BAK
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BAK press release: Sustainability of financial policy 2018

Low taxes and spending discipline: Swiss public finances healthy

BAK Economics, 27.12.2018 (Basel/Zurich): Unlike most European countries, especially Italy and France, in Switzerland taxes are low and public finances viable into the future. This is the conclusion of the latest BAK study on the sustainability of fiscal policy. The cantons therefore have the necessary fiscal leeway to offer a tax burden that is attractive by international standards over the longer term.

The Swiss federation and cantons have sustainable budgets. Most Swiss cantons have no problem in reaching the sustainability criterion used by the EU out to 2032 (a fiscal gap below zero assuming a target debt level of 60% of GDP). The cantons therefore stand out positively against most European countries. Of neighbouring countries, only Germany has a financial policy that is sustainable. Austria falls just short of the criterion. France and Italy are well adrift. Given the current budget plans of the Italian and French governments, this is unlikely to change anytime soon.

The study shows that the Swiss cantons do very well on an international comparison in terms of government debt in particular. With budgets the picture is more mixed; in most cantons they are in the green zone, but a few are in red territory. It is important to note that the calculations are based on cantonal finances over the period 2012 to 2016. As is the case almost everywhere in Europe, Swiss cantonal finances face challenges from demographic trends, for example in the form of higher spending on health and care. Given the sound financial position the cantons are starting from, these costs are manageable.

Sustainability in terms of financial policy has consequences for tax policy. Places where finances are sustainable can keep the tax burden steady or even lower it over the longer term; where they are unsustainable, tax hikes loom. As the BAK Taxation Index shows, the Swiss cantons do excellently in the international tax ranking. This applies to the taxation of corporations and highly qualified employees. International tax competition has stiffened recently, however, especially in corporate taxation. This can be seen for instance in the US tax reform, and also in the international pressure on special tax arrangements like Swiss tax privileges. In this context the planned Tax Proposal and AHV Financing package (STAF) in Switzerland is crucial, as it allows the Swiss cantons to further refine their tax systems to make them competitive and sustainable. A sustainable financial policy gives the cantons the room for manoeuvre they need to be able to shoulder such a reform.

