The debt brake – a success story

Schweizerische Eidgenossenschaft
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Swiss Confederation

Federal Department of Finance FDF

Preface

On 2 December 2001, 85% of Swiss voters approved the constitutional provision on the debt brake. This strong support contributed significantly to the successful implementation of the debt brake in recent years. With a debt ratio of less than 40%, Switzerland remains in very good shape by international standards.

The debt brake is a simple mechanism for managing federal expenditure. It is designed to prevent chronic deficits and thereby an increase in debt. The debt brake's strength lies in the clear and binding setting of rules. This has brought us a stable and forward-looking fiscal policy.

The debt brake has not only contributed significantly to Switzerland withstanding 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 over the past few years, around CHF 1 billion can now be saved on interest expenditure, thereby creating the scope for investments and new important tasks.

Eveline Widmer-Schlumpf, Head of the Federal Department of Finance

The key elements

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

Principle The Confederation shall maintain its income and expenditure in balance at all times.

Rule The ceiling for total expenditure that is to be approved in the budget is based on the expected income after taking account of the economic situation.

Exception Exceptional financial requirements may justify an appropriate increase in the ceiling in terms of paragraph 2.

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.

Implementation The details are regulated by law.

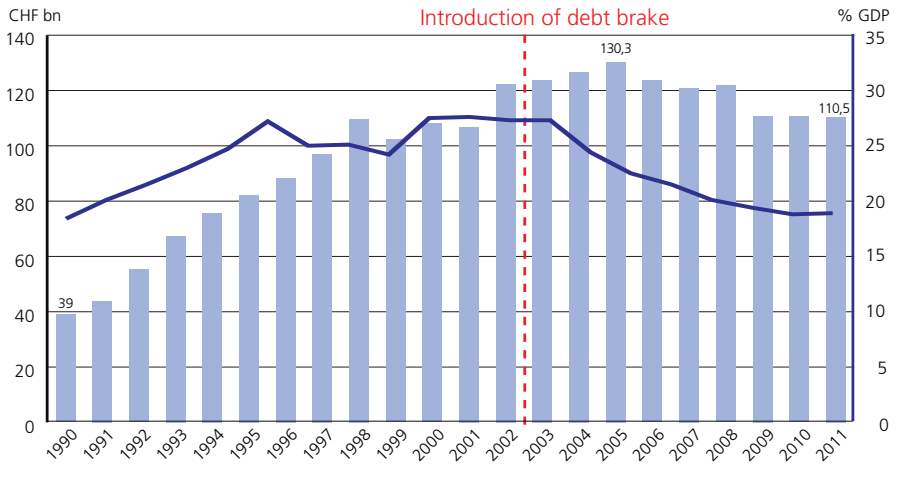
Why a debt brake?

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 Confederation must maintain its receipts and expenditure in balance at all times was already enshrined in the Constitution at that time, but it remained a dead letter, a common phenomenon in politics: there is agreement on the principle, but there are thousands of reasons and individual interests for deviating when it comes to concrete individual cases.

With the fiscal policy experience, there was a growing willingness on the part of the Federal Council and parliament toward the end of the last century to impose fiscal policy restrictions on themselves via concrete and effective **expenditure rules** in order for the principle to actually be observed: the debt brake requires expenditure to be linked to receipts when budgeting. Expenditure may be increased only if its financing is secured by additional receipts or corresponding sacrifices, and tax reductions must be accompanied by corresponding spending cuts.

The effect of the debt brake



Debts of the Confederation 1990–2011

Gross debt (CHF bn)

Gross debt ratio (% GDP)

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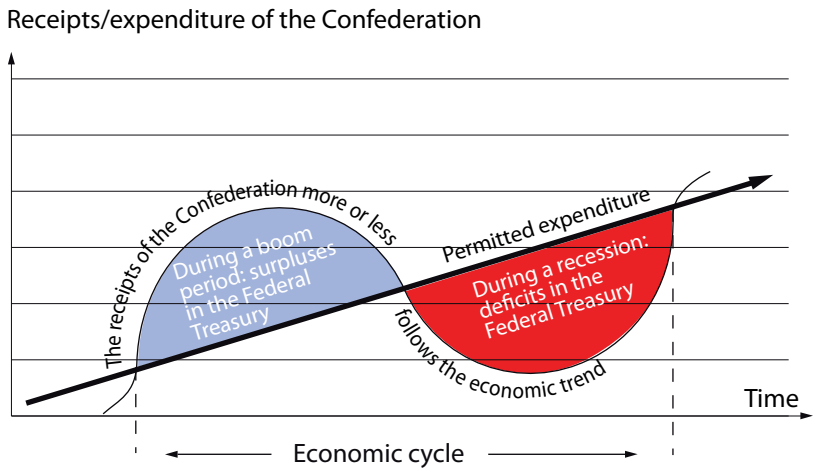
Flexible but effective nevertheless

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 next 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 make extraordinary expenditure. This extraordinary expenditure must be compensated for again in subsequent years. In this way, undue use of the exception should be prevented.

The debt brake is applied to the budget. If its specifications are circumvented when implementing the budget (e.g. via excessive additional credit), the regulatory framework contains a clear **sanction mechanism**: overruns must be fully compensated for. The debt brake thus acts in an extremely effective manner.

How the debt brake works



In the medium term, i.e. over an economic cycle, the federal budget is balanced by using the debt brake. Surpluses have to be managed in boom periods so as to compensate for deficits in subsequent recessions. By and large, there is no need for new borrowing.

Challenges which have been met

Three challenges have been met since the introduction of the debt brake in 2003:

1. When it was introduced, the binding guidelines of the debt brake helped to swiftly balance the federal budget again.

2. The debt brake prevented the high tax receipts from the economically strong years before 2009 from being used for additional expenditure. Instead, it was possible to build up surpluses and reduce debt.

3. The debt brake also proved itself in economically adverse 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 normal mandates of the Confederation. 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.

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. The robustness which has been achieved should be maintained and indeed increased further in the future. To do this, budgetary adjustments will occasionally be required.

While the debt brake ensures a balance between receipts and expenditure, the optimum weighting of the tasks within the federal budget is thereby still not guaranteed, however. 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 (e.g. developing and maintaining the transport infrastructure), so that financing state services remains sustainable for public and private budgets. The setting of priorities required for this very often has to be prepared and fought for in drawn-out political decision-making processes. These processes must therefore be initiated early enough and consistently followed up. This will allow compliance with the debt brake while maintaining a healthy budget.

Track record

International comparison of debt 2005 / 2012
(percentage of GDP)

	2005	2012	Diff. in PP
Switzerland	53	37	-16
Sweden	50	36	-14
Austria	64	76	+11
Germany	69	84	+15
Italy	105	120	+15
Euro zone	70	91	+20
Netherlands	52	68	+16
France	67	90	+23
United Kingdom	43	95	+52
Ireland	27	113	+86

Source: FFA / OECD (2012: estimate)

Switzerland's public finances are among the very best when compared internationally. Along with the Confederation, the cantons and communes have also been well managed in the past few years.

Many cantons have also introduced debt brakes, and similar mechanisms are being discussed for social security.

But the scope of the debt brake extends even further: Germany was the first to introduce a debt brake, basing it largely on the Swiss model. In the meantime, the debt crisis in Europe has resulted in the vast majority of EU countries contractually undertaking to incorporate a debt brake at constitutional level.