


# A two-course Swiss menu: Corona and the debt brake

## Presentation

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The background of the slide features a magnifying glass with a silver handle and frame. The lens is centered on a detailed, textured image of a coronavirus particle. Behind the magnifying glass, a faint world map is visible on the left, and a white line graph with several peaks and troughs is overlaid on the right. The entire scene is set against a teal gradient background.

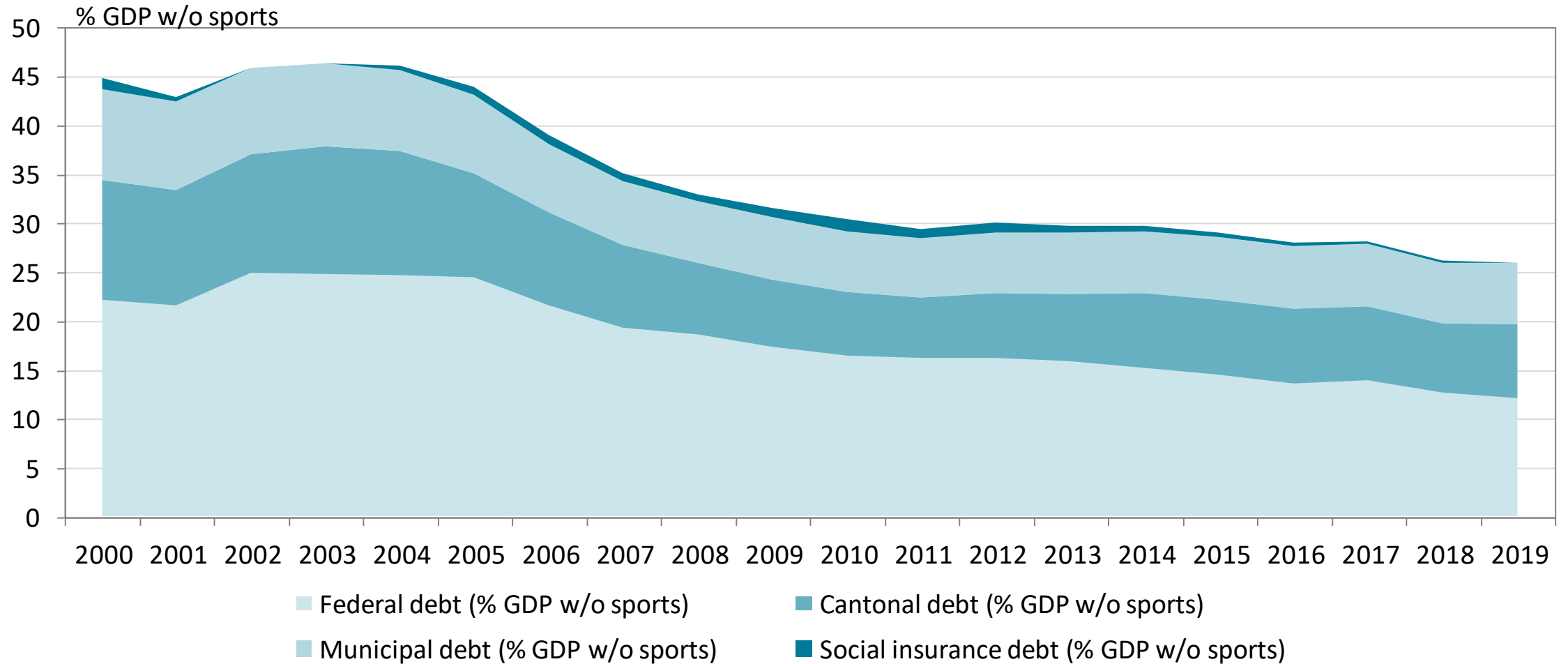
## A two-course Swiss menu: Corona and the Debt Brake

