

Locational Quality 2025: Outlook After the Tax Reform

Locational Quality 2018 | November 2018



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Little Movement in the Cantonal Rankings

Zug, Zurich and Aargau can defend their top rankings in 2018. On balance, there were only minor changes compared to the previous year: Canton Ticino overtook Fribourg, Neuchâtel passed Bern, and Thurgau edged past Obwalden.

The Locational Quality Indicator by Credit Suisse

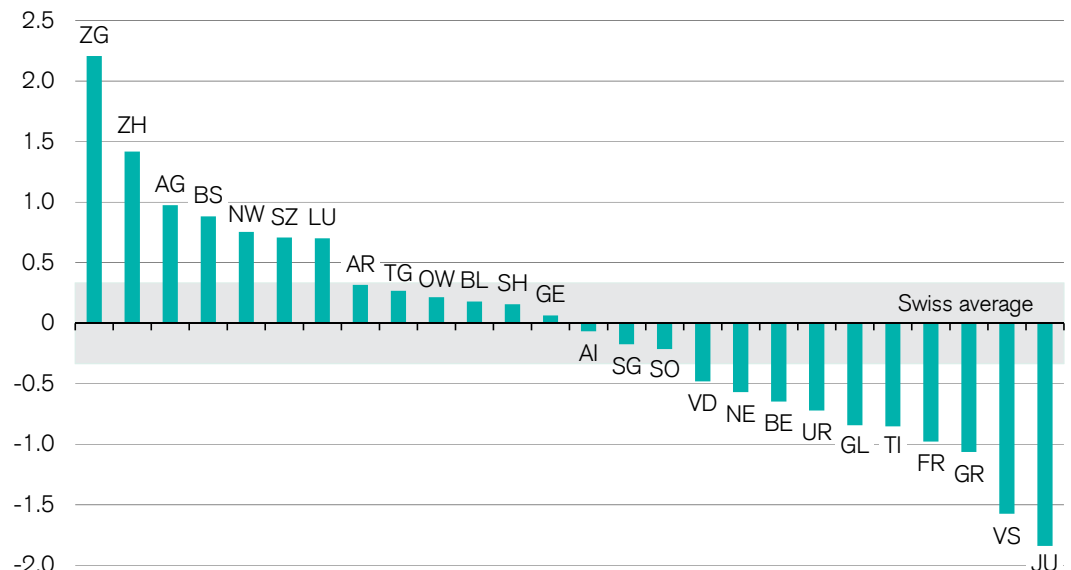
The long-term economic potential of the Swiss cantons is largely determined by the overall conditions for business. Firms tend to invest primarily in attractive locations, thus creating jobs and bringing added value and prosperity. Intense competition between different locations is forcing the Swiss cantons and regions to take steps to optimize their appeal to the greatest extent possible. The annual Credit Suisse Locational Quality Indicator (LQI) measures the attractiveness of the Swiss cantons and regions to business (see appendix for detailed results). The indicator is based on the following seven quantitative sub-indicators (see box on page 6): tax burden on legal entities and private individuals, availability of specialist labor and highly qualified personnel, population accessibility, employee accessibility, and access to airports. In this way, the LQI serves on the one hand as a guide for companies that are in the process of evaluating potential locations, and on the other as a benchmarking tool for the optimization of cantonal or regional location policy.

Stability at the top, crowded mid-field

Canton Zug has been the undisputed leader of the cantonal ranking for years, followed by Zurich. Third place has gone to Canton Aargau since 2016, when it overtook Basel-Stadt, among others, thanks particularly to its enhanced fiscal appeal for companies. These locations exhibit the most favorable combination of attractiveness factors. The results for Cantons Nidwalden, Schwyz and Lucerne are also well above the average. A series of suburban cantons, plus the city canton of Geneva, make up the broad mid-field. The peripheral Cantons Jura and Valais, with their challenging topography, display the lowest locational quality. Compared to the previous year, Canton Ticino rose one place, overtaking Fribourg. Canton Neuchâtel passed Bern, advancing to 18th place, while Canton Thurgau overtook Obwalden to reach 9th place. On balance, though, the picture remains stable.

