Executive Summary

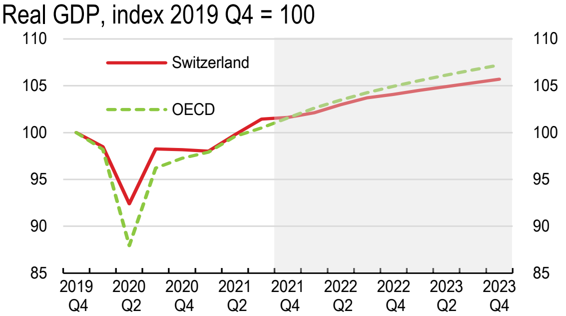
The economy is set to recover but some sectors and groups were hard hit

The COVID-19 pandemic continues to raise uncertainty and challenges. Infections started rising steeply again at the end of 2021 and the emergence of a new variant has clouded prospects for a rapid exit from the pandemic. The vaccination campaign accelerated once again thanks to booster shots, but the share of vaccinated remains below many OECD peers. Major constraints on economic life were largely lifted in the course of 2021, boosting economic activity, but uncertainty remains high.

The Swiss economy has been relatively resilient. Globally competitive companies, a highly skilled workforce, and low reliance on hospitality and entertainment activities mitigated the adverse impact of pandemic containment measures. The authorities swiftly extended generous support to sustain incomes and liquidity, while high trust in the government and the highly effective health system enabled less strict lockdowns.

Figure 1. The Swiss economy has been relatively resilient

Real GDP, index 2019 Q4 = 100



Source: OECD Economic Outlook database.

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The economy recovered to pre-crisis levels in the first half of 2021. GDP dropped by 2.5% in 2020 (calendar-adjusted) as activity in high-contact sectors was severely limited and private consumption restricted. Elevated uncertainty dampened investment. Yet, the rise in unemployment remained subdued thanks to government support, notably the expanded short-time work compensation scheme. The lifting of pandemic restrictions from spring 2021 triggered a quick rebound in activity, but global supply constraints and renewed pressures from the pandemic weighed on the recovery.

The impact of the crisis differed significantly between different sectors, companies and workers. Sectors less affected by distancing requirements and sectors that could adapt easily to the opportunities of increased digitalisation recovered quickly after the first wave. Other activities, more dependent on direct contacts, have faced heavy restrictions, some of them for almost a year. This has had a disproportionate impact on low-middle skilled and low-wage workers, given their high employment in these sectors. There is a risk that consumer preferences have changed and that demand for some goods and services remains depressed more permanently, requiring restructuring and employment transitions in the coming years.

Table 1. The economy has recovered to pre-crisis levels

Growth rates, unless specified	2021	2022	2023
Gross domestic product (GDP)	3.5	3.0	1.8
Unemployment rate (% of labour force)	5.1	4.8	4.6
Consumer price index	0.6	1.1	0.8
General government net lending (% of GDP)	-2.3	0.2	0.8

Source: Based on OECD Economic Outlook 110 database with updates to selected variables.

Policy support should increasingly target only the hardest-hit firms and vulnerable groups

Monetary policy has remained expansionary. The policy interest rate stayed at -0.75% and the countercyclical capital buffer for mortgages was deactivated in early 2020 to support credit. In spring 2020, the SNB set up a refinancing facility to complement the government's guarantee programme for corporate loans (COVID-19 credits). The SNB has intervened regularly in the foreign exchange market to stave off safe-haven pressures on the Swiss franc and resulting deflationary pressures.

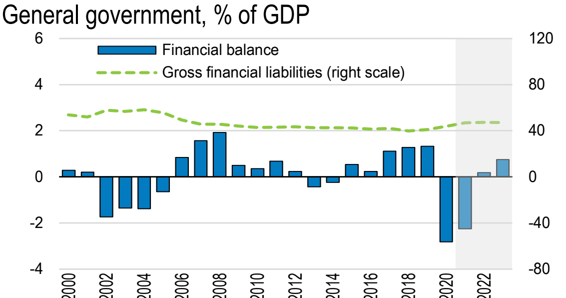
Risks in the financial sector have risen. Adequate capital and liquidity buffers in the Swiss financial system have contributed to stability. Yet, credit defaults and market corrections may materialise only with delay, once the extensive policy support at home and abroad is withdrawn. Stress tests point to overall resilience, but a number of individual institutions face a risk of capital being depleted in the event of an adverse shock. The build-up of imbalances continued in the residential real estate market, partly as a side effect of low interest rates, raising risks.