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14 December 2020



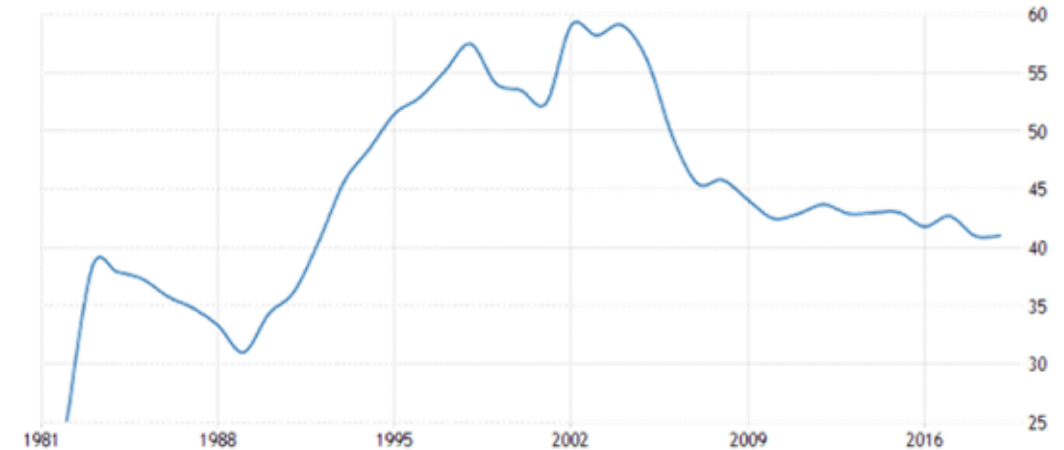
# The Swiss Debt Brake

# Public debt in Switzerland



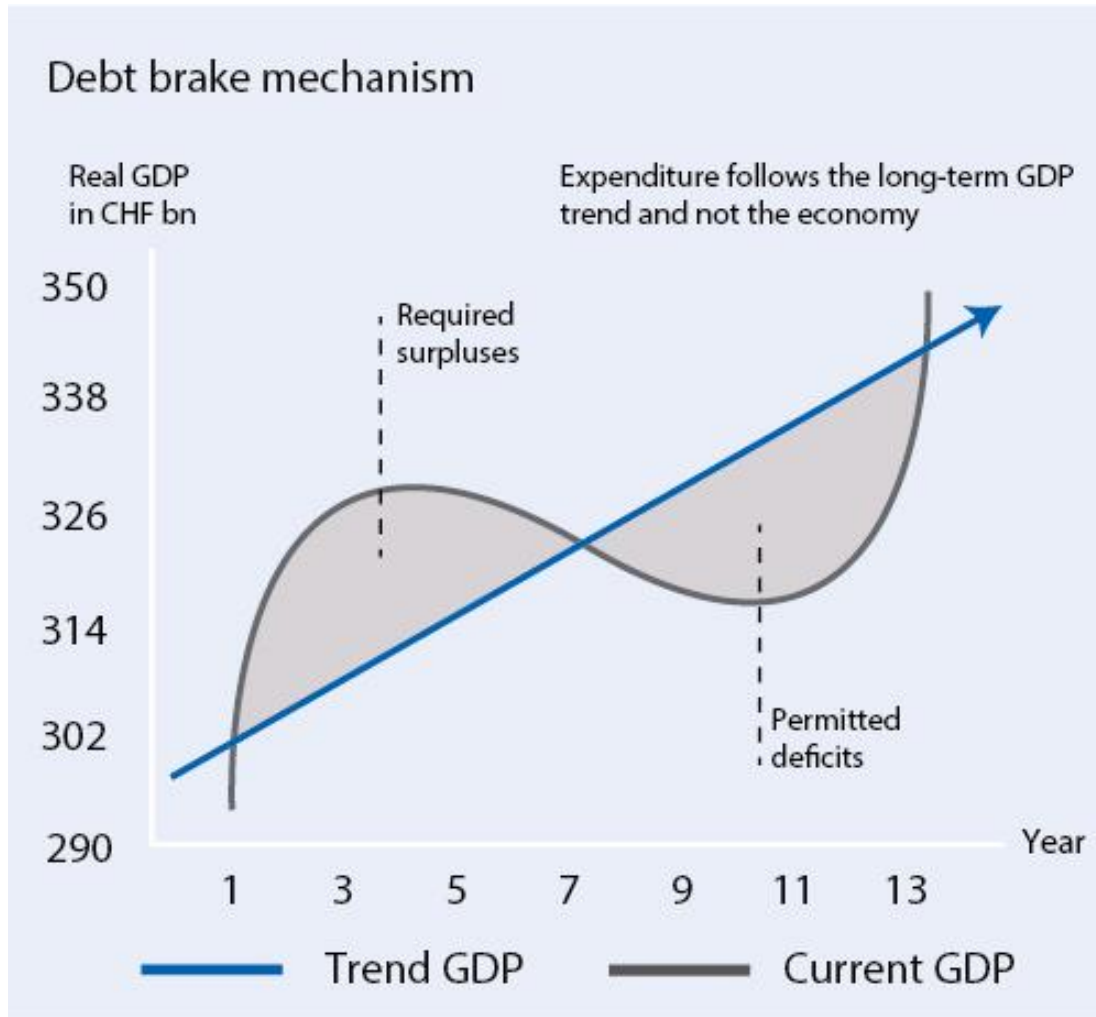
Sources: EFV, BFS

- The expansion of federal debt in 1990s
  - Spending bias coupled with a pro-cyclical fiscal policy: economic upturns not used for fiscal consolidation
  - Raising federal revenues usually requires a constitutional amendment. Spending increases require only a simple majority vote in parliament
  - Weak fiscal rule since 1959
- 1997: start of planning the introduction of the debt brake
  - Structurally largely balanced budget as necessary condition for its introduction
  - Budget target for 2001 was formulated in 1997 (temporary constitutional provision in 1998 referendum: 70.7% Yes)
- 2003: first application of the debt brake
  - 2001 referendum: 84.7 % Yes



- Goals
  1. Ensure medium- and long-term debt stabilization by avert (chronic) structural imbalances
  2. Grant short-term countercyclical budget leeway
- Application
  - The Swiss debt brake applies since 2003 to the ordinary budget.  
Since 2010, extended to extraordinary income and expenditures but managed seperately
- Constitutional provision for the debt brake principles
  - Strict implementation through the Financial Budget Act (FHG)

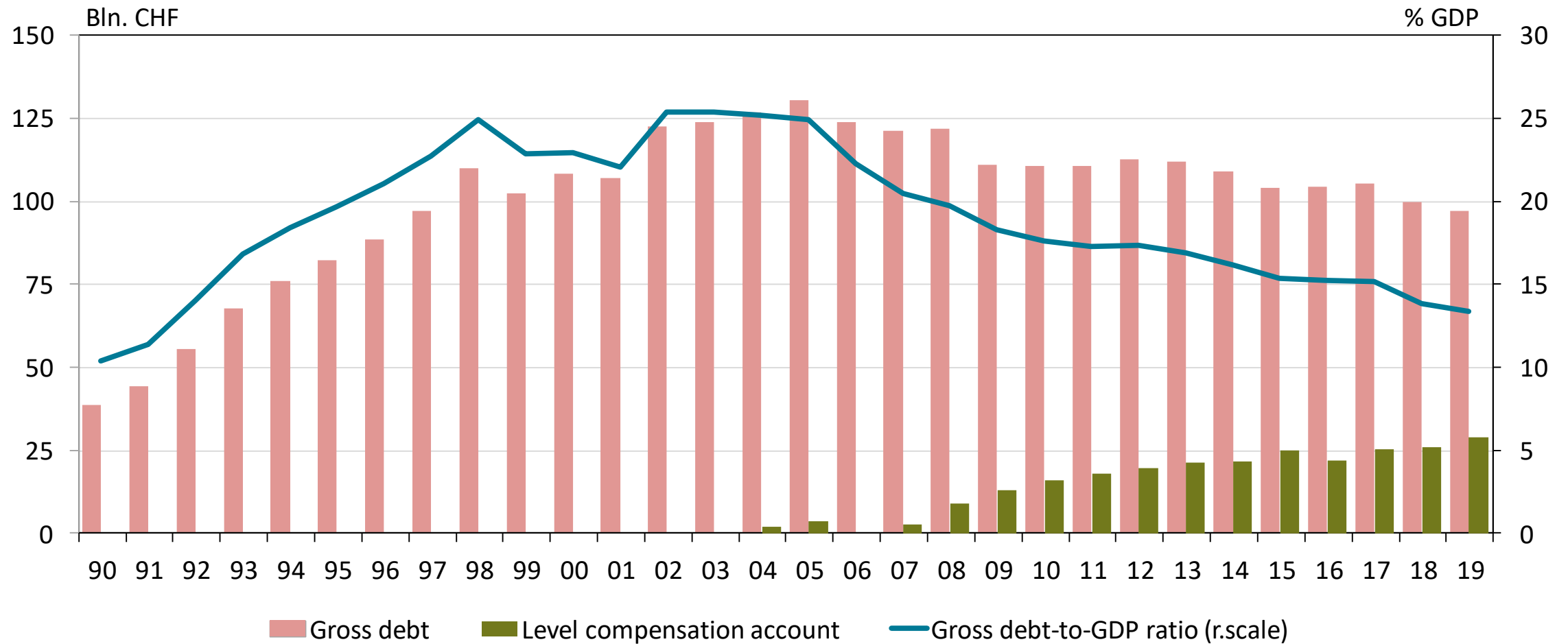
1. Application only to the expenditure side
  - The budget must be balanced given tax revenues subject to a business cycle correction
  - Constitutional upper limits on main tax rates make it (almost) impossible to act on the revenue side
  - No short-run economic impulses are intended to come from the expenditure side
    - Tax revenues are supposed to act as automatic stabilizers
2. Management of surpluses and deficits
  - Asymmetric management: Deficits and surpluses are treated differently
    - Constitutional framework permits symmetrical management, but current law is more restrictive
      - Parliament gave priority to debt reduction over spending increases or tax relief
  - Deficits and surpluses are managed in the (notional) compensation account
    - Surpluses cannot be used to increase the expenditure ceiling or to reduce taxes
      - They thus lead to a reduction in debt
    - A surplus in the compensation account is continued and there is no obligation to reduce it
  - Balance in the compensation account increases also in case of systematic forecasting errors of revenues, of the cyclical adjustment factor, and thus the maximum expenditure ceiling



- Rule: expenditure may not exceed receipts over an economic cycle. (Constitution)
  - $G_t \leq k_t T_t$  with  $k_t = \frac{Y_t^*}{Y_t}$ 
    - A modified HP filter is used to calculate  $Y_t^*$
    - Tax revenues act as automatic stabilizers
- If actual expenditure differs from ceiling, this is charged to a (notional) compensation account
  - Rule applied to budget forecasts and outcomes
    - Second calculation determines what must be credited or debited in the compensation account
  - Deficits have to be eliminated in the following years - No rules are provided for surpluses
  - The rule offers an escape clause for unexpected situations and uncontrollable developments



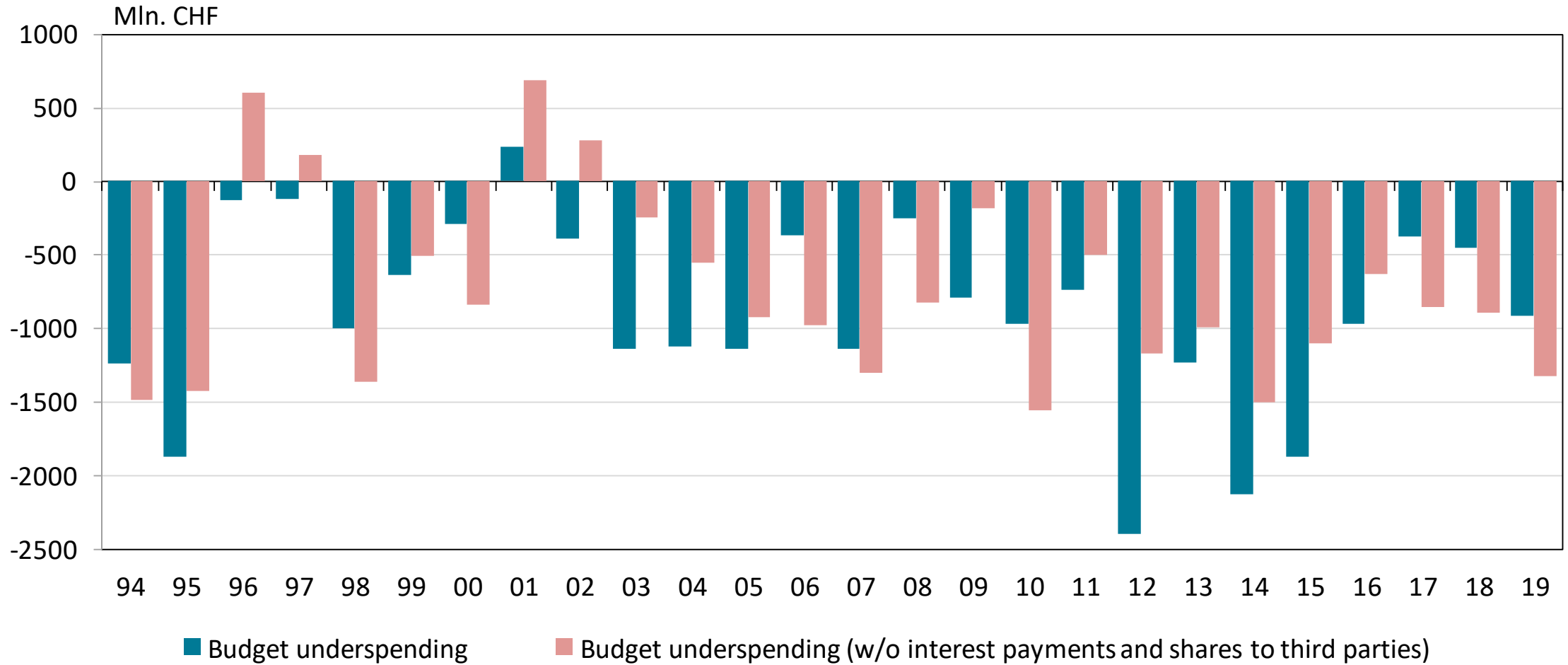
# Development Swiss central government debt, 1990-2019