Locational quality of Swiss cantons, 2018

Locational quality indicator (LQI), synthetic index, CH = 0



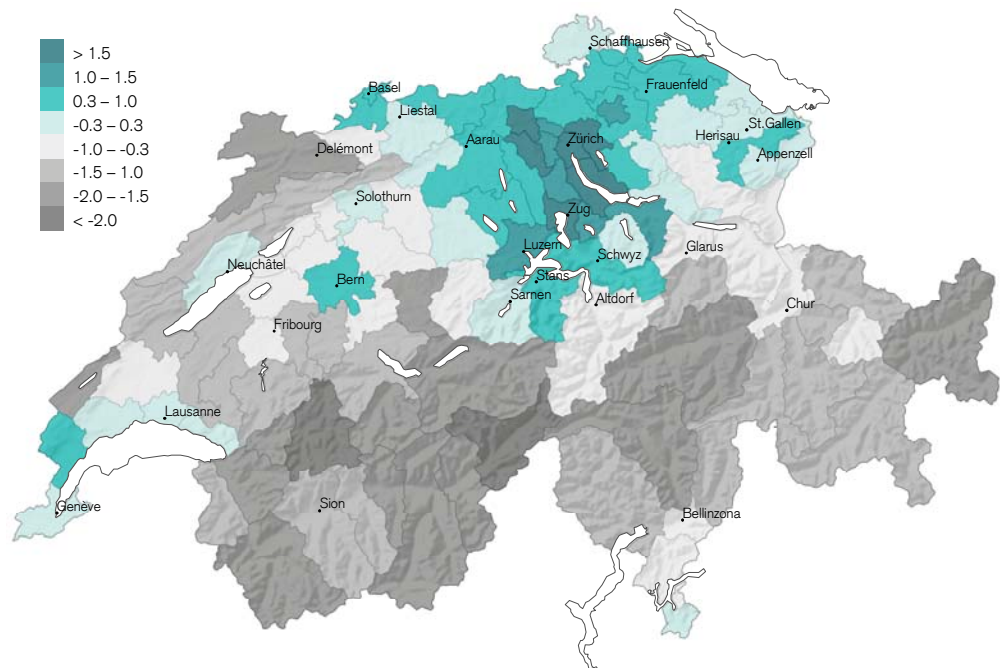
Source: Credit Suisse

**Regional view:
significant
differences within
the cantons**

For the larger, heterogeneous cantons – such as Bern, Vaud, Ticino or Graubünden – an analysis solely at cantonal level is too superficial. Thus we also analyze locational quality at the level of Switzerland's economic regions. The highest degree of attractiveness is exhibited by the centers Zurich, Zug, Baden, Lucerne, Basel, and Bern, as well as their agglomerations, thanks mainly to their accessibility. In the Suisse Romande, Nyon is positioned well above the neighboring regions, and in Ticino the same is true for the Lugano region and, especially, Mendrisio. Alpine areas and the regions of the Jura arc are clearly less attractive to companies, due to their topographical features and the length of travel time into the urban centers. The varying conditions in different regions make it difficult for cantons to orient their location policy towards their individual strengths and weaknesses. For example, from a business viewpoint, an above-average tax burden is less of a disadvantage in urban centers than it is in peripheral regions. This is because, from a cost-benefit perspective, the generally larger offering of government services and infrastructure in urban areas compensates for the greater expense. An overview of the locational quality of the 110 economic regions and individual locational factors is located in the appendix from page 11.

Locational quality of Swiss economic regions, 2018

Locational quality indicator (LQI), synthetic index, CH = 0



Source: Credit Suisse, Geostat

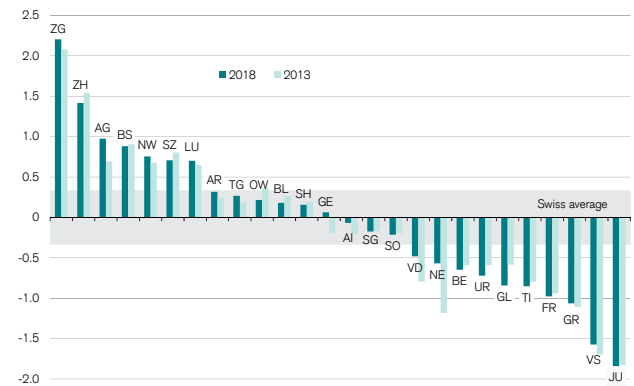
Locational Quality 2018

Neuchâtel has advanced six places since 2013

Although the LQI primarily measures locational quality in a regional cross-comparison, time comparisons are largely possible as far back as 2013. A positive development is visible in Canton Neuchâtel, which climbed six places, particularly thanks to a reduction in corporate tax rates. Cantons Vaud and Thurgau each advanced by three places, while Glarus fell back four places. The top rankings for Zug and Zurich, as well as the lowest rankings for Cantons Valais and Jura, have remained the same throughout the years.

