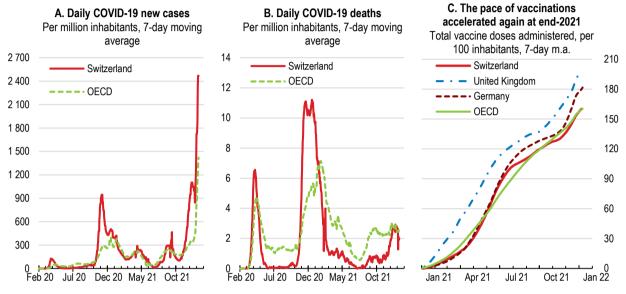
1 Key Policy Insights

Introduction

Switzerland continues to face uncertainty and challenges from the ongoing pandemic (Figure 1.1). The steep rise in infections and the emergence of a new variant at the end of 2021 clouded prospects for a rapid exit from the pandemic. Meanwhile, the economy has been on the path to recovery. Containment measures and restrictions on social and economic life were largely lifted during 2021, boosting economic activity. After a 2.5% drop in GDP in 2020 (calendar-adjusted), growth has resumed in 2021 and GDP reached its pre-pandemic level already in the second quarter of 2021.

Figure 1.1. Risks and challenges from the ongoing pandemic persist

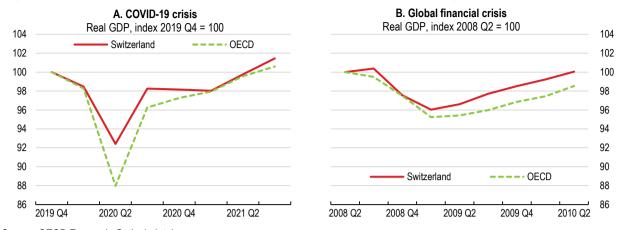


Source: OECD calculations based on Our World in Data.

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The Swiss economy has again shown its resilience in the face of a global crisis (Figure 1.2), despite its integral position in global value chains and dependence on foreign demand. The stable macroeconomic environment, high skills-based economy with globally competitive industries and companies, and well-functioning product and labour markets are all factors contributing to this resilience. In addition, national lock-downs and containment measures were less strict than in other OECD economies. A quick and targeted policy reaction to sustain jobs and incomes, and support companies and liquidity, also hindered the rise in unemployment and prevented numerous firm bankruptcies.

Figure 1.2. The Swiss economy has shown its resilience in the face of a global crisis

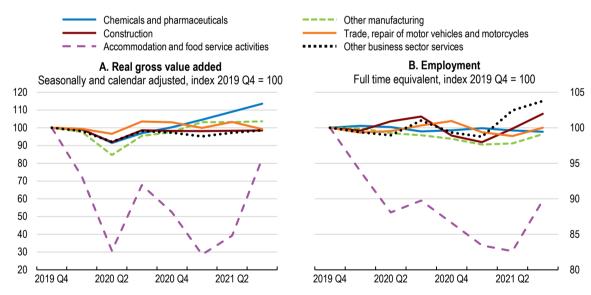


Source: OECD Economic Outlook database.

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Nevertheless, the overall strength of the economy masks heterogeneity across sectors and groups (Figure 1.3). Sectors less affected by distancing requirements, such as manufacturing, or services that could adapt easily to the opportunities of increased digitalisation, recovered quickly after the first wave. Other services, more dependent on direct contact between consumers and producers faced heavy restrictions for almost a year. This has had a disproportionate impact on low-income and low-skilled workers, the self-employed and foreign workers, given the relative importance of these sectors for their employment.

Figure 1.3. The overall resilience masks high heterogeneity across sectors and groups



Source: State Secretariat for Economic Affairs (SECO); Federal Statistical Office (FSO).

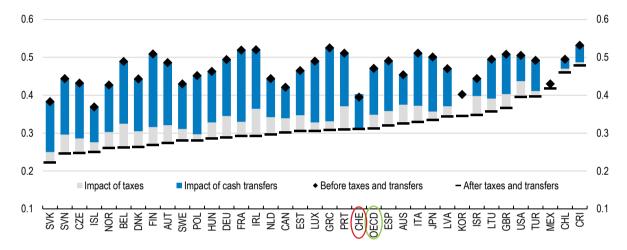
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For some firms in the most affected sectors, the recovery may be difficult. Moreover, there is a chance that consumer preferences have changed and demand for some goods and services will remain depressed more permanently. With the removal of government support, the number of firm bankruptcies, which have stayed very low, is likely to rise. The challenge now is to allow labour and capital reallocation to strengthen growth, while targeting support to viable jobs and companies. Equally challenging and important is helping vulnerable workers and groups, to prevent poverty and deprivation.

