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Lessons from a Happy Place

BY RICHARD W. RAHN

LIMITED GOVERNMENT AND LOW TAXES MAKE SWITZERLAND IMPROBABLY SUCCESSFUL

Geneva, Switzerland – What is the happiest place? Last week in its annual "World Happiness Report," the United Nations reported that Switzerland was No. 1. The United States ranked No. 15, and the African country of Togo came in last, at number 158.

Switzerland is arguably the world's most successful country — and most improbably so. It is landlocked and without much in the way of natural resources. It has four official languages, many different religious groups, and is surrounded by warring neighbors. Yet, it has remained an island of peace and prosperity. The last armed conflict on Swiss territory occurred in a less-than-one-month-long civil war in 1847, where about 130 were killed. The last time it was invaded was by Napoleon in 1798. The core of the Swiss Confederation goes back to 1291, when three Swiss cantons (i.e., states) united in a common defense. Over the centuries, Switzerland has grown to its present 26 cantons.

The modern Swiss federal state goes back to 1848, when a federal constitution was adopted, giving the central government responsibility for defense, trade and legal matters. All other government matters were left to the cantons and the communes (i.e., cities and towns). The U.S. Constitution, which is more than a half-century older than the Swiss, also greatly limited the powers of the central government — but unlike the Swiss, there has been a centralization of power in the capital at the expense of the states and local governments.

Switzerland now has a higher real per capita income than the United States, a lower unemployment rate (3.2 percent versus 5.5 percent), and approximately one-third the amount of government debt in relation to gross domestic product. According to the latest annual Economic Freedom of the World index, Switzerland ranks No. 4 in economic freedom while the United States ranks No. 12. And by the way, Switzerland has the second-highest life expectancy in the world, while the U.S. is far down the list.

In previous articles over the years, I have presented the above data and made the argument that other countries can learn much from the Swiss success. I am now in Switzerland to do pre-production work on a documentary about what makes Switzerland so successful, as part of a series on improbably successful countries. Unlike the other countries we are presenting, Switzerland is not a recent success, yet is unique among developed democracies in not succumbing to the fatal disease of endless growth in the size and centralization of government.

There is a considerable body of empirical evidence that as the size of government increases as a percentage of GDP above about 25 percent, economic growth tends to slow. The Swiss government is too big by that standard, because almost a third of GDP goes through the government sector — but this percentage is far smaller than its European neighbors and the United States — and most importantly, the Swiss have been able to create a spending "brake" so that government is not growing as a percentage of GDP.

The Swiss, despite all of their differences, learned to live together by not forcing their views on neighboring towns and cantons. As a result, there is a healthy degree of tax and regulatory competition between the cantons. For instance, the central government income tax rate maxes out at about 12 percent. Total tax rates — federal, canton (state) and local — max out in some cantons as low as about 20 percent while in other cantons, such as Geneva, they can be more than 40 percent. (The maximum income tax range in the U.S., depending on the state, can range from 38 percent to well over 50 percent.) As in the United States, people move around Switzerland selecting the tax rates and level of government they find most comfortable, but the Swiss have a much larger choice.

Switzerland has been ranked No. 1 in international competitiveness, in part, because their maximum corporate tax rate of 18 percent is below the world average (the U.S. has a non-competitive 35 percent federal corporate tax rate — plus state corporate taxes).

Unlike the United States and many other countries, Switzerland is not all hung up on the notion of everyone going to college. Being the practical folks they are, they have created an apprenticeship program, which two-thirds of young adults choose. As a result, they learn a profession as employees of a company with on-the-job training coupled with two days a week in the classroom. After four years, they have basic professional qualifications. This has resulted in a youth unemployment rate of only 3.2 percent (a fraction of that in the United States and most European countries).

The slowdown in world economic growth is a global concern. If improbably rich jurisdictions, such as Singapore, Chile, Hong Kong and Switzerland, can succeed — economic policymakers in all countries should look at the best practices in these and other places to emulate. Economic prosperity and freedom is not pre-ordained — it is merely a function of creating good policies and institutions.

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