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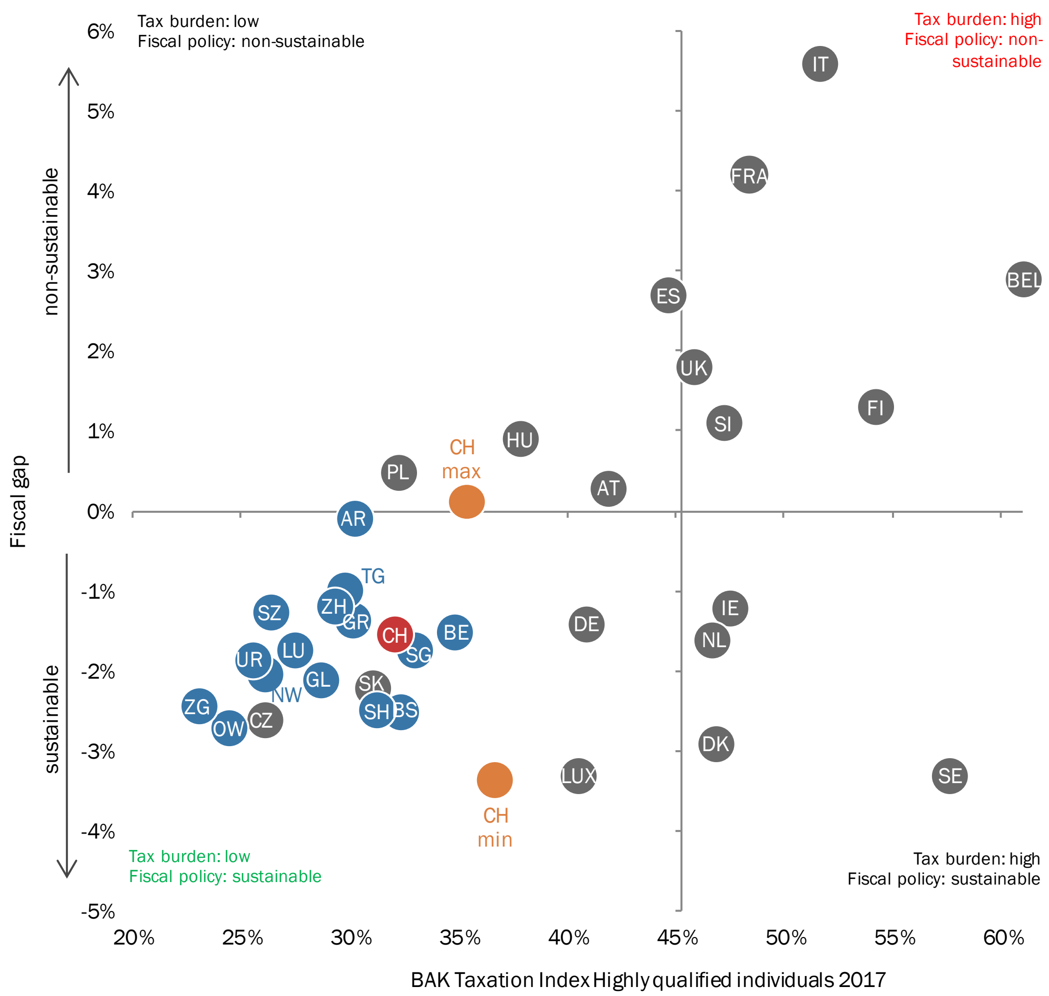
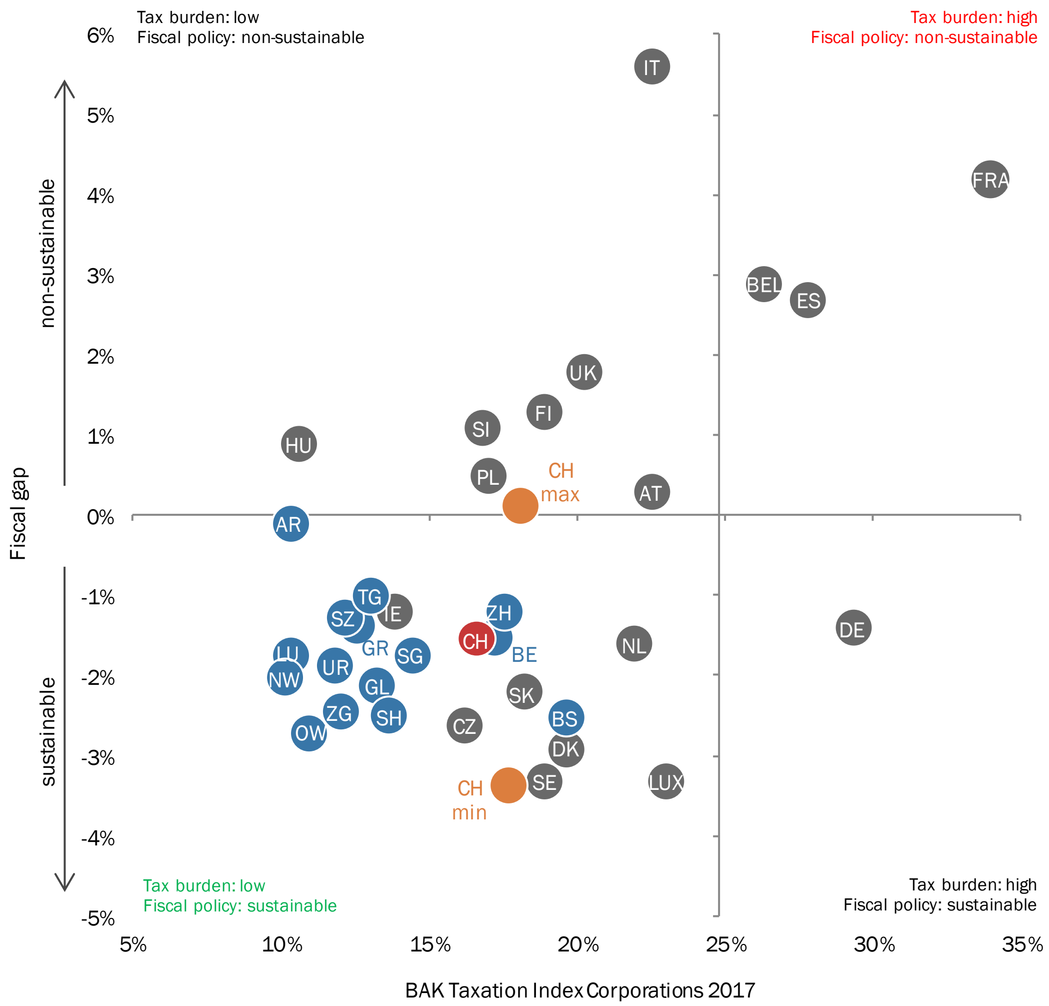
Combined view of tax burden on highly qualified individuals and financial sustainability