Source: Federal Administration

- Since 2006, the revenue growth was under- and the expenditure growth overestimated
- During the time period 2004-2019:
  - Forecast errors for revenues explained 52% of the inflows
  - whereof 44% were due to 'Withholding Taxes'
  - Forecast errors for expenditures 40%
- Are budget underruns a first-class problem?
  - Systematic forecasting bias undermines the trust in the finance ministry's forecasting abilities. This might be detrimental in other contexts.
  - From a division of power perspective, the budget authority of the parliament is undermined if forecast errors have a systematic bias in favor of fiscal surpluses.

# Budget underspending, 1994-2019



Source: Federal Administration

# Expenditures: Difference budget and budget estimate

KOF

	million CHF		% of the budget estimate	
	Ø 2004-2019	Ø 2007-2019	Ø 2004-2019	Ø 2007-2019
<b>Ordinary expenditures</b>	<b>1'055</b>	<b>1'095</b>	<b>1.7%</b>	<b>1.7%</b>
	(621)	(664)	(1.0%)	(1.0%)
Transfers' to third parties	-194	-199	-2.5%	-2.6%
	(303)	(333)	(3.9%)	(4.2%)
Interest expenditures	292	306	11.4%	12.7%
	(337)	(324)	(13.3%)	(13.6%)
Other ordinary expenditures	956	988	1.9%	1.9%
	(373)	(399)	(0.7%)	(0.8%)
thereof own expenditures		440		4.2%
		(197)		(1.8%)

# Revenues: Difference budget and budget estimate

KOF

	million CHF		% of the budget estimate	
	Ø 2004-2011	Ø 2012-2019	Ø 2004-2011	Ø 2012-2019
<b>Ordinary revenues</b>	<b>2'504</b>	<b>267</b>	<b>4.4%</b>	<b>0.3%</b>
	(1'934)	(1'469)	(3.3%)	(2.2%)
Withholding tax	1'338	973	43.4%	17.0%
	(993)	(797)	(33.2%)	(13.2%)
Other revenues	1'166	-706	2.2%	-1.2%
	(1'234)	(1'212)	(2.3%)	(2.0%)

# Four reasons why budgets are not fully spend

## 1. Lower costs or lower demand

- Such estimation errors should be symmetrical and balanced in the medium to long term
- However, the last decade was marked by the financial crisis and franc shocks
  - Interest rate, inflation and economic developments were (systematically) misjudged

# Four reasons why budgets are not fully spend

1. Lower costs or lower demand
2. Shifts between fiscal years
  - Article 36 FHG allows the Federal Council, in the case of delays, to transfer already granted credits to the following year
  - However, this regulation presents a certain bureaucratic hurdle and may therefore not be fully exploited
  - The new management model for the federal administration (NFB) allows administrative units to create reserves that can be reused as credit overruns (introduced in 2017)

1. Lower costs or lower demand
2. Shifts between fiscal years
3. The precautionary motive
  - Budgetary hurdles, or even social and cultural practices, can make it more costly for administrative units to undercut budgets
  - Over-budgeting is used to cover unforeseen events or to avoid filing for supplementary credits
    - Administrative units tend to (over-) cautiously budget (but also to use funds economically)
  - In these situations, the effective expenditure is more likely to correspond to the social optimum than the tentatively carefully negotiated budget ceilings
  - Reducing budget underspending then implies designing the “costs” of exceeding and falling short of the budget more symmetrically
    - The introduction of global budgets under the NFB goes in this direction



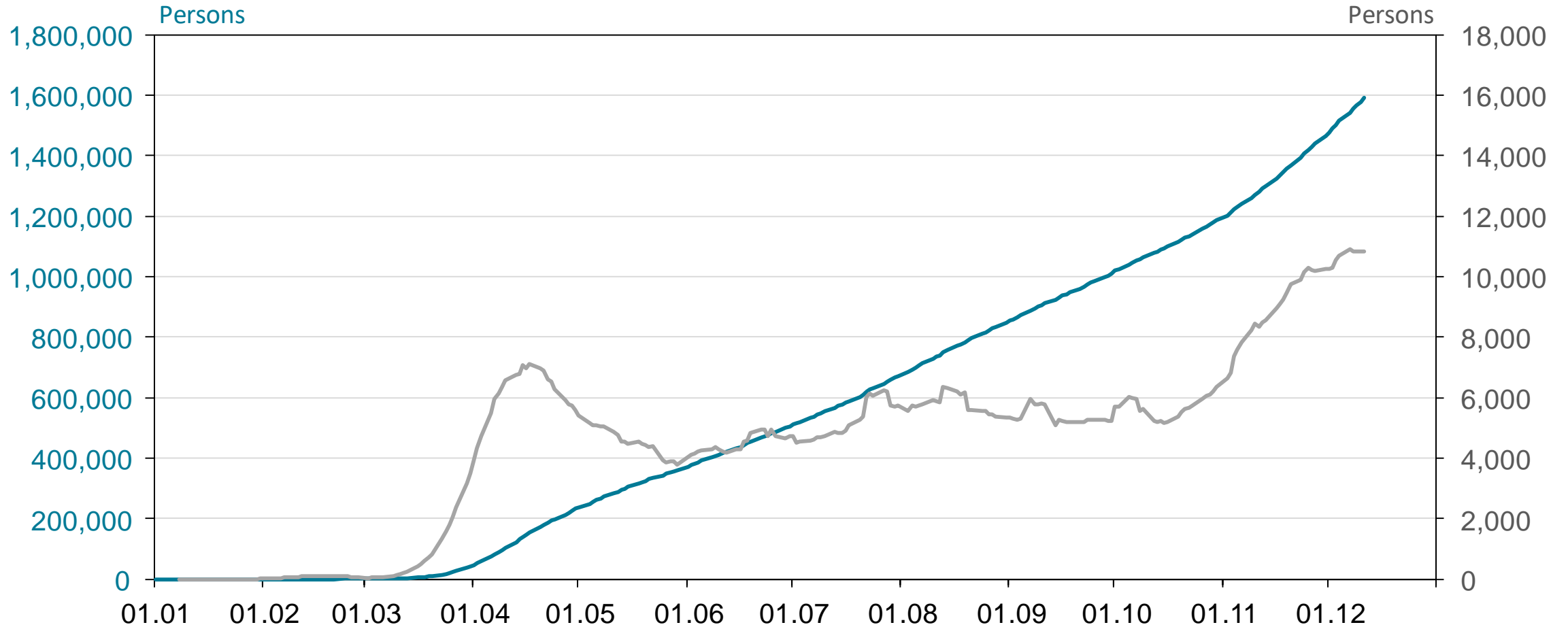
1. Lower costs or lower demand
2. Shifts between fiscal years
3. The precautionary motive
4. The problem of the fiscal commons
  - The political economy assumes that the administration is budget-maximizing
    - Influence and prestige are positively related to the size of the budget
    - All administrative units are competing for access to the common source of revenues
  - The decisive factor is the institutional design of the budgetary process or the control mechanisms designed to prevent inefficient use of public funds
    - For practical reasons, control mechanisms are more pronounced when budgets are spend than during the budgeting process. This should result in budget underspending.
    - Global budgets and intertemporal transferability of budgets are likely to increase this problem
    - Penalties for budget underspending, such as a budget cut in the following year or a strengthening of the role of fiscal management in the budget process, could reduce such budget underspending (but could increase the “December fever”).

