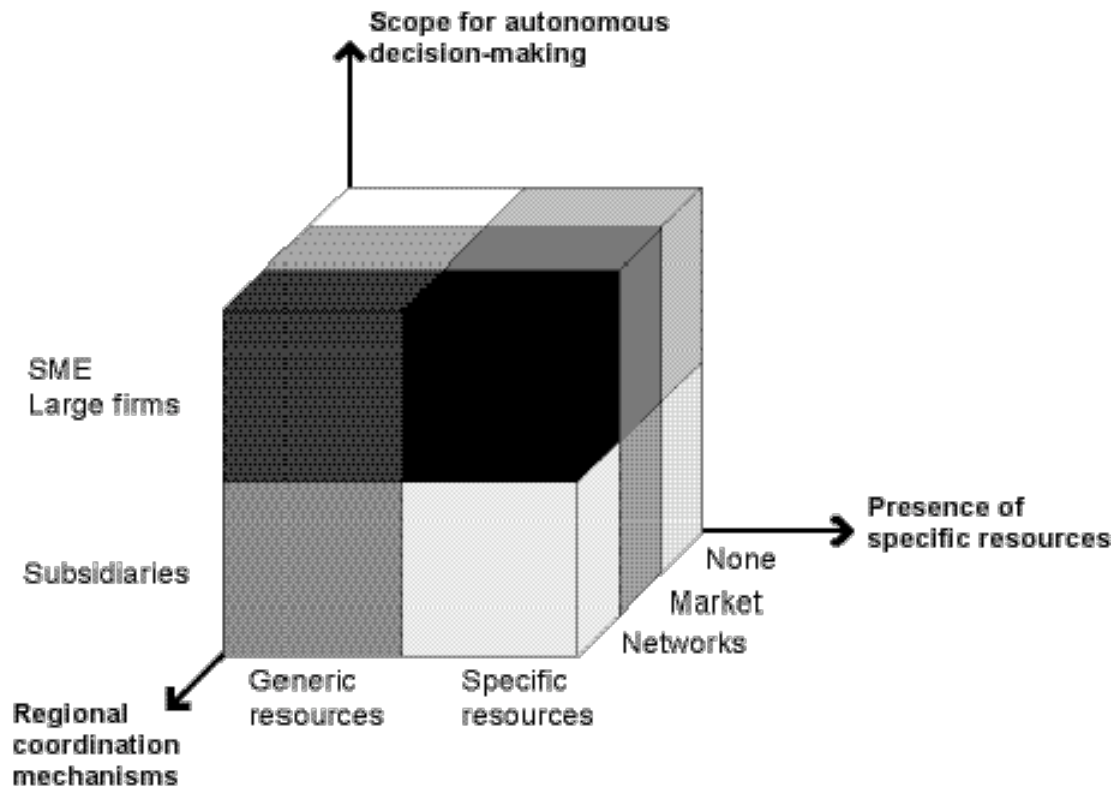
Competitiveness of firms is not only a case of a fixed list of static location factors. It has to be regarded from a more dynamic point of view. Looking at competitiveness as an ongoing process, the capacity for innovation and adaptation to a changing economic context is of crucial importance. Therefore we seek to embed the single firm in a broader regional framework. We argue that the competitiveness of a firm also relies on the degree to which the public and private stakeholders within a territory are able to respond proactively to challenges from outside the region.

Our main analytical approach for assessing firms' behaviour within a regional context is the concept of 'regional innovation and production systems' (RIPS) as shown in Figure 3 (Corpataux et al. 2002; Maillat 1996). RIPS are anchored in different structures depending on the region in question (Dümmler, Thierstein 2002). They are characterised by

- their scope for autonomous decision-making,
- their coordination mechanisms and
- their specific resources.

The extent to which they are anchored in their particular region influences their capacity for innovation and adaptation to a changing economic context.

Figure 3: The territorial anchorage cube



Source: Crevoisier et al., 2001, p.40

A regional innovation and production system (RIPS) is defined as a geographical area of productive specialisation(s) including a certain number of regional actors (firms – small or large -, institutions, public authorities). These actors interact with one another in accordance with certain relationships of

- technical complementarities (trade input/output relations, relations between training and education systems/research and firms) and
- competition and/or co-operation.

A RIPS harbours and generates specific resources (in particular know-how of all kinds), which form the basis of its competitiveness. It also has a more or less

pronounced autonomy with respect to its own evolution. The economy of some regions may be composed nearly exclusively of its RIPS. In other regions, on the contrary, the RIPS and its specialised branches are only a tiny part of the economy, because the region is more diversified or it has a larger number of induced activities. The autonomy of a RIPS is also more or less pronounced, ranging from a dependent RIPS, consisting mainly of subsidiaries of large firms with few local ties, to truly innovative milieus. Thus the spatial boundaries of a RIPS comprise a certain number of elements: specialisation of activities compared with the other national territories; specific relationships between regional actors which also define a particular area; presence of specific resources which give the region a specific edge over its neighbours and finally, in a more general way, the autonomous capability for adjustment and innovation, involving a certain number of actors in a dynamic interaction which distinguishes this territory from the surrounding ones.