X axis: Effective average tax burden for highly qualified individuals (single, no children, income EUR 100,000) in the main locations (exception: Italy: Lombardy); X axis cuts the Y axis at the average tax rate of the countries under review. Y axis: Fiscal gap = Extent by which the primary balance ratio in the base year (2019) would have to be adjusted in order to achieve a gross debt ratio of 60% by 2032; positive values: achievement of target entails improvement of primary balance ratio; negative values: achievement of target ensured even if primary balance ratio deteriorates. Swiss cantons including communes and assigned federal share (including social insurance). Of the Swiss cantons, all project sponsors are shown in blue; the canton with the smallest fiscal gap (CH min = most sustainable canton) and the canton with the largest fiscal gap (CH max = least sustainable canton) are shown in orange.

Source: BAK Economics / ZEW

Combined view of tax burden on corporations and financial sustainability



X axis: Effective average tax burden for corporations in the main locations (exception: Italy: Lombardy); X axis cuts the Y axis at the average tax rate of the countries under review. Y axis: Fiscal gap = Extent by which the primary balance ratio in the base year (2019) would have to be adjusted in order to achieve a gross debt ratio of 60% by 2032; positive values: achievement of target entails improvement of primary balance ratio; negative values: achievement of target ensured even if primary balance ratio deteriorates. Swiss cantons including communes and assigned federal share (including social insurance). Of the Swiss cantons, all project sponsors are shown in blue; the canton with the smallest fiscal gap (CH min = most sustainable canton) and the canton with the largest fiscal gap (CH max = least sustainable canton) are shown in orange.

Source: BAK Economics / ZEW

Fiscal gap and BAK Taxation Index 2017 for corporations and highly qualified individuals

Code	Country/Canton	Fiscal gap	Tax burden corporations	Tax burden highly qualified individuals
CH min	CH Minimum	-3.4%	17.7%	36.7%
LUX	Luxembourg	-3.3%	23.0%	40.5%
SE	Sweden	-3.3%	18.9%	57.6%
DK	Denmark	-2.9%	19.6%	46.8%
OW	Obwalden	-2.7%	10.9%	24.4%
CZ	Czech Republic	-2.6%	16.2%	26.1%
BS	Basel-Stadt	-2.5%	19.6%	32.3%
SH	Schaffhausen	-2.5%	13.6%	31.2%
ZG	Zug	-2.4%	12.0%	23.0%
SK	Slovakia	-2.2%	18.2%	31.0%
GL	Glarus	-2.1%	13.2%	28.6%
NW	Nidwalden	-2.0%	10.1%	26.1%
UR	Uri	-1.9%	11.8%	25.5%
SG	St. Gallen	-1.7%	14.4%	33.0%
LU	Lucerne	-1.7%	10.3%	27.4%
NL	Netherlands	-1.6%	21.9%	46.7%
CH	Switzerland	-1.5%	16.6%	32.1%
BE	Bern	-1.5%	17.2%	34.8%
DE	Germany	-1.4%	29.3%	40.9%
GR	Grisons	-1.4%	12.5%	30.1%
SZ	Schwyz	-1.3%	12.1%	26.3%
IE	Ireland	-1.2%	13.8%	47.5%
ZH	Zurich	-1.2%	17.5%	29.3%
TG	Thurgau	-1.0%	13.0%	29.7%
AR	Appenzell Ausserrhoden	-0.1%	10.3%	30.2%
CH max	CH Maximum	0.1%	18.1%	35.4%
AT	Austria	0.3%	22.5%	41.9%
PL	Poland	0.5%	17.0%	32.2%
HU	Hungary	0.9%	10.6%	37.8%
SI	Slovenia	1.1%	16.8%	47.2%
FI	Finland	1.3%	18.9%	54.2%
UK	United Kingdom	1.8%	20.2%	45.8%
ES	Spain	2.7%	27.8%	44.6%
BEL	Belgium	2.9%	26.3%	61.0%
FRA	France	4.2%	34.0%	48.4%
IT	Italy	5.6%	22.5%	51.6%

