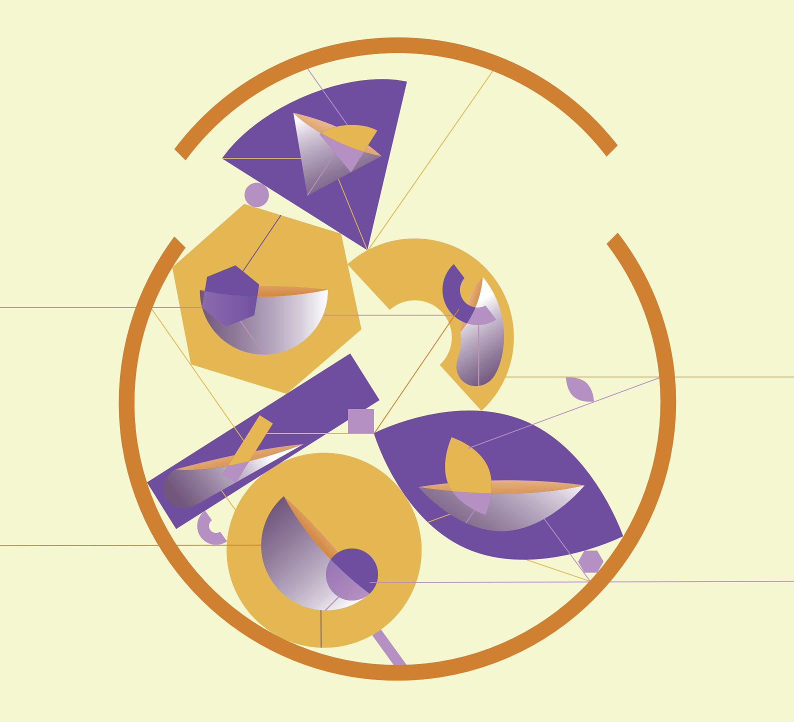


The debt brake

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 even 20 years after its introduction in 2003, the debt brake still enjoys strong support among the population and in Parliament.

With a debt ratio of around 30% of gross domestic product, Switzerland remains in excellent shape by international standards. The debt brake has not only significantly helped Switzerland to overcome multiple crises relatively well; it has also allowed for a considerable reduction in federal debt. Thanks to the debt reduction in the years before the COVID-19 crisis, the Confederation continues to save a considerable amount on interest expenditure.

The COVID-19 pandemic was the biggest test for the debt brake so far. The Confederation made CHF 30 billion available within a very short time to cushion the economic impact. The expenditure rule's flexible design allowed for this, but this debt must be reduced again. With a legislative amendment, Parliament extended the deadline for this until 2035. The consequences of COVID-19 will therefore affect the federal budget for a long time to come.

The purpose and need for further adjustments are discussed time and again, and the "right" level of national debt is the subject of lively debates. In principle, however, the achievements of the debt brake are undisputed.

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	In the event of exceptional payment requirements, the ceiling under paragraph 2 may be increased appropriately.
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 federal finances. 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.

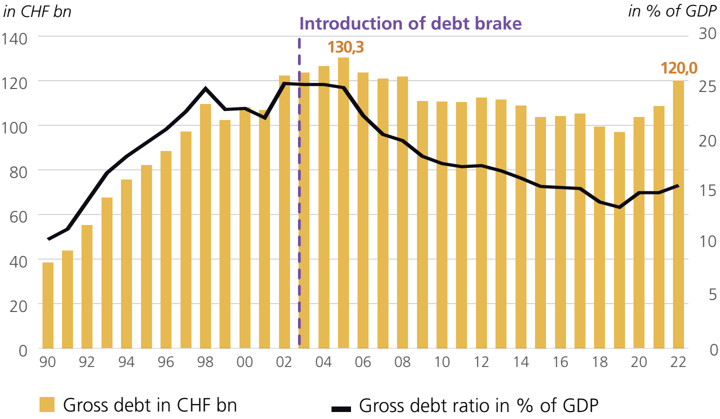
The principle that the "shortfall in the Confederation's statement of financial position must be paid off" was already enshrined in the Constitution at that time. However, the required debt reduction remained a dead letter, a common phenomenon in politics: there is agreement on the principle, but there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

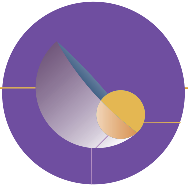
THE EFFECT OF THE DEBT BRAKE

The objective of the debt brake is to at least stabilise the debt level. Between 2003 and 2019, federal debt was even reduced by around CHF 27 billion. This was due to structural surpluses, which mainly came about because expenditure was lower than budgeted. Due to the high extraordinary expenditure during the COVID-19 pandemic, debt increased again.