The Corona Crisis  
– a Swiss Perspective



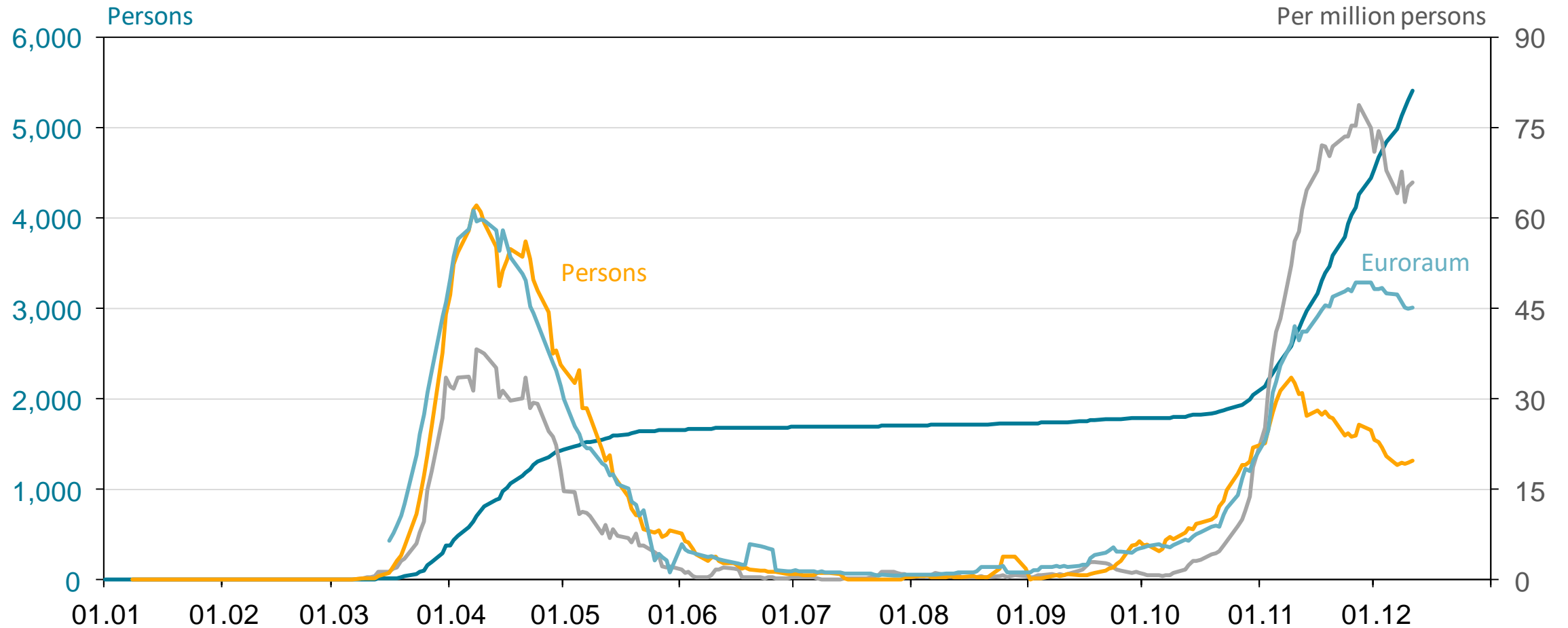
# COVID 19 pandemic: registered deaths worldwide

- cumulative & daily (7-day average)



