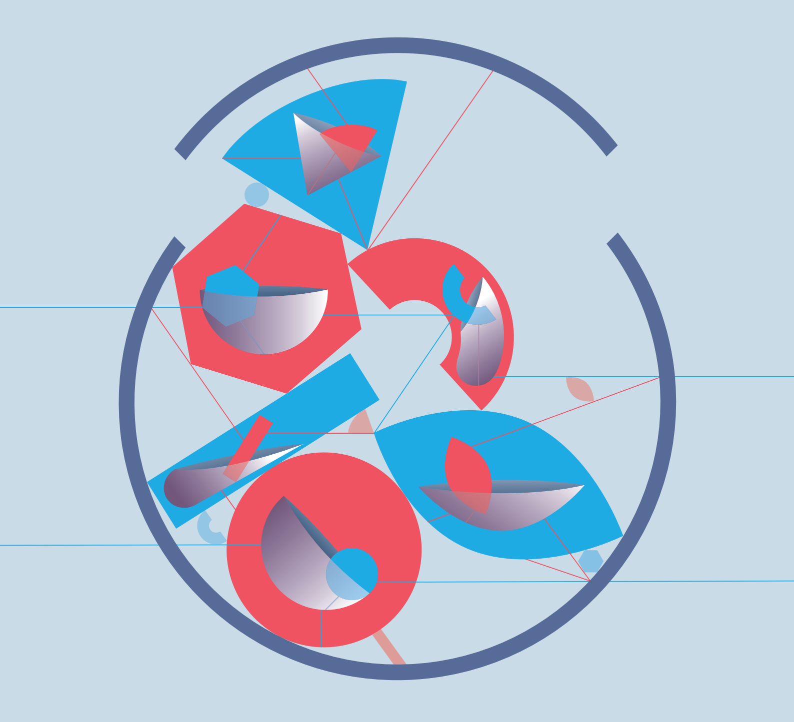


The debt brake

Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
Confederaziun svizra

Swiss Confederation

Federal Department of Finance FDF
Federal Finance Administration FFA

BRIEF SUMMARY

The debt brake is a simple mechanism for managing federal expenditure. It is designed to prevent chronic deficits and thereby an increase in debt. It enjoys strong support among the population: 85 % of voters approved the constitutional provision on the debt brake in 2001, and approval remains very high according to surveys.

With a debt ratio of 30 %, Switzerland remains in excellent shape by international standards. The debt brake has not only helped Switzerland to withstand the financial and economic crisis relatively well; it has also allowed for a considerable reduction in federal debt. As a result of the **reduction in debt** in recent years, considerable amounts can be saved on interest expenditure each year, which creates the scope for investments and other important tasks.

Despite that, the mechanism is occasionally criticised too: among other things, it has led to the federal financial statements always being significantly better than anticipated in the budget. Although the debt brake is undisputed in principle, its design and implementation are thus nevertheless a recurrent topic of discussion.

THE KEY ELEMENTS

The components of the debt brake are anchored in Article 126 of the Federal Constitution:

1 Principle	The Confederation shall maintain its receipts and expenditure in balance at all times.
2 Expenditure rule	The ceiling for total expenditure that is to be approved in the budget is based on the expected receipts after taking account of the economic situation.
3 Exception	Exceptional financial requirements may justify an appropriate increase in the ceiling in terms of paragraph 2.
4 Sanctions	If the total expenditure in the state financial statements exceeds the ceiling in terms of paragraphs 2 or 3, compensation for this additional expenditure must be made in subsequent years.
5 Implementation	The details are regulated by law.

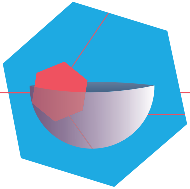
WHY A DEBT BRAKE?

The 1990s were difficult times for the finances of the Confederation. In the space of a few years, billions in deficits led to a sharp increase in debt, which was exacerbated by the funding of federal pension funds and enterprises affiliated with the Confederation.

The principle that the «shortfall in the Confederation's statement of financial position must be paid off» was already enshrined in the Constitution at that time. However, the required debt reduction remained a dead letter, a common phenomenon in politics: there is agreement on the principle, but there are always reasons for deviating as soon as it comes to implementation and the concrete individual case.

With this fiscal policy experience, there was a growing willingness on the part of the Federal Council and Parliament to impose fiscal policy restrictions on themselves via a concrete and effective **expenditure rule** in order for the good intention to actually be observed. The debt brake limits expenditure to the level of structural, i.e. cyclically adjusted, receipts. Expenditure may be increased only if its financing is secured by receipts or corresponding sacrifices, and tax reductions must be accompanied by corresponding expenditure cuts.

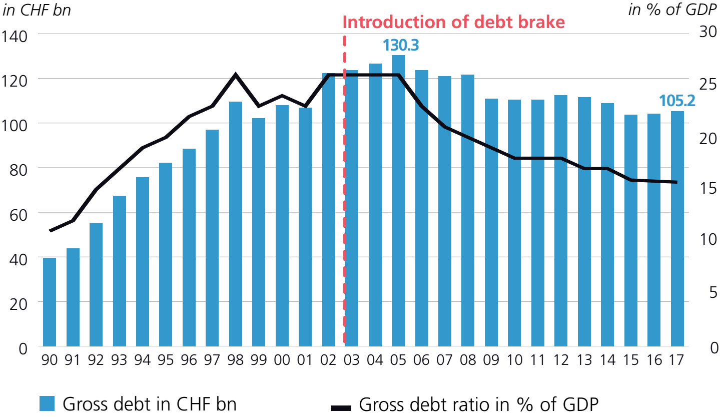
THE EFFECT OF THE DEBT BRAKE



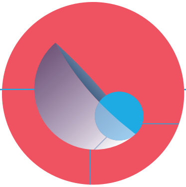
The objective of the debt brake is to **stabilise** debt. Between 2003 and 2017, federal debt was even reduced by around CHF 18.5 billion. This was due to structural surpluses, which came about because receipts were higher on the one hand, and expenditure was lower than budgeted on the other.