The fiscal position remains strong. Extensive emergency spending and a marked drop in fiscal revenues have pushed public finances into a deficit. The total cost of pandemic-related extraordinary fiscal expenditures is estimated at roughly 2.4% of GDP in 2020 and again in 2021. The fiscal position nevertheless remains very strong: gross general government debt stood at 44% of GDP in 2020 and net debt is negative. Interest rates on issuing new debt remain at very low levels.

Fiscal policy should remain supportive until the recovery is well under way. The strong fiscal position with low public debt has been achieved within the framework of the federal debt brake rule and cantonal fiscal rules. Nevertheless, the existing federal framework risks tightening fiscal policy too soon as it requires extraordinary COVID-19 expenditures to be compensated over a relatively short period. Premature fiscal tightening could undermine the recovery and should be avoided.

Figure 2. The fiscal position remains strong despite the fiscal expansion during the crisis

General government, % of GDP



Source: OECD Economic Outlook database.

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For the most affected firms and vulnerable people, targeted government support will continue to be needed. Debt financing and credit guarantees have helped to ease immediate financial constraints. Many companies may however face deteriorating balance sheets due to low profitability and rising debt. Likewise, workers in certain sectors risk unemployment in great numbers in case of premature withdrawal of support.

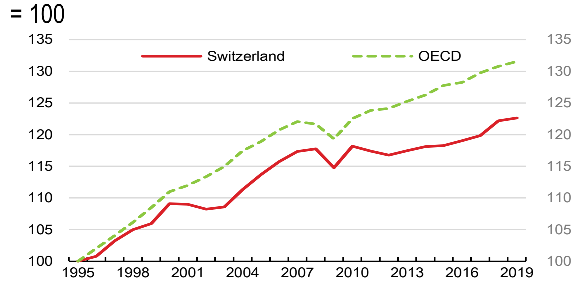
A key challenge is to provide sufficient support for viable firms while helping displaced workers find new jobs. Scaling back the short-time work scheme and asking firms to increasingly bear part of the cost of the scheme can be an effective way to support viable companies in need, while avoiding delaying layoffs in non-viable companies. More effective active labour market policies can help displaced workers find new jobs or gain new skills. A broader use of financial incentives for the unemployed to take up jobs would notably benefit the young, low-skilled workers and foreigners. Also, lower disincentives to hire older workers would help raise employment.

Boosting competition to raise productivity and growth

Fostering productivity growth is crucial to maintain high living standards in the future. Switzerland is one of the top OECD performers in terms of labour productivity, but productivity growth has slowed markedly over the last three decades. Productivity improvements are needed to counter the impact of an ageing population on GDP per capita growth.

Figure 3. Productivity growth has slowed

Labour productivity (real GDP per person employed), 1995 = 100



Source: OECD Productivity database.

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Barriers to free and open competition within the internal market remain. Competition in the domestic market is still hampered across cantonal borders. The administrative burden on start-ups is higher than in top performers and resolving commercial disputes takes a long time. The merger control framework remains too permissive and civil action against cartels is rare due to high complexity and short prescriptive periods. State involvement in the economy, notably in the network sectors, and the advantageous position of numerous state-owned enterprises reduce competition.

Lower barriers to trade and continued access to global markets are needed. Some sectors remain shielded from international competition, notably agriculture and some services sectors, harming productivity. Switzerland also imposes some constraints on inward foreign direct investments mainly through equity restrictions. The partnership between Switzerland and the EU is also at risk of eroding over time, in case various bilateral agreements become outdated. Ensuring a continued stable framework for the economic relationship with the EU would secure access and competitive exposure to the most important trading partner, raising productivity and growth.