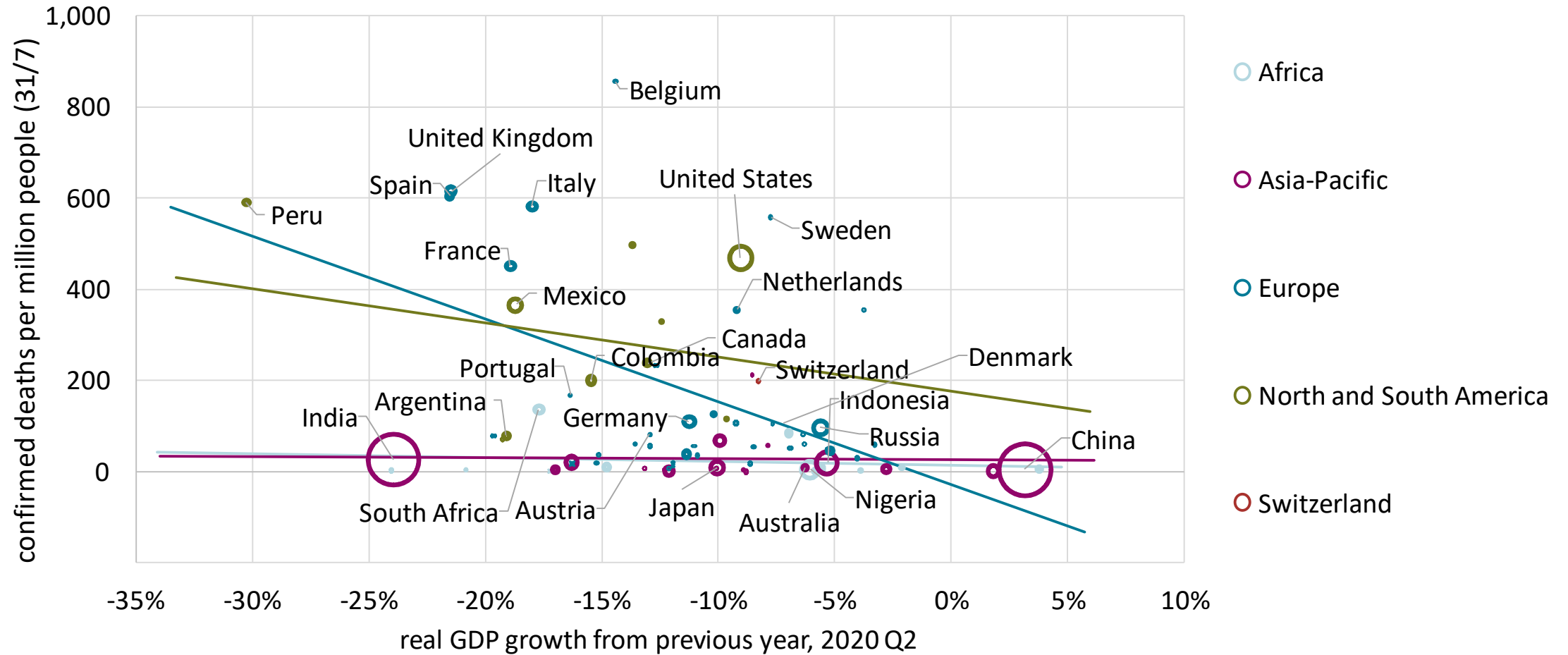
Source: Reuters

# COVID 19 pandemic: registered deaths in **Switzerland** - cumulative & daily (7-day average)



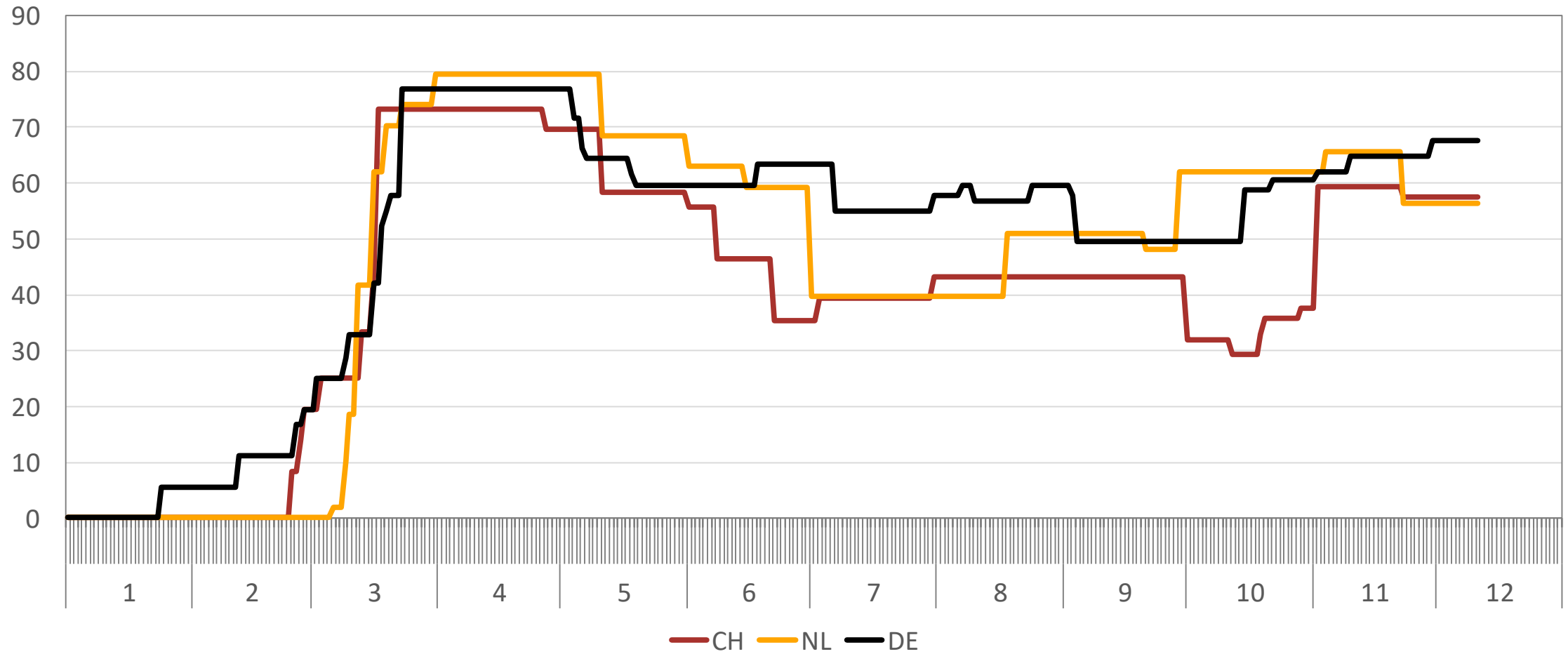
Source: Reuters

# Health-Wealth Trade-Off? Experiences from the first wave



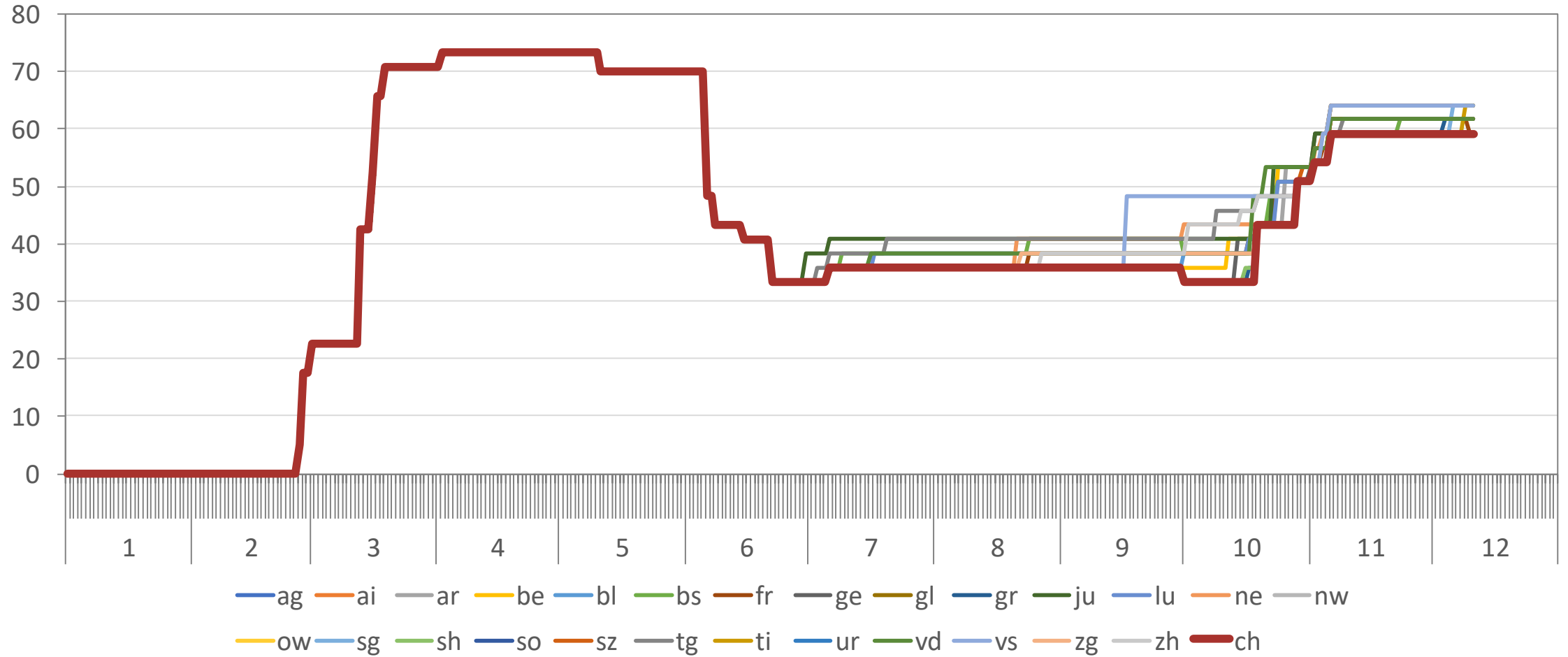
Sources: Reuters, national statistical offices, Datastream. Circle size ~ Population size

