

43th Congress of the European Regional Science Association

“Peripheries, centers, and spatial development in the new Europe”

Jyväskylä, August 27-30 2003

Christof Abegg

Prof. Dr. Alain Thierstein

Institute for Territorial Development and Landscape (IRL)
ETH Zurich – Hoenggerberg
CH – 8093 Zurich / Switzerland
Tel: 0041/1/633 2946 + Fax: 0041/1/633 1098
Abegg@nsl.ethz.ch

The liberalization of public services and their impact on the competitiveness of firms: a case study in the Alpine regions of Switzerland¹

Abstract

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 liberalization trends on the competitiveness of firms and on regional development is still largely unknown.

The paper has therefore the following objectives: (1) to show the context of the liberalization of public services (2) to discuss possible spatial effects of the liberalization (3) to outline the empirical design for analysing the impact on firms in the Swiss Alpine regions and (4) to show implications on political strategies in regional development.

¹ This paper is based on an ongoing research project, which is funded by the Swiss National Research Programme 48 ‘Landscapes and habitats of the alps’ (www.nrp48.ch).

1. Background

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, 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).

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. They have hitherto frequently been implemented as important, but frequently not explicitly designated, instruments of economic and regional policy.

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 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. 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.

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). 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. Spatial effects of the liberalisation of public services

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.

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.

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.

The supply of public services is not only a question of efficiency and productivity. Thus considerations of the spatial effects of liberalisation cannot be undertaken from a one-dimensional economic viewpoint. 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.

3. 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**

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. Public services thereby become a differentiating factor of the competition between locations.

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. 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.

- **The direct or indirect 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.

- **The capacity of firms for innovation and adaptation to a changing economic context.**

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) (Corpataux et al. 2002; Maillat 1996). RIPS are anchored in different structures depending on the region in question. 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.

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). A RIPS harbours and generates specific resources (in particular know-how of all kinds), which form the basis of its competitiveness. 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.

4. Alpine Regions - The research design

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 dispersed settlement pattern, low density of population and mainly small-business-based structure. The likely consequence is an increase in economic concentration and the disparities between the economically strong central regions and the rural and peripheral regions.

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.

We have focused on four areas of public services: regional public transport, postal services, telecommunications and electricity. Although the various sectors show different stages of progress and 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 main approach to investigate these issues was a written questionnaire of primarily multiple-choice and semi-open questions. In November 2002, around 6'500 questionnaires were sent to firms with at least 3 employees in the cantons of Wallis, Uri and Grison, all in the Alpine range of Switzerland. 1'385 questionnaires were mailed back, which amount to a return rate of 21 percent.

The quantitative results of the firm survey will be supplemented by interviews with representatives of companies in each case-study region. This will make it possible to analyze in greater depth the interconnections and response strategies that have been identified as critical. The interviews will also make it possible to acquire additional assessment on the timescale of the dynamics behind the change in provision and on the expectations concerning future developments.

5. Preliminary conclusions and implications on political strategies

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.

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