5. Preliminary conclusions

From the considerations so far, a number of preliminary conclusions can be drawn at a spatial and political level. We are proceeding on the assumption that the liberalisation of the public services has given rise to a spatial differentiation in the provision, which reduces the competitiveness of companies in the Swiss mountainous regions. Even assuming an improvement of the situation of the economy as a whole, the demand-oriented reorganisation of public services means disadvantages for the mountainous regions with their scattered populations. The likely consequence is an increase in economic concentration and the disparities between the economically strong central regions and the rural and peripheral regions. Particularly high-valued

industries with highly qualified workers, for example the new telecommunications or the medical/biotech firms, are concentrated in the larger metropolitan area of Zurich. Changes to the provision of individual service sectors are often only slight. The narrow focus on individual sectors neglects essential connections and interactions. The accumulation of several negative influences can reach a pain threshold for certain companies beyond which they are disadvantaged in their economic activities, or their very existence is threatened.

The spatial effects of liberalisation are not only shaped by changes on the supply side, but also by the structural prerequisites on the demand side. A decisive factor is what endogenous capacities are available within the individual regions to be able to meet the new challenges actively. Reaction patterns showing regional variations and adaptations in line with existing production systems are to be expected.

If we link the spatial effects of liberalisation referred to with political considerations, it can be seen that the current developments in public services frequently run contrary to the politically desirable spatial development. Further concentration of economic activities puts at risk the declared objective of decentralised settlement in Switzerland. As shown by the numerous advances in the national parliament, the need for political action is widely recognised. However, it is not clear in what way intervention can be made. The relevant legal and political instrumentation is undergoing a process of upheaval. With regard to the separation of commercial and political responsibility, the influence of the present and former Federal public enterprises on the provision of services is declining. They are losing their function as indirect instruments of regional political equalisation objectives. The existing regional political programmes offer an insufficient substitute.

Any comprehensive reaction must take account of the various functions of public services (Figure 1). The most difficult situation is that of the income function, which is defined by the workforce of the service provider. A regional-politically motivated tax imposition affects the operative independence of the enterprises. As it is only imposed on former state enterprises, it represents a disadvantage in comparison with private providers. Concessions are in contravention of the fundamental thinking of liberalisation; however, taxes are possible within the framework of clearly controlled payments for loss-making services.

On the provision side, the emphasis is on a comprehensive strengthening of the provision function. This requires the clearest possible, yet flexible, definition of the scope of the basic provision. A basic provision with purely an ‘assurance character’ will not be sufficient to equalise the economic weaknesses of peripheral regions. The differences between these and the central regions will further increase. Therefore, in addition to a coherent basic provision policy, solutions adapted to suit the individual regions must be tried out. Contributions to the financing of these could be made by the Cantons and Regions. Support for the provision function can also come from a strengthening of the demand. A significant contribution can be made here by an efficiency and competition oriented regional policy. This is also a sign that the Federal Government is willing to consider the stability and identity functions.

The considerations so far show that the public services are embedded in the broader context of the Swiss spatial development policy. The two central pillars, regional policy and the Federal Government’s financial equalisation scheme, are currently being restructured. The Federal Government’s financial equalisation scheme requires fundamental revision. The existing system is inefficient, untransparent and gives false

stimuli (Frey 2001). This assessment is based on specificities of the Swiss scheme. The fiscal gap, i.e., the difference between subnational governments' expenditures and own revenues, is quite significant in Switzerland compared to other OECD countries, particularly its Western European neighbours. Whereas subnational governments accounted for 75% of total public expenditures in Switzerland in 1998, the respective ratio for subnational tax revenue was 56%, leaving a fiscal gap of 19 percentage points (OECD 2002). Despite their considerable fiscal autonomy, the cantons depend extensively on intergovernmental transfers, which is but one example of how responsibilities and functions between cantons and the Confederation are becoming increasingly entangled. Recent economic evaluations have revealed the weaknesses of the present transfer and equalisation system. They concluded „that the system has achieved neither equity nor efficiency. While transfers have been growing at 7.3% annually for the past three decades, they have reduced fiscal disparities by not even 5%“ (OECD 2002: 64). This comes as no surprise. Given that cantonal expenditures on public services increase when fiscal capacity increases (positive income elasticity), a transfer system whose matching rates are proportional to spending will favour rich over poor cantons. This pro-rich bias may even be exacerbated by the fact that some subsidised facilities, e.g., universities, do not exist in poor cantons. As for efficiency, the transfer system also shows severe shortcomings. Vertical transfers are likely to distort the behaviour of recipient cantons and increase subnational spending. By designing transfers proportional to expenditure with high contribution rates, transfers undermine cantonal budget discipline. The more a canton spends, the more transfers it obtains, triggering the

perverse incentive to maximise expenditures for subsidised functions. Since transfers are mainly spent in the local economy, a canton is even able to earn additional tax income by rising subsidised expenditures.