Forecasting errors on the receipts side are likely to decrease in the future thanks to improved estimation methods. However, as budgeted expenditure will generally not be fully utilised in the future either, debt will continue to be gradually reduced.

Debts of the Confederation 1990–2017

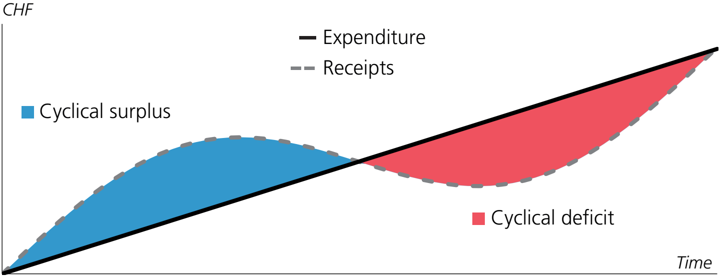


HOW THE DEBT BRAKE WORKS



In the medium term, i.e. over an **economic cycle**, the federal budget is balanced with the debt brake: surpluses must be generated during a boom to offset the deficits of the subsequent recession. Expenditure is limited to the level of structural, i.e. cyclically adjusted, receipts. This allows for a steady expenditure trend and prevents a stop-and-go policy.

Consistent path of expenditure and cyclically-dependent receipts



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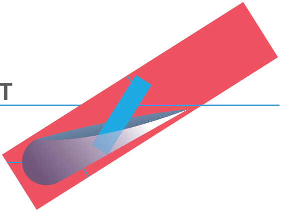
FLEXIBLE BUT EFFECTIVE NEVERTHELESS

In order for a fiscal policy rule to work, it must be stringent and binding; however, it must also allow sufficient leeway to be able to react appropriately to external developments. The debt brake ensures this flexibility by taking the current economic situation into account, as illustrated by the chart on the previous page. Furthermore, the debt brake contains an **exemption clause**: in extraordinary situations (e.g. natural disasters, severe recessions and other uncontrollable developments), it is possible to deviate from the rules and incur extraordinary expenditure. This extraordinary expenditure must be compensated for in subsequent years if it cannot be covered by extraordinary income from previous years. In this way, undue use of the exception should be prevented.

The debt brake is applied to the budget and recalculated and controlled with the annual financial statements. The cyclically adjusted surpluses and deficits are captured in the so-called compensation account. If the requirements were not met during budget implementation (e.g. due to excessive supplementary budget credits) and the compensation account therefore shows a deficit, the regulatory framework contains a clear **sanction mechanism:** the deficit of the compensation account must be fully offset.

CHALLENGES WHICH HAVE BEEN MET



The debt brake has passed several **tests** since its introduction in 2003:

- The binding guidelines of the debt brake helped to swiftly balance the federal budget when it was introduced.
- The debt brake prevented the high tax receipts from the pre-2009 economically strong years from being used for additional expenditure. Instead, it was possible to build up surpluses and reduce debt.
- The debt brake proved its worth also for inclement times during the financial and economic crisis. Thanks to the exemption clause, it was possible to temporarily strengthen the equity capital base of UBS without thereby compromising the proper performance of the Confederation’s tasks.
- In addition, the economically compatible structure of the regulations prevented expenditure from having to be cut in the recession when the crisis struck. Furthermore, it provided scope for moderate stabilisation measures.

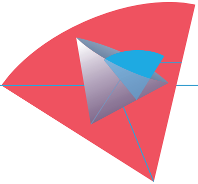
A prolonged recession would be another challenge. Switzerland has been spared this since the introduction of the debt brake.

FISCAL POLICY CHALLENGES

The debt brake and the political will to comply with its guidelines have contributed in no small degree to the recovery of the federal finances.

In view of the dynamic growth in task areas with strong statutory commitments (e.g. social welfare due to the ageing population), the long-term fiscal policy challenge will be to meet other requirements as well, while still ensuring that the financing of state services remains sustainable for public and private budgets.

Budgeted expenditure has consistently been undershot since the introduction of the debt brake, and this is also due to the economical use of funds. The surpluses thus achieved automatically lead to a reduction in debt under the applicable rules. Against this backdrop, it is being considered whether other uses should also be possible in addition to automatic debt reduction. In 2017, the Federal Council appointed a group of experts whose report initially advises against adjusting the debt brake's current structure.



TRACK RECORD

Switzerland's public finances are well positioned when compared internationally. Aside from the Confederation, most of the cantons have a debt brake too.

The success of the debt brake extends beyond Switzerland: Germany introduced a debt brake based largely on the Swiss model in 2011. Because of the sovereign debt crisis in Europe, the vast majority of EU member states undertook in the 2012 Fiscal Compact to introduce a debt brake at constitutional level.

Development of debt ratios 2003–2017

in % of GDP