LQI 2018 and LQI 2013 in comparison

Locational quality indicator (LQI), synthetic index, CH = 0



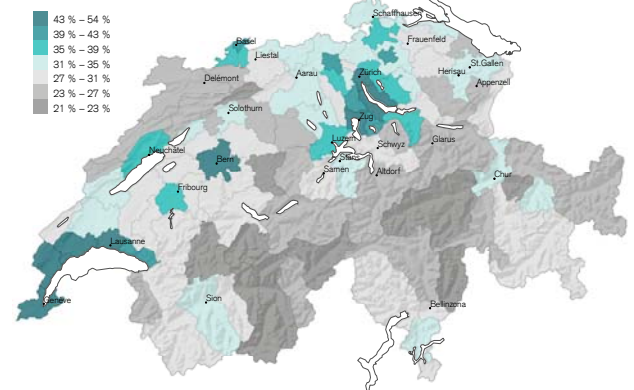
Source: Credit Suisse

Highly qualified workers concentrated in urban regions

Manufacturing and commercial businesses are dependent on workers with professional training. In knowledge-intensive areas of the economy, highly qualified employees are a key factor of production. The city of Zurich tops the list of 110 economic regions in Switzerland with nearly 54% of highly qualified workers. The other urban regions (Geneva, Lausanne, Bern, Basel) as well as the immediate suburban areas on the lakes of Zurich and Geneva also have a relatively large pool of workers with a tertiary degree (university of applied science, university, or college of professional education and training).

Availability of highly qualified personnel

Percentage of working-age population with tertiary education, 2012–2016



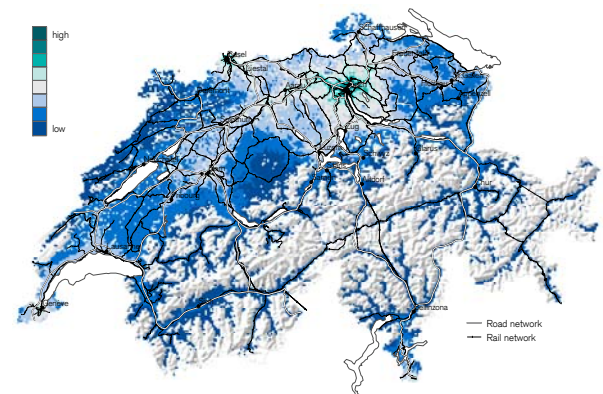
Source: Swiss Federal Statistical Office, Credit Suisse, Geostat

Traffic corridors are an advantage

The quality of a location is strongly dependent on the economic potential of its catchment area. Most businesses' production operations depend on suppliers, business partners and subsidiary service providers. On the sales side, companies need corresponding customer markets for their products. The "population accessibility" score takes this point into account. Not surprisingly, the highest accessibility scores are found in the major Swiss cities, followed by their suburbs. Regions along key traffic corridors are similarly attractive.

Population accessibility

Results per populated square kilometer, private motorized transportation and public transport summarized.



Source: Credit Suisse, Geostat

The Credit Suisse Locational Quality Indicator (LQI)

Quantitative analysis of the locational quality of Switzerland's cantons and regions has been part of the Credit Suisse research offering since 1997. The LQI is calculated on the basis of current data. Compared with the revision in 2013, however, the methodology remains largely unchanged.

The tax burden on private individuals is calculated on the basis of taxes on income and wealth at federal, cantonal and municipal level and also takes account of the normal deductions. The tax burden on legal entities examines taxes on profit and capital. The calculations are based on the statutory tax rates and municipal tax rates for 2018, where available. Special tax systems such as lump-sum taxation or tax privileges for special status companies cannot be taken into account, as these privileges are not published in a suitable statistical form.

The availability of specialist labor and highly qualified personnel is based on the level of education of the residents, inbound commuters and cross-border commuters of a region. Specialist labor refers to persons with vocational or higher training, while highly qualified personnel have completed tertiary education at a higher technical college, university of applied sciences or university. The database is the 2012–2016 structural survey conducted by the Swiss census. The level of education of cross-border commuters is estimated on the basis of the wage structure survey of the Swiss Federal Statistical Office.