Since the beginning of the 1990s, the federation together with the cantons initiated a thorough reflexion on how to reform the grant and equalisation system. A project proposal was presented in 1999. Soon the “New Financial Equalisation” turned into a general reform of federalism in Switzerland and tried to revive the philosophy of a federal state. In autumn 2001, the government issued the official proposal to be submitted to the parliament. If parliament and popular vote approve this reform in 2003/04, it will mean reforming task allocation, the transfer system and territorial equalisation. The reform is supposed to be implemented in 2007 at the earliest. The central objective of the new financial equalisation scheme is the strengthening of the federalist structures and to make fiscal equalisation more effective. The Cantons receive more targeted funding. The equalisation of resources and encumbrances should lead to a breaking down of the inter-cantonal disparities. The project consists of five major elements: (1) Disentanglement of shared tasks; (2) new forms of intergovernmental co-operation; (3) horizontal and vertical financial equalisation; (4) compensation for topographical and for socio-demographic burden; (5) horizontal collaboration (OECD 2002).

Despite emphasis placed on the equalisation objective, the financial equalisation scheme cannot replace the regional policy. Rather, it will enable a clearer division of tasks and new alignment of regional policy. It has a new focus on the productivity and competitiveness of companies and institutions, and thus on the

strengthening of regional production systems. The “New regional policy” focuses on three strategic issues: (1) promotion of innovation processes; (2) co-ordination of sector policies; (3) establishment of know-how networks (State Secretariat for Economic Affairs 2003). This suggests a complementary division of work between Federal Government and the Cantons: the Federal Government is responsible from above for the management of major regional disparities, while the Cantons oversee from below the management of the regional innovation process.

Both reform projects strengthen the role and the significance of the Cantons as member states of a federal state structure. On the one hand they are the primary contact for the implementation of the new regional policy. On the other hand, thanks to the financial equalisation scheme, they will have more financial leeway in which to operate. As a consequence of this, the Cantons will be under greater pressure to innovate, and to draw up their development plans comprehensively and for the longer term, that is, more strategically.

If Switzerland wants to benefit from the advantages of liberalisation of public services, but at the same time cushion itself from the adverse effects, the interplay between very different political areas must be intensified. This interplay of the instruments is also recognised and supported by the current OECD Territorial Review of spatial development in Switzerland (OECD 2002). Only with the combined effects of a coherent basic provision policy, a renewed financial equalisation and a regional policy oriented towards innovation can the peripheral regions be given the necessary impulses. Based on these three pillars, the

tightrope between the international competitiveness of Switzerland and national spatial cohesion can be successfully navigated.

6. Summary and research outlook

Businesses in outlying regions, particularly small and medium-sized enterprises (SMEs), are having to face a broad range of different challenges in order to maintain their competitiveness. An important input factor has in the past always been the supply of public services. In recent years, public services have undergone a number of radical changes. The impact of the liberalisation trends on the competitiveness of firms and on regional development is still largely unknown.

The aim of this section has been to lay the conceptual basis for a differentiated consideration of the spatial effects of the liberalisation of public services. Against the background of fundamental considerations of the role of the state, Section 2 gave a brief overview of the current situation of the individual sectors in Switzerland. An essential key to deeper understanding of spatial effects is provided by the differentiation between supply and demand of public services, which was set out in Section 3. On the supply side, a distinction was made between the provision of services and the workforce of the service provider, on the demand side between consumers and companies. On the basis of this model a typology of the functions of public services can be drawn up (Figure 1). With the help of this typology, the possible spatial effects of liberalization were discussed. In Section 4 we concentrated on the conditions for competitiveness of companies,

shedding more light on the relative significance of public services as locational factors, the direct and indirect effects on the production process and companies' ability to adapt.

In relation to the empirical evidence, knowledge to date has essentially been limited to individual partial aspects. The following directions of thrust for further empirical research can be seen to be as follows²:

To identify the relative importance of the provision of public services as a locational factor for businesses in the Alpine regions of Switzerland from both a static and a dynamic point of view.

To gain insight into the reciprocal effects between the different aspects of the changed supply of public services and the business trends as seen and perceived by the companies.

To highlight the effects of the changed provision of public services on the competitiveness of the Alpine regions in Switzerland and to identify critical factors in the provision and strategies for action taken by the companies as a response to the changes.

Only with more in-depth quantitative and qualitative knowledge can well-founded, differentiated solution approaches and information be formulated on the policies for guaranteeing a sufficient regional provision of public services.

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² The empirical part of the research project which forms the basis for this article began at the end of 2002 with a written questionnaire sent out to companies, interviews and workshops.

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