Fiscal gap = Extent by which the primary balance ratio in the base year (2019) would have to be adjusted in order to achieve a gross debt ratio of 60% by 2032; positive values: achievement of target entails improvement of primary balance ratio; negative values: achievement of target ensured even if primary balance ratio deteriorates Swiss cantons including communes and assigned federal share (including social insurance). Of the Swiss cantons, all project sponsors are shown; the canton with the smallest fiscal gap (CH min = most sustainable canton) and the canton with the largest fiscal gap (CH max = least sustainable canton) are shown in orange. Tax burden according to BAK Taxation Index 2017 (see also remarks on the charts above).

Source: BAK Economics / ZEW

Sustainability of fiscal policy

The evaluation of fiscal sustainability in the context of the BAK Taxation Index is based on an EU indicator used to monitor the financial sustainability of the member states (latest publication: 'Debt Sustainability Monitor 2017'). In specific, this is the 'fiscal gap indicator S1' which has been designed to evaluate fiscal sustainability in the (medium-term) period 2019 (base year) to 2032.

The fiscal gap indicator depends on a country's intertemporal budget constraint, which requires that the present value of the target debt plus all future revenue must cover the present value of the initial debt plus all future expenditure. The target debt is assumed to be a debt ratio (government debt as a percentage of GDP) of 60% for all locations. This figure is in line with the Maastricht criteria and ensures comparability of the results of different regional administrative bodies. The impact of demographic change is included in the future expenditure.

The fiscal gap indicator that is derived from the intertemporal budget constrain is defined as the difference between the sustainable primary balance ratio and the primary balance ratio in the base year (the primary balance ratio is consistent with the primary balance – i.e. the difference between primary income and primary expenses – as a percentage of GDP). The sustainable primary balance ratio is the primary balance ratio that would have to be achieved every year starting from the base year (2019) in order to achieve a gross debt ratio of 60% at the end of the reference period (2032). Hence the fiscal gap indicates the extent by which the primary balance ratio in the base year would have to be adjusted to achieve the gross debt ratio of 60%. It should be noted that, according to the interpretation of the fiscal gap, negative values indicate sustainable fiscal policy and positive values non-sustainable fiscal policy.

The following two examples illustrate the interpretation of the fiscal gap: In the BAK Taxation Sustainability Module, Belgium's fiscal gap amounts to 2.9% and the country's primary balance ratio in the base year (2019) to -0.9%. This means that, every year in the period 2020 to 2032, Belgium requires a primary balance ratio that exceeds the primary balance ratio in the base year by 2.9% percentage points, i.e. a primary surplus ratio of 2.0% (= sustainable primary balance ratio), in order to achieve a gross debt ratio of 60% in 2032. Conversely, the fiscal gap in the Canton of Lucerne amounts to –1.7% and the primary balance ratio in the base year (2019) to -0.4%. In theory, in the period 2020 to 2032, the Canton of Lucerne can therefore afford an annual primary balance ratio that is -1.7% percentage points lower than that in the base year, i.e. a primary deficit ratio of -2.1% (=sustainable primary balance ratio), and still achieve the target debt ratio of 60% in 2032.

The cantonal data are processed such that the individual cantons include both their communes and a federal share (including social insurance) that is commensurate with their economic performance. Hence, the total of all cantons represents the country as a whole.

A separate methodology paper relating to this study provides a detailed overview of the approach and sources used. The methodology paper and further information and studies pertaining to the BAK Taxation Index project are available at www.baktaxation.com → Sustainability of Fiscal Policy.