Sustainability of fiscal policy 2021

Results

09.11.2021

Contents

Problem

- In combination, the BAK Taxation Index (current tax rates) and the sustainability of fiscal policy provide a comprehensive picture of a location's tax attractiveness.
- The sustainability of a location's fiscal policy is an indicator of the state of health of its public finances and hence of the sustainability of its current tax level:
  - Sustainably financed locations can afford the current taxation level in the long term
  - Non-sustainably financed locations are likely to require tax raises
- This module of the BAK Taxation Index studies how sustainable the fiscal policy pursued by the Swiss cantons is in national and European comparison.

Sustainability indicator I

- The study is based on the fiscal policy monitoring process carried out by the EU („Debt Sustainability Monitor 2020“). The EU’s fiscal gap indicator S1, which has been designed to evaluate sustainability in the (medium-term) for a period of 15 years, serves as the methodological foundation.
- Due to the corona-crisis, debt levels increased substantially in several countries. In order to compare countries without this special effect, the EU chose a specific base year for each country in which the budget situation has returned to normal according to forecasts. Hence the base years of the countries differ.
- For the Swiss cantons, the analyses were based on the assumption that the financial situation will return to normal in 2022. Hence the base year for the Swiss cantons is 2022. The cantons' debt levels were extrapolated to 2022 based on a projection by the Swiss Federal Finance Administration.

Sustainability indicator II

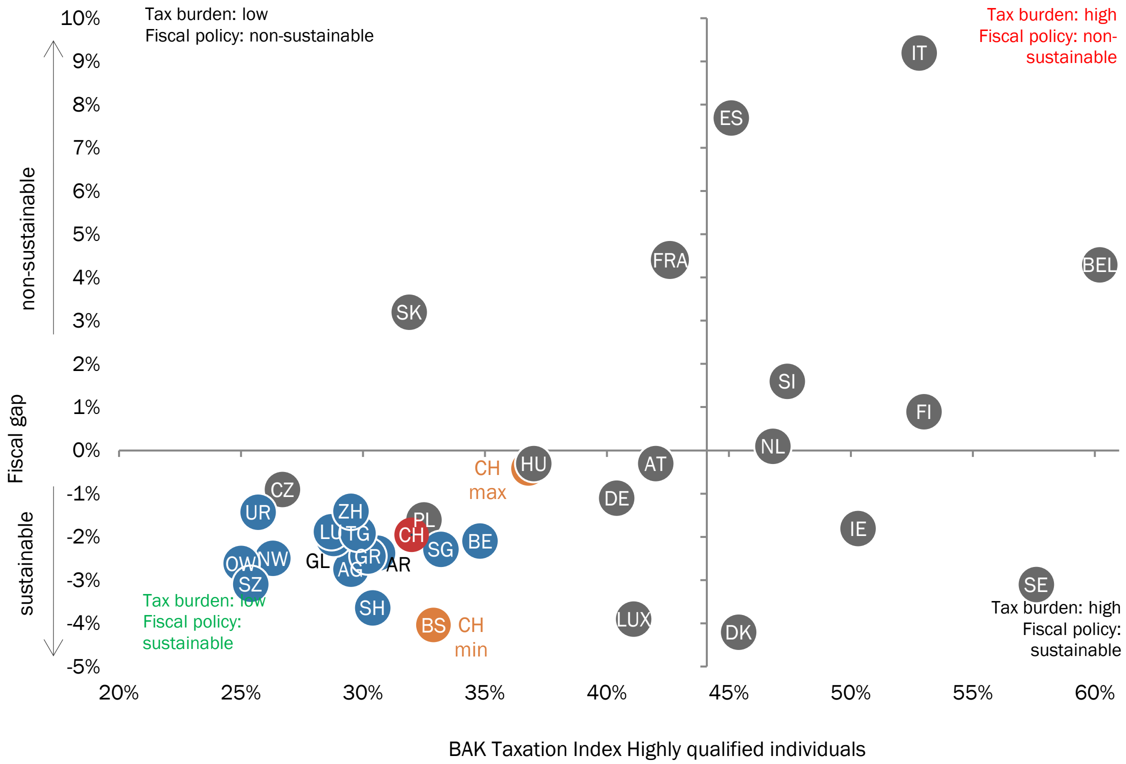
- Sustainable primary balance ratio = primary balance ratio that would have to be achieved every year starting in the base year (for Swiss cantons: 2022, differs for EU-countries) in order to achieve a gross debt ratio of 60% at the end of the 15 year reference period (Maastricht criterion).