Population accessibility, employee accessibility and access to airports have remained unchanged compared to last year's calculation. The indicators are calculated for each populated square kilometer and based on the entire road network and all public transportation connections. The opening of the Gotthard base tunnel will have improved slightly the accessibility of the Gotthard region (see section "Outlook for Locational Quality in 2025: Basel-Stadt Overtakes Zurich, Geneva In 4th Place"). According to our analysis, the opening of the New Railway Link through the Alps (NEAT) will add 0.04 LQI index points to Ticino's score, due particularly to the Monte Ceneri tunnel (opening in 2020), while Canton Uri will gain an additional 0.01 points.

Additional information: "Locational Quality: Basel-Stadt Set to Overtake Canton Zurich", Credit Suisse, September 2016.

Regional locational quality: clients of Credit Suisse can order factsheets on individual economic regions from their client advisor.

Basel-Stadt Overtakes Zurich, Geneva in 4th Place

Two components of locational quality will change significantly in the years ahead. On the one hand, the fiscal package “Tax Reform and AHV Financing” (TRAF) will have a fundamental impact on the corporate tax system. On the other, the opening of the Ceneri base tunnel in 2020 will improve the accessibility of Canton Ticino, in particular. With this in mind, we have sketched out a forecast of locational quality in 2025.

Lower taxes on net profits and capital taxes as a result of corporate tax reform

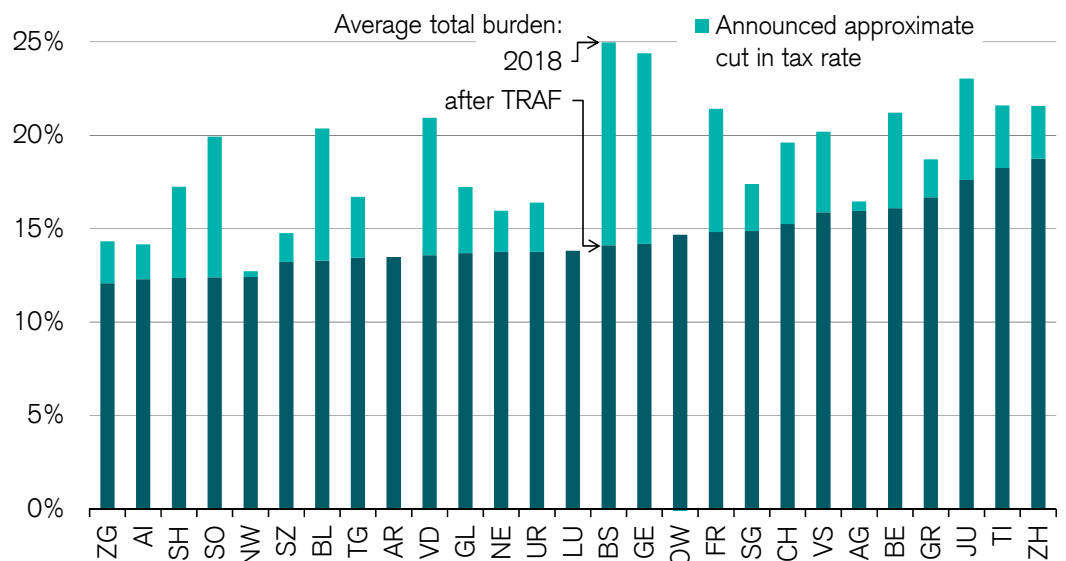
The referendum on Corporate Tax Reform III was rejected by the electorate. In order to give companies a measure of planning security as soon as possible, federal authorities and parliament immediately began work on a new proposal that would be acceptable to a consensus, especially since the need for reform is undisputed. The Federal Council’s proposals are intended to restore international acceptance and preserve locational attractiveness. Parliament supplemented the original “Tax Reform 17” with social policy adjustments in favor of the social security system, and presented the fiscal package on September 28, 2018, under the name “Tax Reform and AHV Financing” (TRAF). If there is no referendum on the matter, the urgent measures could take effect as early as January 2019, and the rest probably in January 2020. If a referendum is demanded, it would likely take place on May 19, 2019.