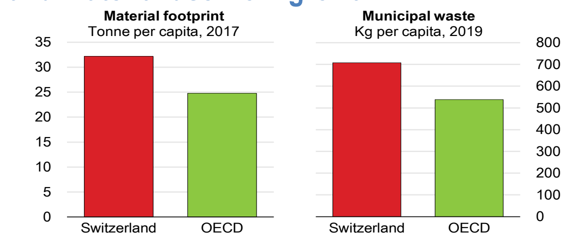
Ensuring the effective use of resources to raise sustainability and inclusion

Switzerland has successfully decoupled economic growth from domestic greenhouse gas emissions and material use, but environmental pressures remain. A high standard of living together with a relative lack of domestic raw materials and energy resources necessitate high imports. As a result, the material footprint per capita is significant and a large share of the associated environmental damage occurs abroad. Municipal waste per capita is among the highest in the OECD and municipal waste generation has not been decoupled from consumption, despite a number of policy instruments.

Switzerland has set a net-zero greenhouse gas emissions target by 2050, but sufficient measures to achieve it remain to be adopted. Switzerland prices its CO_2 emissions at high rates, but various exemptions to the carbon tax reduce its effectiveness. In addition, plans to further raise the carbon tax and introduce an air-ticket levy have recently been halted. Environmentally harmful subsidies and tax exemptions in agriculture, forestry and public transportation give rise to a pricing and incentive system that distorts the link between market signals and costs of environmental damage across sectors.

There is room to better align investment portfolios with climate goals and foster eco-innovation. The Swiss financial sector has a global outreach, but is still heavily invested in oil and coal extraction, despite significant progress in recent years. Higher transparency on the climate compatibility of investment portfolios and exposures to climate-related risks can help in adoption of effective climate-related initiatives. Switzerland is a global leader in innovation activity, but it could further leverage its position to boost environment-related R&D and eco-innovation.

Figure 4. Environmental pressures remain despite decoupling of domestic emissions and material use from growth



Source: OECD Environment Statistics (database).

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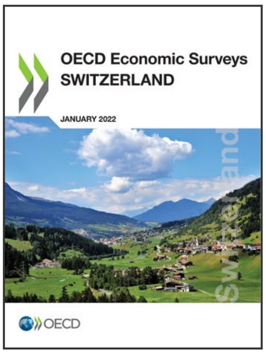
A substantial pension reform is overdue. The statutory retirement age has remained at 65 years for men since its introduction in 1948. Ageing creates fiscal pressures, by lowering revenues and putting pressures on age-related costs (pension, health-care and long-term care), and weighs on employment and growth. On current policies, the ratio of retirees to employees is set to soar and pension replacement rates for the mandatory pension system are set to drop significantly over time. Yet, reforms have proven very difficult.

A range of disincentives and barriers contribute to early retirement and low uptake of work by older workers. After the age 65, the otherwise high employment rate shows a steeper decline than in OECD peers. Once unemployed, older workers can have difficulties in finding a job. Narrow specialisation, lack of job-search experience and rising wage costs with age, including due to rising pension contribution rates, play a role. Pension reform and targeted policies to support older workers in their job search and retraining could help bring more of them to work.

The gender pay gap is sizable. The interplay between the tax and benefit systems and high costs of childcare result in disincentives to work for second earners, notably mothers. Low supply of affordable and high-quality childcare exacerbates the issue, contributing to a high take up of part-time work and markedly lower working hours. Increasing the supply of childcare and lowering work disincentives for second earners would help raise labour incomes for women and promote equity. Better access to early childhood education could help children from disadvantaged backgrounds to succeed later in life.