# Oxford Stringency Index



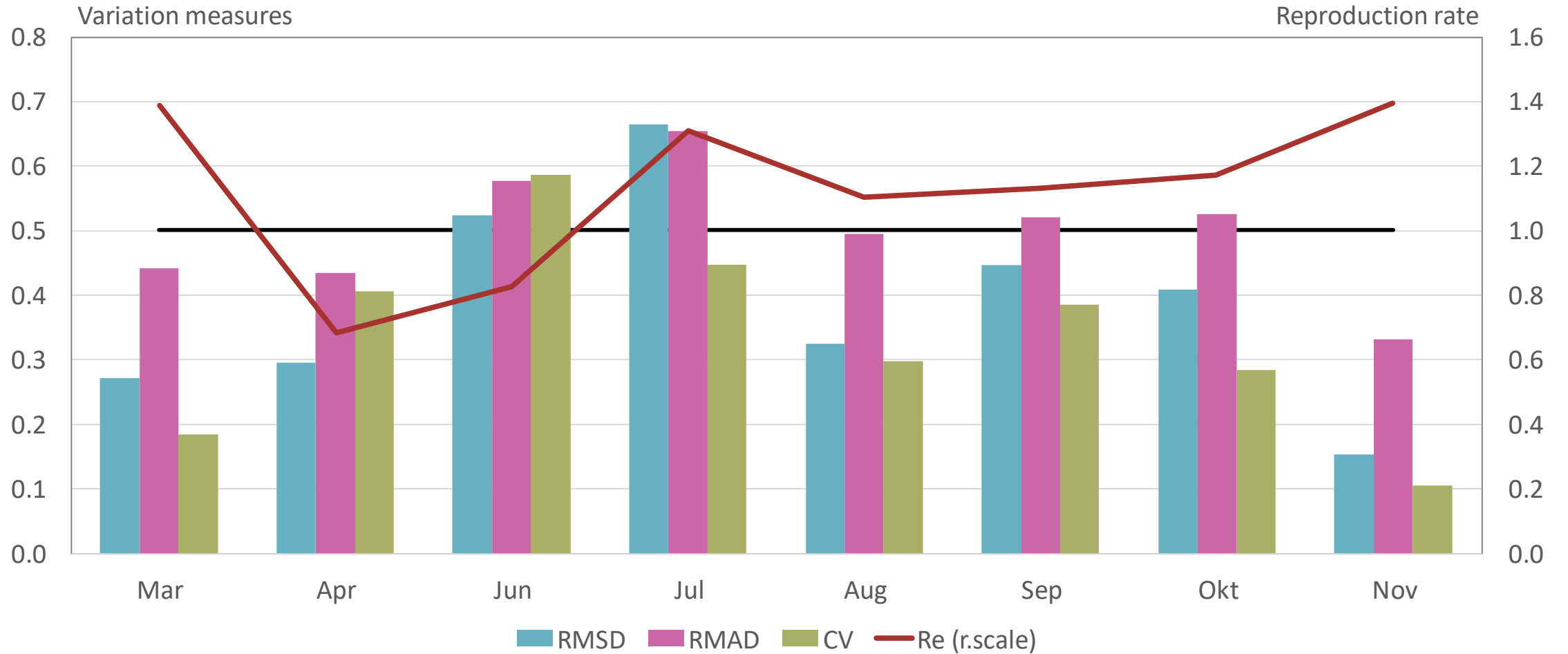
Source: Oxford

# KOF Stringency Index – cantonal differences



Source: KOF

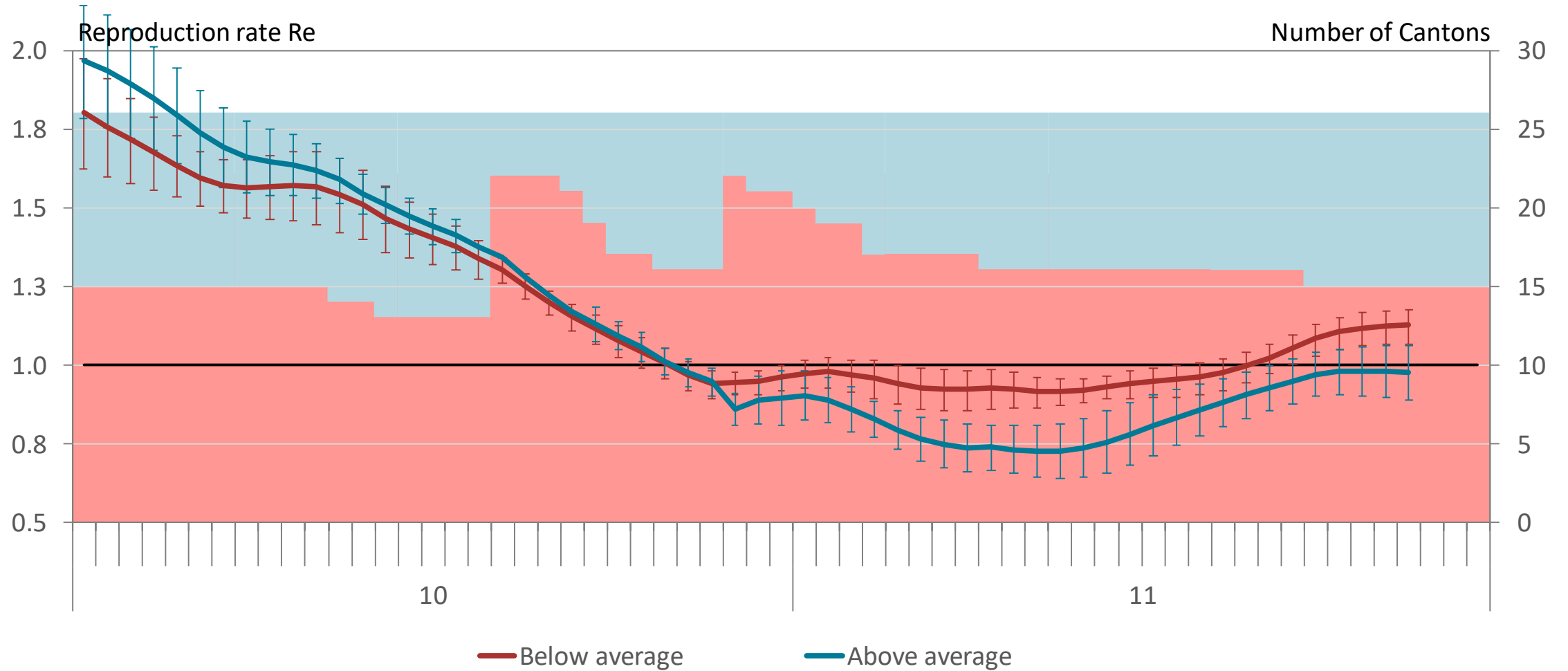
# Variation of the reproduction rate in the cantons