- Fiscal gap = sustainable primary balance ratio – primary balance ratio in the base year
  - Interpretation of the indicator: The fiscal gap indicates the extent to which the primary balance ratio in the base year would have to be adjusted to achieve the gross debt ratio of 60%.
  - Value of the indicator: The bigger the fiscal gap, the less sustainable the fiscal policy. Positive values: The primary balance ratio must improve to reach the target. Negative values: The target can be reached even if the primary balance ratio deteriorates.

Sustainability indicator III

- Variables included:
  - Public debt → imbalances from the past
  - Primary balance → current budget status
  - GDP projections → revenue trend
  - Expenditure projections → inclusion of demographic change
- The cantons' debt levels were extrapolated to 2022 based on a projection by the Swiss Federal Finance Administration.
- Detailed description of methodology can be found in the “Methodenbericht” (available only in German)

Sustainability and BAK Taxation Index for highly qualified individuals



Annotations:

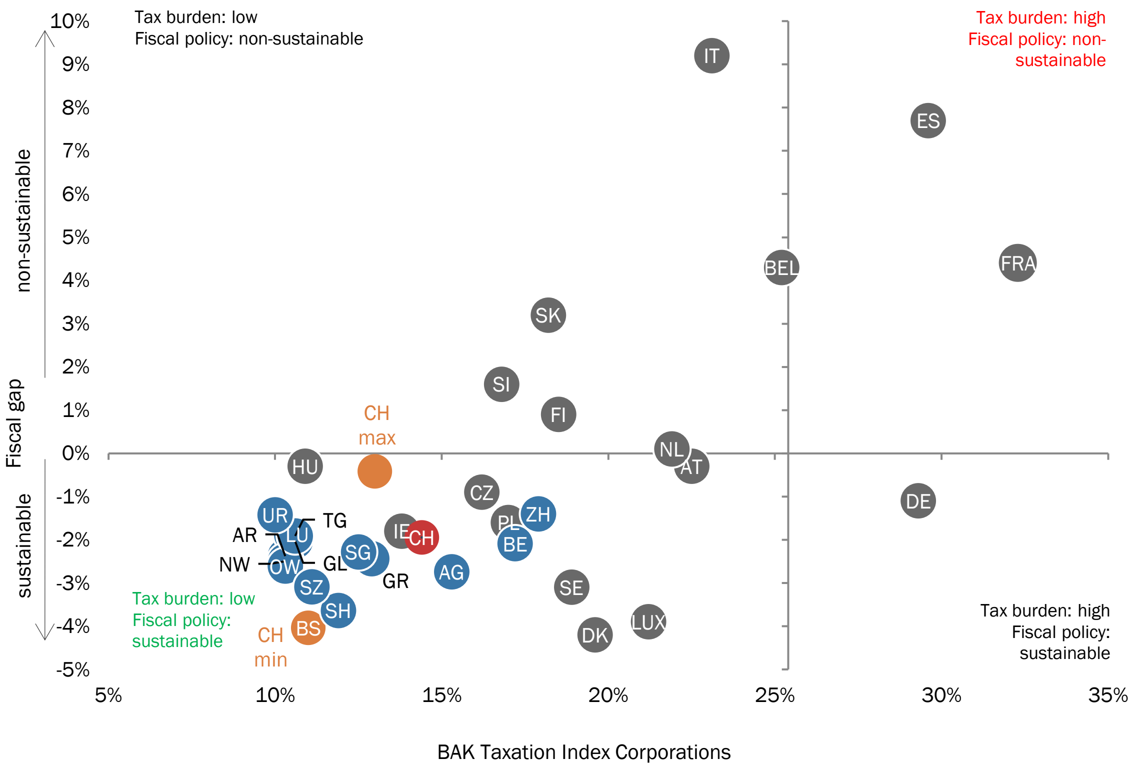
X axis: Effective average tax burden for highly qualified individuals (single, no children, income EUR 100,000, CH: 2020, EU: 2019) in the main locations (exception: Italy: Lombardy); X axis cuts the Y axis at the average tax rate of the countries under review.