MAIN FINDINGS	RECOMMENDATIONS
Supporting the economy to exit the crisis	
Inflation is projected to remain moderate as the economy recovers, with substantial risks and uncertainty.	Monetary policy should remain accommodative until the recovery is firmly underway.
The Swiss financial system enjoys adequate capital and liquidity buffers. However, credit defaults and market corrections may materialise with delay.	Consider reactivating the countercyclical capital buffer targeted at residential mortgages. Progress further on managing the risks from "too-big-to-fail" banks, notably with strengthened liquidity requirements and resolution and emergency plans.
The deficit increased but gross general government debt remains low and net debt is negative (positive net assets). Interest rates on issuing new debt remain at historically low levels.	Use the flexibility within the fiscal framework (the debt brake rule) to apply temporary adjustments and avoid a too rapid tightening in fiscal policy.
The crisis had differing impacts across sectors. A premature withdrawal of support could trigger unnecessary bankruptcies and labour shedding and may result in scarring and poverty. A key challenge is to provide sufficient support for hard-hit firms and workers, while facilitating resource reallocation.	Continue to narrow policy support to hardest-hit sectors and vulnerable groups.
The extensions to the short-time working compensation scheme during the pandemic have adequately protected workers and firms but risk hindering job reallocation and restructuring during the recovery.	Once most pandemic restrictions are lifted, scale back the short-time working compensation scheme and reintroduce firms' financial participation to the cost of the scheme.
Boosting competition to raise productivity and growth	
Competition in the domestic market is still hampered by cantonal borders. The merger control framework remains too permissive and civil action against cartels is rare due to high complexity and short prescriptive periods.	Fully implement the Internal Market Act to ensure equal access to markets in all cantons. Harmonise the merger control framework with that of the EU and strengthen the civil law on cartels.
The administrative burden on start-ups is higher than in top performers, and resolving commercial disputes takes longer and is costlier than on average in the OECD.	Reduce the administrative burden on start-ups. Introduce "Silence is consent" licensing rules. Expand the government one-stop shop (EasyGov.swiss) by integrating cantonal governments' services.
Barriers to trade in services are higher than in most other OECD countries. Switzerland also imposes constraints on inward foreign direct investments (FDI) mainly through equity restrictions. Agriculture is heavily shielded from foreign competition and it receives high direct support payments.	Lower restrictions on trade in both goods and services, notably in agriculture. Remove the barriers to FDI where applicable and keep them low.
Ensuring effective use of resources to raise sustainability	
Municipal waste per capita is above the OECD average and has not decreased for the last 15 years, despite a number of policy instruments aimed at reduction.	Prepare a federal waste prevention strategy including indicative targets for municipal waste reduction.
The measures and targets of the proposed revised CO2 Act would have set important milestones on the way to reaching the net-zero greenhouse emissions target by 2050. However, plans to further raise the carbon tax and introduce an air-ticket levy have recently been halted (with the rejection of revised CO2 Act by a popular vote).	Continue efforts to broaden the base of the carbon tax by reassessing exemptions and align pricing of CO2 emissions with international climate cost benchmarks.
Switzerland could better leverage its internationally competitive financial and corporate sectors, and high saving rate to boost green investment and foster eco-innovation. The financial sector is still heavily invested in oil and coal extraction, and much less in renewable energy or electro-mobility.	Continue increasing transparency in relation to climate compatibility of financial portfolios. Strengthen the disclosure of climate-related risks for large companies and the financial sector.
Raising labour market participation and inclusion	
Population is ageing rapidly. First pillar funding faces serious pressures and pension replacement rates from the mandatory pension system are set to drop significantly.	Fix the retirement age at 65 for both genders and link it to life expectancy.
The gender income gap is high in Switzerland, in part due to high incidence of part-time employment. The interplay between the tax and benefit systems and a high cost of childcare result in lower working hours and lower labour incomes for women.	Keep expanding the supply of childcare and provide targeted measures (means-tested fee reductions, childcare benefits or tax credits) to improve affordability. Reduce disincentives to work for second earners, by moving from family-based to individual-based taxation or through tax adjustments and slower withdrawal of benefits.
Students from a disadvantaged background are significantly more likely to underperform and less likely to graduate with a tertiary degree.	Improve access to early childhood education and care for low-income households.



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