Ongoing trend towards competition via lower standard tax rates

The objective of the reform is to eliminate tax privileges for holding and management companies that generate most of their sales and costs outside Switzerland – these companies are referred to as “special status companies”. Instead, new privileges are to be introduced at cantonal level (such as the “patent box” and deductions for R&D) that are also recognized abroad. On balance, however, the cantons will have less scope to reduce the basis for assessment, and many companies will not be able to profit from the proposed new tax instruments. For this reason, a majority of the cantons plan to reduce corporate tax rates (see figure), but in most cases this step must be approved by the citizens. Only in Canton Vaud was corporate tax reform already approved by voters in March 2016. On balance, the global trend towards greater fiscal competition via lower ordinary tax rates remains unbroken.

Lowest corporate tax rates likely in Zug and Appenzell Innerrhoden

Total burden* of taxes on profit and capital taxes, as % of net profit, 2018 and taking into account the adjustments to corporate tax rates already announced by cantonal government (as at October 19, 2018)



Source: TaxWare, cantons, Credit Suisse

* Average effective burden for a company with capital of CHF 2 million and net profit between CHF 80,000 and CHF 1,040,000.

NEAT: the continuous flat route from Altdorf to Lugano will become reality in 2020

The opening of the Ceneri base tunnel planned for 2020 will signal completion of the New Railway Link through the Alps (NEAT). This further improves the accessibility of regions in Ticino and Uri. Their catchment areas will expand, and they will be somewhat “closer” to the major cities. In order to quantify the effects of the project, we modeled the complete timetable of public transportation (PT) following the opening of the Gotthard and Ceneri base tunnels. We recalculated the catchment areas of every Swiss town based on all 450 million connections between every square kilometer, as well as preferred travel times. We further included the impact of foreign urban areas. The improvements in PT accessibility will result in changes to the indicators of transport accessibility, which in turn will affect the locational quality rankings. Compared to the tax cuts, however, these improvements have only a minor impact.

Update of provisional rankings after tax reform and NEAT completion

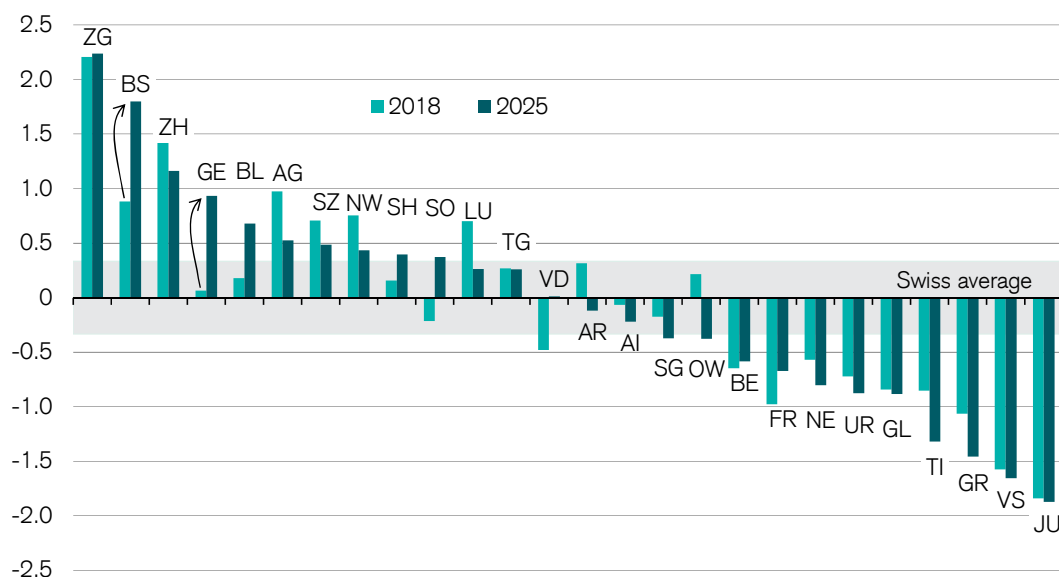
In our 2016 study on locational quality¹, we ventured an outlook for locational quality in 2020. At that time, we assumed that the cantons would lower their corporate tax rates as a result of Corporate Tax Reform III (CTR III). Now that most of the cantons have communicated their fiscal strategies in the context of TRAF, it is time for another look into the future. Based on the adjustments to corporate tax proposed by cantonal governments, which would in many cases be implemented in steps until around 2025, we recalculated the locational quality sub-indicator “fiscal attractiveness for legal entities”. As in our last edition, we have taken into account the changes in accessibility indicators following the completion of the NEAT. The other locational factors remain unchanged.