Debts of the Confederation 1990–2022

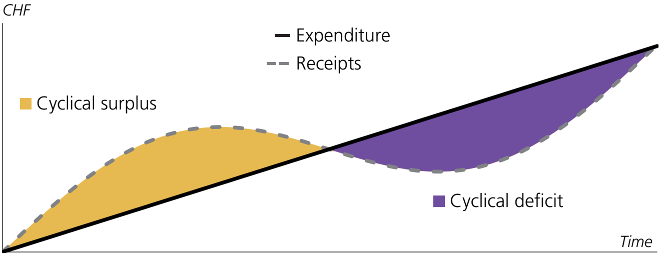


HOW THE DEBT BRAKE WORKS



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. Ordinary 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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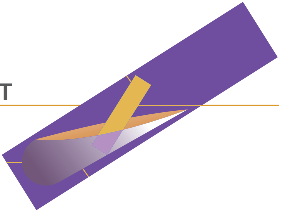
EFFECTIVE BUT FLEXIBLE NEVERTHELESS

The debt brake is applied to the budget and specifies the maximum amount the Confederation may spend. At the end of the year, the annual financial statements determine whether this ceiling for ordinary expenditure has been complied with. The so-called compensation account is used to record this. If the compensation account shows a deficit, the regulatory framework contains a clear sanction mechanism: the deficit of the compensation account must be fully offset again.

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. Furthermore, the debt brake contains an exemption clause: in extraordinary situations that cannot be controlled by the Confederation (e.g. a pandemic or a natural disaster), it is possible to deviate from the rules and incur extraordinary expenditure. This extraordinary expenditure must be offset in subsequent years if it cannot be covered by extraordinary receipts from previous years. In this way, undue use of the exception should be prevented.

The COVID-19 pandemic showed that the previous rules for offsetting shortfalls were too restrictive for such high expenditure. Therefore, a temporary legislative revision became necessary in order not to jeopardise the economic recovery through austerity programmes or tax increases. However, the Confederation has stuck to the tried and tested basic principle of the debt brake.

CHALLENGES WHICH HAVE BEEN MET



The debt brake has had to pass several tests since its introduction in 2003:

- The binding guidelines of the debt brake helped to keep the federal budget structurally balanced after it was introduced.
- The debt brake prevented the high tax receipts from the economically strong years from being used for additional expenditure. Instead, it was possible to build up surpluses and reduce debt.
- In addition, the economically compatible structure of the regulations meant that expenditure did not have to be cut in periods of recession.
- The debt brake has also proven to be crisis resistant. Thanks to the exemption clause, it was possible to incur high extraordinary expenditure without compromising the proper performance of the Confederation's tasks. This helped stabilise UBS during the 2008 financial crisis and cushion the economic impact during the 2020–2022 COVID-19 pandemic.

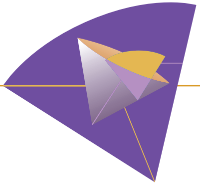
CURRENT AND FUTURE CHALLENGES

The debt brake and the political will to comply with its guidelines have contributed a great deal 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, which is due to the economical use of funds. As a result, the Confederation does not have to borrow in order to finance its ordinary tasks. But the constantly growing receipts have also made it easier to adhere to the expenditure rule – a longer recession and the associated slump in tax receipts would seriously put the debt brake to the test. A new extreme event that would require high spending would be another test.

TRACK RECORD



Switzerland's public finances are well positioned when compared internationally. In addition to the Confederation, most cantons also have a debt brake.

The success of the debt brake extends beyond Switzerland: Germany introduced a debt brake based largely on the Swiss model in 2011.
The sovereign debt crisis in Europe led to the fact that the vast majority of EU countries committed themselves to anchoring a debt brake in their national legislation as part of the Fiscal Compact of 2012.

Development of debt ratios 2003–2022

in % of GDP