Sources: NCS-TF, KOF

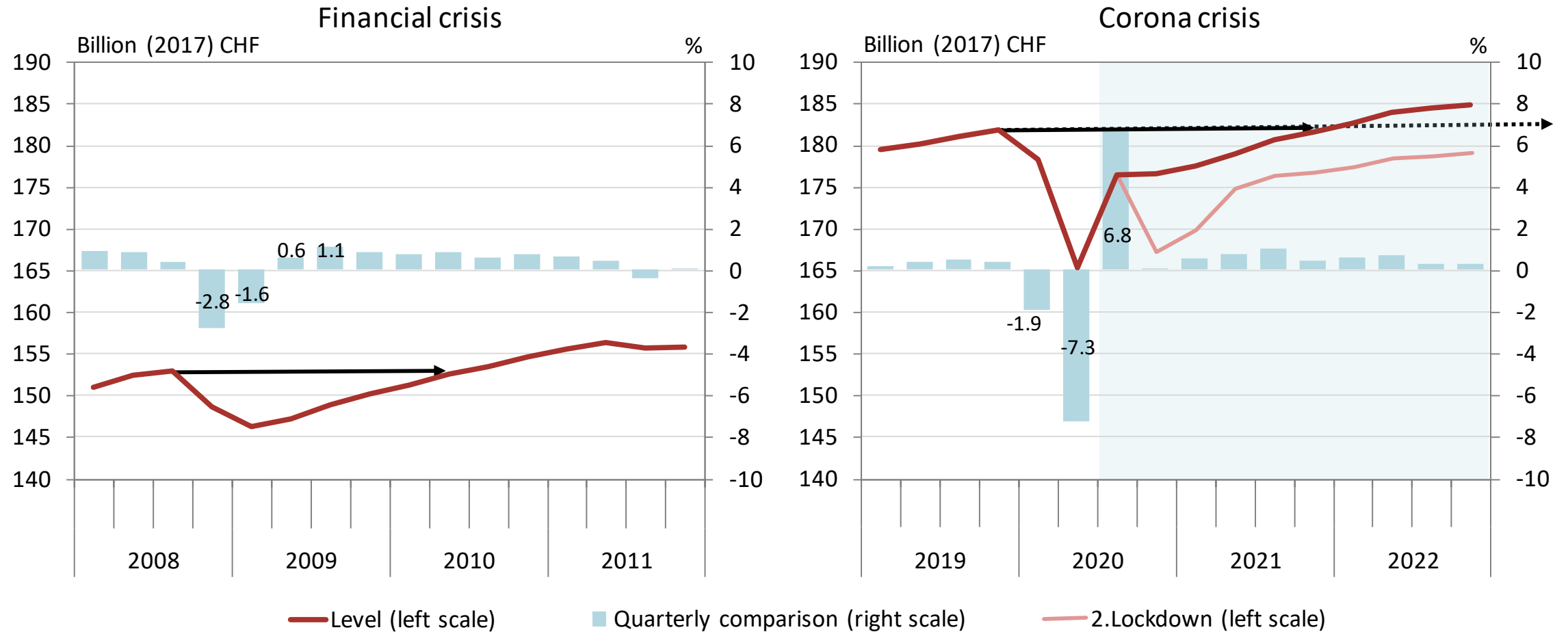


# KOF Stringency-Plus Index and Cantonal Differences in Reproduction Rates



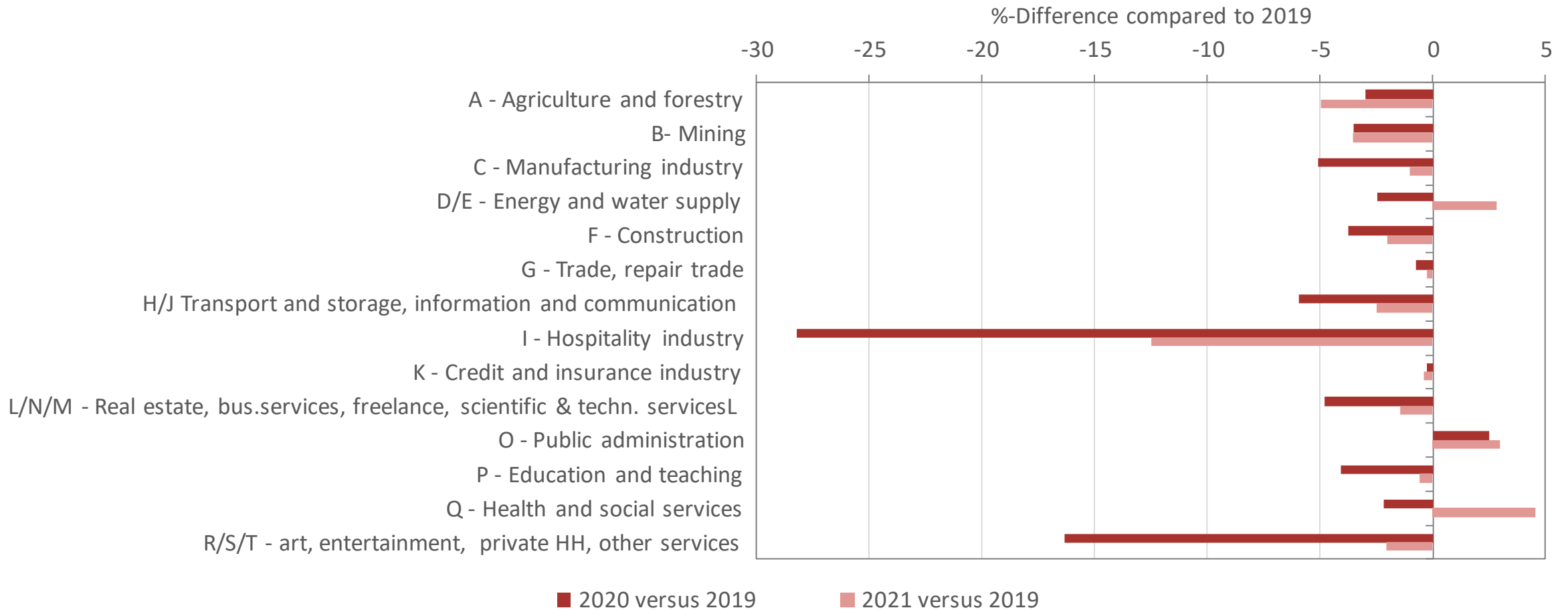
Sources: NCS-TF, KOF

# Comparison of Swiss GDP developments - financial versus corona crisis



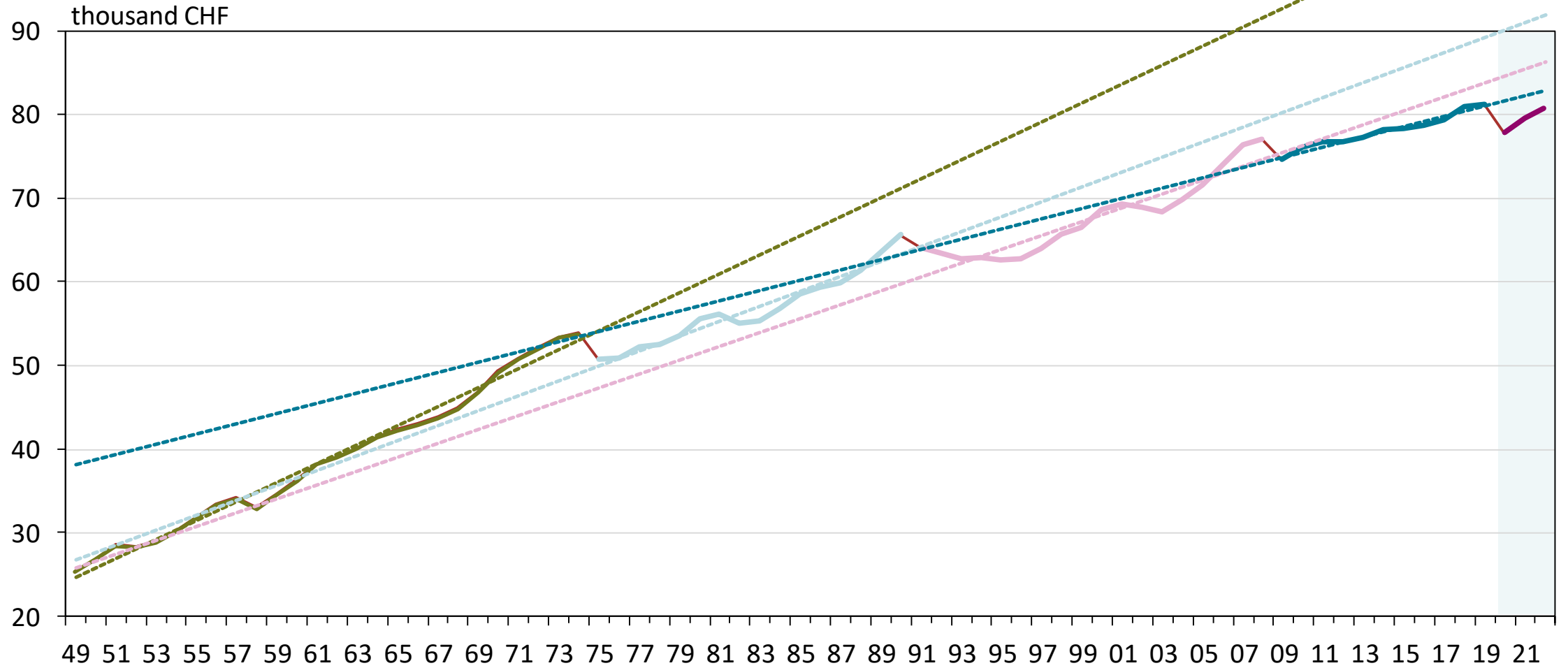
Sources: Seco, KOF

# A sector perspective for Switzerland



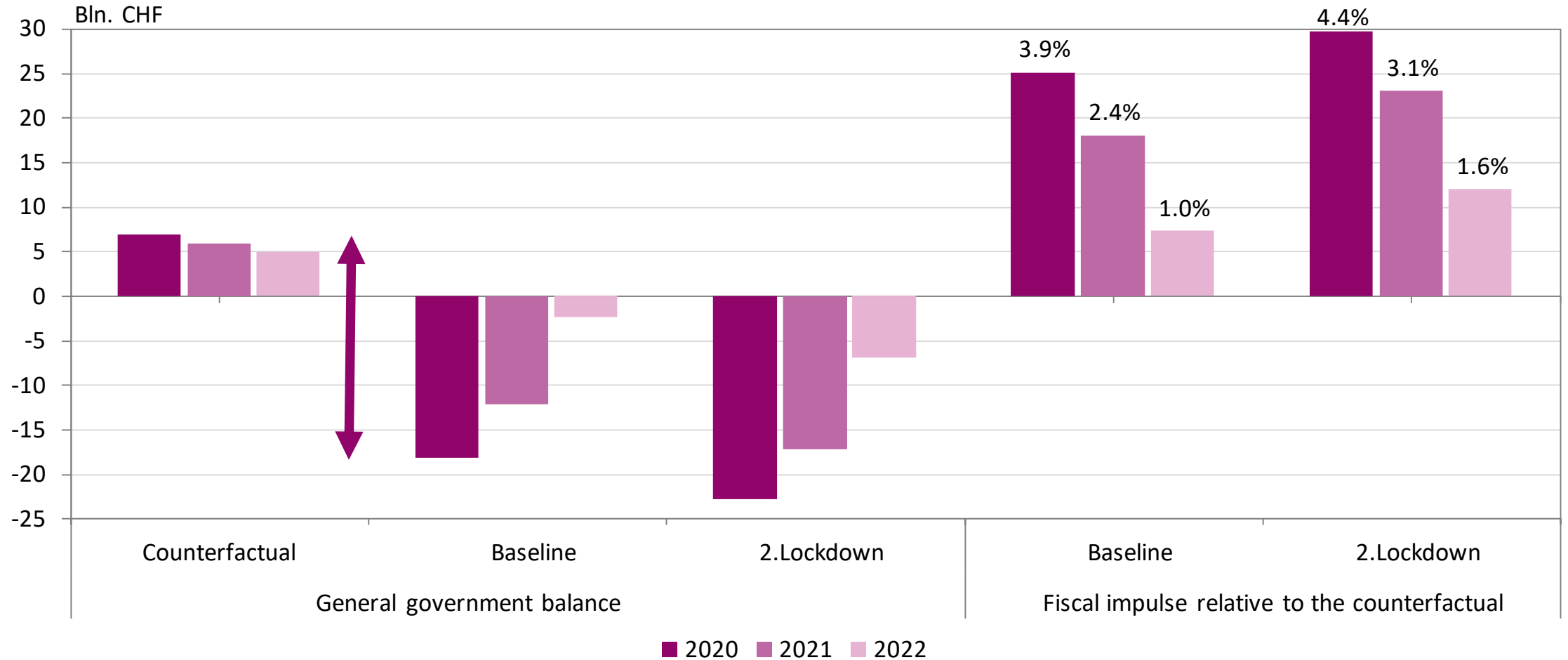
Source: KOF

# Swiss GDP per capita since 1949



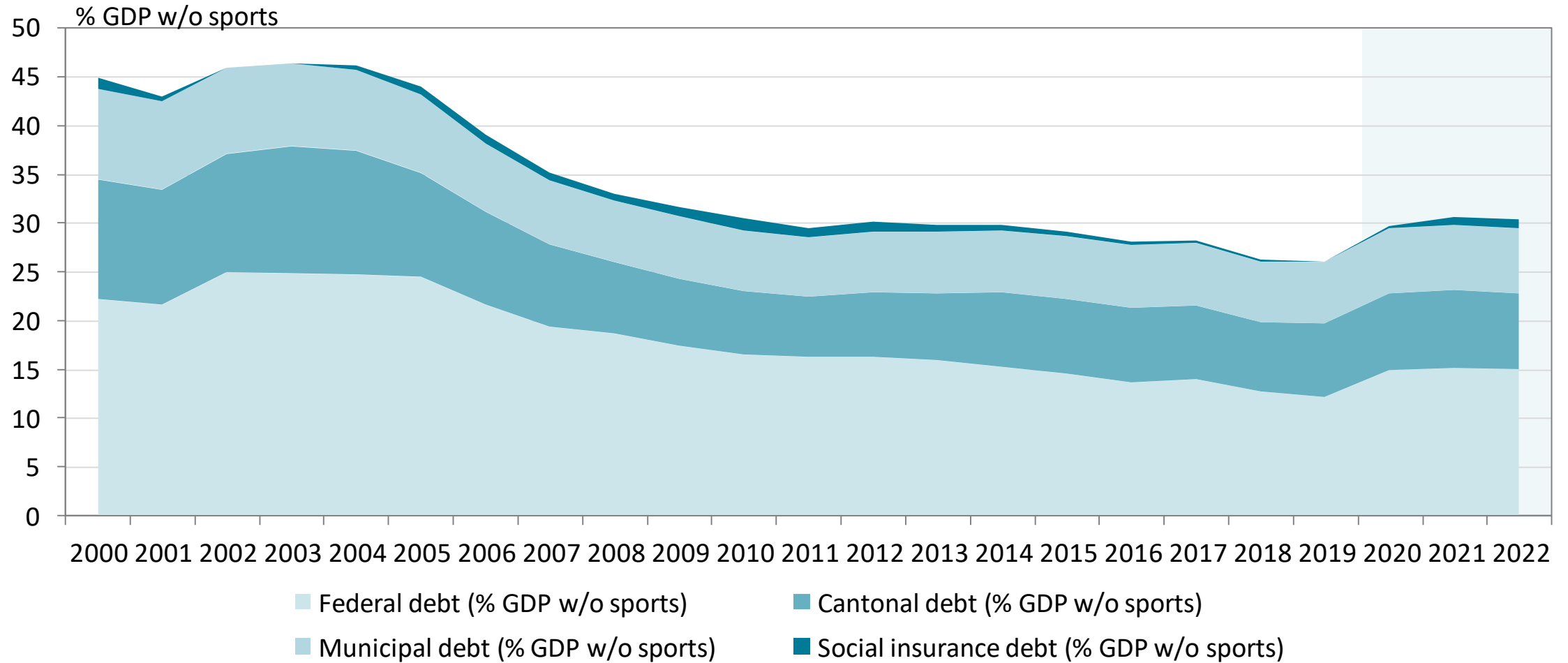
Sources: BFS, KOF

# General government balance and fiscal stimulus against a counterfactual scenario



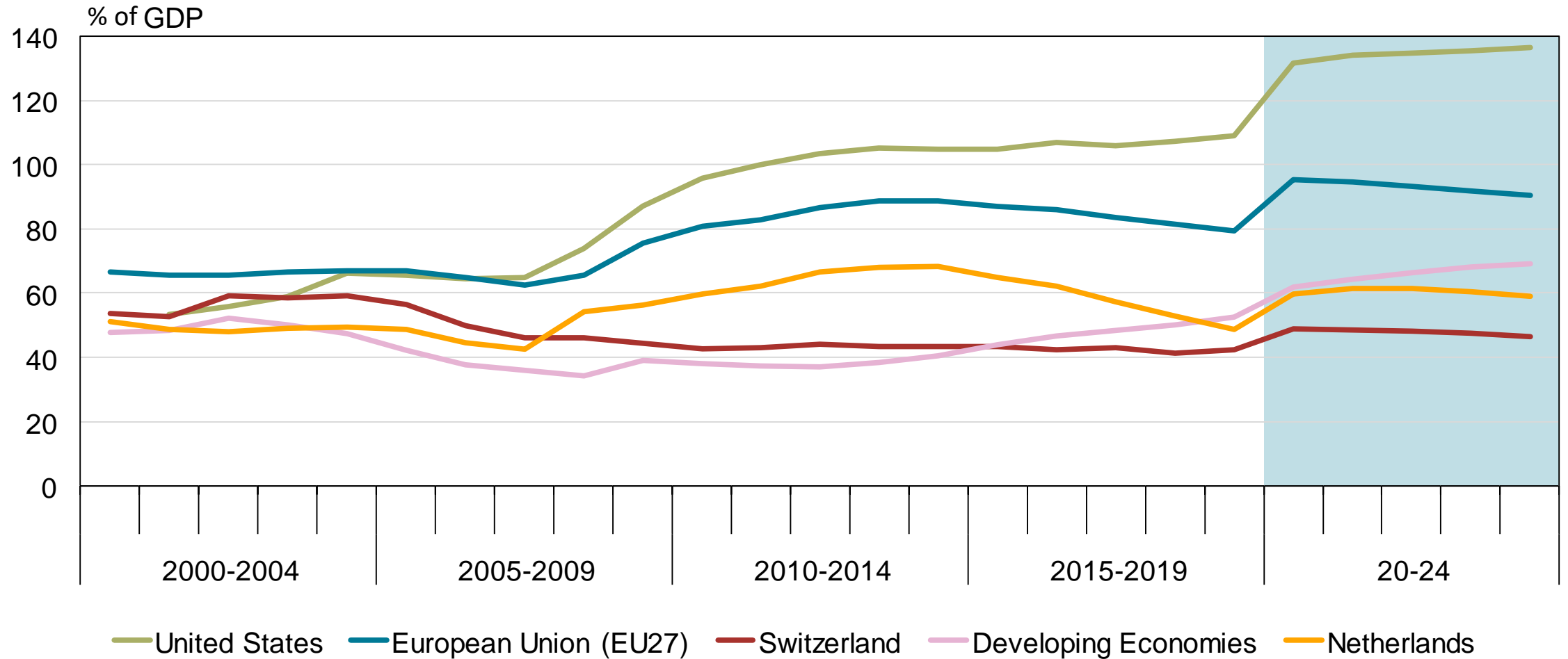
Source: KOF

- “Noch einmal ein 30 Milliarden Hilfspaket könne sich die Schweiz nicht leisten.”  
24.10.2020
  - ““Switzerland cannot afford another 30 billion aid package.”
- “Wir könnten dann mindestens einmal die Olympischen Spiele auf dem Schuldenberg haben. Der wird so hoch das es dort sicher schneesicher ist.”  
11.12.2020
  - “We should then be able to have the Olympic Games on our debt mountain at least once. It will be so high that snow is guaranteed there.”



Sources: EFV, BFS, KOF

# General Government Debt in selected countries/regions



Source: IMF



- Solid public finances at the beginning of the COVID-19 pandemic
- Estimated central government deficit for 2020: 21 billion (general government deficit: 25 billion)
  - The law provides for a period of six years for the reduction of this debt
  - The parliament can decide to extend the repayment period
- Current expert discussion
  - Time period over which this extraordinary debt should be paid back
  - Tax increases or acceptance of higher debt levels are hardly discussed despite -0,5% interest rate on short-term Swiss government bonds
  - Budget underruns and forecasting errors will not be discussed (negatively) in the near future
- Strong support for the debt brake in the population