LQI 2025: Zug continues to lead, Basel-Stadt overtakes Zurich and Aargau

In this hypothetical LQI for the year 2025, Canton Zug remains in first place (see figure). According to current information, the proposed reduction in the profit tax rate to 13.04% would propel Canton Basel-Stadt the furthest: it would push Canton Zurich (planned profit tax rate of 18.19%), which has occupied second place since we began our survey, clearly back to third place. Canton Geneva (planned profit tax rate of 13.79) would make similar gains, advancing an entire nine places. Basel-Landschaft and Solothurn would both climb six places, because they also foresee a significant reduction in profit tax rates (to 13.45% and 13.0%, respectively) and on top of that, they intend to cut capital taxes as well. Aargau, which occupies third place in 2018, would find itself in sixth place with its anticipated reduction in the profit tax rate to 17.9% and the capital tax rate to 0.75 per mill.

Locational quality of the Swiss cantons: 2018 vs. 2025

Locational quality indicator (LQI), synthetic index, CH = 0, 2018 and after recalculation of sub-indicators for accessibility and tax burden for legal entities



Source: Credit Suisse

¹See “Locational Quality: Basel-Stadt Set to Overtake Canton Zurich”, Credit Suisse, September 2016.

**Relative advantage
of low corporate
taxes is diminishing**

The planned reductions in corporate tax rates increase locational quality. However, given the relative assessment of locational quality, cantons may still fall in rank in the LQI despite easing the tax burden. The cantons that have long granted the greatest fiscal incentives are losing some of their relative advantage because the differences are narrowing, on balance, and some cantons intend to take an even more fiscally attractive position. Except for Zug, the indicator ranking is set to fall for every canton in Central Switzerland, as well as in the two Appenzells. The greatest setback – an entire seven places – would be in store for Canton Obwalden, but Appenzell Ausserrhoden (–6) and Lucerne (–4) would also lose significant ground.

LQI 2018 results in detail

Factors of locational quality at cantonal level

Ordered by rank, + / ++ more attractive than the Swiss average; - / -- less attractive than the Swiss average; = Swiss average

Canton	Fiscal attractiveness		Availability		Accessibility			Locational quality 2018		
	Private individuals	Legal entities	Specialized labor	Highly qualified personnel	Population	Employees	Airports	LQI 2018		Rank 2018 (vs. 2017)
ZG	++	++	++	++	+	+	+	2.21	++	1 (=)
ZH	++	-	+	+	++	++	++	1.42	++	2 (=)
AG	+	++	+	-	+	++	+	0.97	+	3 (=)
BS	=	--	=	+	++	++	+	0.88	+	4 (=)
NW	++	++	+	-	-	=	-	0.75	+	5 (=)
SZ	++	++	=	-	=	=	=	0.71	+	6 (=)
LU	+	++	+	-	=	=	=	0.70	+	7 (=)
AR	+	++	+	-	-	=	-	0.32	+	8 (=)
TG	+	+	=	-	=	+	=	0.27	=	9 (+1)
OW	++	++	=	-	-	-	-	0.22	=	10 (-1)
BL	-	-	+	-	+	++	=	0.18	=	11 (=)
SH	=	+	+	-	=	=	=	0.16	=	12 (=)
GE	-	--	--	++	+	=	++	0.06	=	13 (=)
AI	++	++	=	--	-	-	-	-0.07	=	14 (=)
SG	=	+	=	-	=	=	=	-0.17	=	15 (=)
SO	=	=	=	-	+	+	=	-0.21	=	16 (=)
VD	--	-	-	+	=	-	=	-0.48	-	17 (=)
NE	--	++	--	-	-	-	-	-0.57	-	18 (+1)
BE	-	-	+	-	=	=	-	-0.65	-	19 (-1)
UR	++	++	--	--	-	-	-	-0.72	-	20 (=)
GL	+	+	-	--	-	-	-	-0.84	-	21 (=)
TI	+	-	--	-	-	-	-	-0.85	-	22 (+1)
FR	-	-	--	-	=	=	-	-0.98	-	23 (-1)
GR	+	=	=	--	--	--	-	-1.06	--	24 (=)
VS	-	-	--	--	-	--	-	-1.57	--	25 (=)
JU	-	--	--	--	-	-	-	-1.84	--	26 (=)

Source: Credit Suisse

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