Y axis: Fiscal gap = Extent by which the primary balance ratio in the base year (for Swiss cantons: 2022, differs for EU-countries) would have to be adjusted in order to achieve a gross debt ratio of 60% at the end of the 15-year-period; 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

Sustainability and BAK Taxation Index for corporations



Annotations:

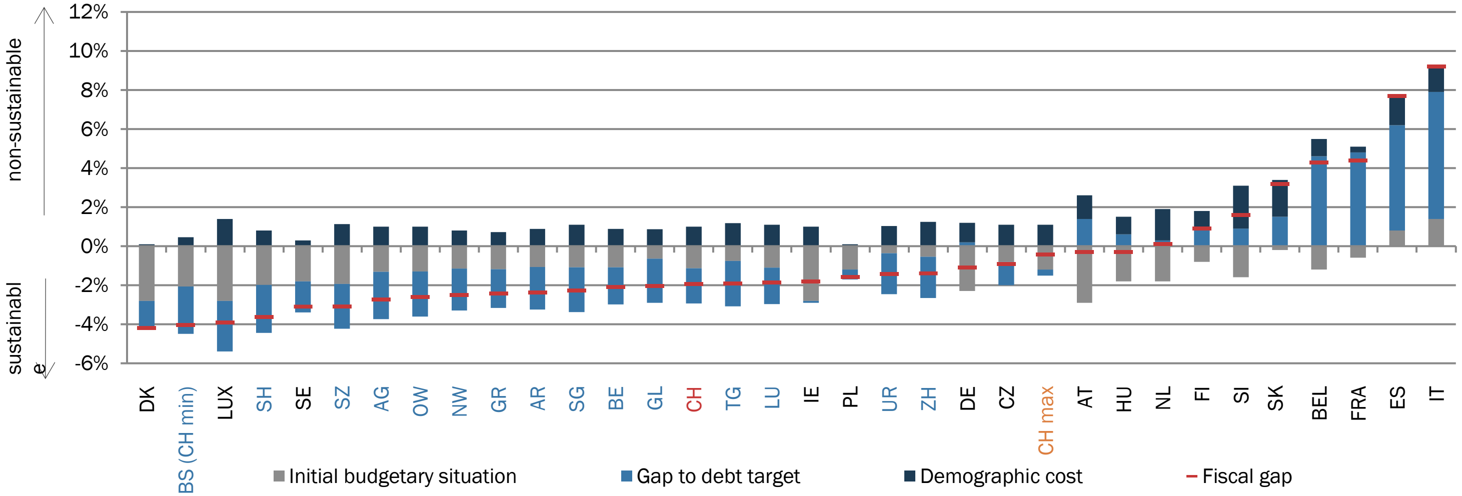
X axis: Effective average tax burden for corporations in the economic main locations (CH 2020, EU 2019); X axis cuts the Y axis at the average tax rate of the countries under review.

Y axis: Fiscal gap = Extent by which the primary balance ratio in the base year (for Swiss cantons: 2022, differs for EU-countries) would have to be adjusted in order to achieve a gross debt ratio of 60% at the end of the 15-year-period; 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

Components of the fiscal sustainability indicator



Values presented according to fiscal gap. Fiscal gap = Extent by which the primary balance ratio of the base year (for Swiss cantons: 2022, differs for EU-countries) would have to be adjusted in order to achieve a gross debt ratio of 60% at the end of the 15-year-period; positive values: achievement of target entails improvement of primary balance ratio; negative values: achievement of target ensured even if primary balance ratio deteriorates. ‘Initial budgetary situation’ component = adjustment of the primary balance ratio required to stabilise public debt if the demographic costs and the target debt of 60% are disregarded; essentially reflects the budget situation (primary balance ratio) in the base year. ‘Gap to target debt’ component = adjustment of the primary balance ratio required to bridge the gap between the debt ratio in the base year and the target debt ratio of 60%; reflects the level of the debt ratio in the base year. ‘Demographic cost’ component = adjustment of the primary balance ratio required to cover the expenditure associated with demographic change. 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

Conclusion

- Measured against the EU criterion, the Swiss cantons have a more sustainable financial policy than most of the EU countries. The financial situation of most cantons is in very good shape compared to the EU countries. It should be noted that the results are based on a projection of cantonal debt levels in 2022 in order to take the Corona crisis into account.
- The excellent performance of the majority of the Swiss cantons is particularly due to comparably low public debt. With respect to the initial budgetary situation, the picture is more nuanced: Most cantons achieve a surplus, some cantons a deficit. Moreover, demographic change will raise costs in all cantons.
- Swiss cantons are in an excellent position to maintain their international tax attractiveness in the longer term thanks to their sustainable finances. However, it remains to be seen how the adjustments under STAF will affect cantonal finances.

References

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