The crisis has hit low-income households harder. Overall, high employment rates and a compressed wage distribution underpin a high standard of living and relatively low income inequality (Figure 1.4). Yet, evidence shows that during the crisis, households in the higher income brackets lost a lower share of their income and their situation improved more rapidly during economic recovery (Figure 1.5). While all households reduced spending, they did it for different reasons. Poorer households spent less due to income loss and uncertain prospects. Richer households, on the other hand, cited lower opportunities to spend as the main reason for lower spending. Moreover, savings of poor households fell significantly while they rose in richer households, adversely impacting wealth inequality (Martinez et al, 2021; SRG/Sotomo, 2021). This said, government support was well-targeted and poorer households received stronger support in relative terms.

Figure 1.4. The Swiss enjoy a high standard of living and relatively low income inequality

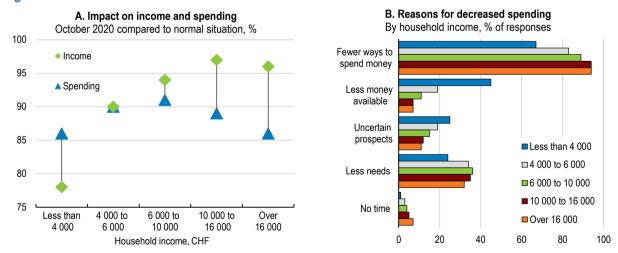
Household income distribution, Gini coefficient¹, 2019 or latest available year



1. Scale from 0 "perfect equality" to 1 "perfect inequality". Source: OECD Income Distribution database (IDD).

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Figure 1.5. The crisis has hit low-income households harder



Source: SRG/Sotomo, 2021, https://sotomo.ch/site/wp-content/uploads/2021/03/7.-SRG-Corona-Monitor.pdf

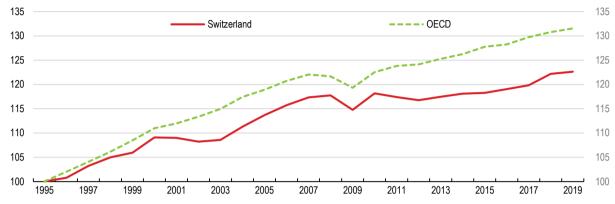
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A revival in productivity growth is crucial to maintain high living standards in the future. Employment rates face pressures from rapid population ageing, weighing on future economic growth. Switzerland is one of

the top OECD performers in terms of labour productivity, but productivity growth has been low over the last three decades (Figure 1.6). There still exist barriers to competition within the internal market, including due to the advantageous position of numerous state-owned enterprises. Also, some sectors remain shielded from international competition, notably agriculture and some services sectors, harming productivity. Lower barriers to trade and competition and an improved business environment can spur competition and foster investments that will help revive productivity.

Figure.1.6. Productivity growth has slowed

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



Source: OECD Productivity database.

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Effective and sustainable use of resources can sustain a stronger and more inclusive growth. Switzerland has successfully decoupled economic growth from domestic greenhouse gas emissions and material use. Yet, environmental pressures remain, notably due to high levels of consumption and resulting high levels of emissions and resource use embodied in imports. The pension system has not been sufficiently reformed in decades, and older workers should be better equipped to work longer. Taxes and benefits provide low work incentives for second-earners and together with the high cost of childcare, contribute to a high gender gap in working hours and labour incomes. Targeting skills provision – including of digital skills – to older workers and low-income workers would aid the post-crisis recovery and help better prepare the Swiss economy to the challenges of technological change.

Against this background, the main messages of this Survey are:

- Fiscal and monetary policy should continue to support the economy until the recovery is well under way. Yet, support should increasingly focus on people, rather than jobs, by facilitating job search, upskilling and preventing poverty. It should also be channelled towards hardest-hit but viable firms and aim to alleviate debt overhang. Enhancing insolvency procedures would facilitate capital reallocation.
- A more dynamic economy with fewer barriers to firm exit and entry and a lower administrative burden on start-ups can spur competition and productivity growth. Stability in international agreements and openness to trade and investment will sustain access to export markets and exposure to valuable competitive pressures.
- High labour market participation by all groups and environment-friendly policies will make growth
 more inclusive and sustainable. A reformed pension system and higher incentives to work for
 mothers and older workers will help in this regard. Better targeting of skills training to low-income
 workers will allow them to benefit from the digital transformation. Policies to improve the
 environmental sustainability of consumption and investment as well as consistent pricing of
 environmental externalities will also boost well-being in the long-term.

Policy support should target hardest-hit firms and vulnerable groups

The COVID-19 pandemic continues to raise uncertainty

The virus started to spread in February 2020 and the government quickly introduced strict epidemiological measures. Containment measures have been in place ever since, but to varying degrees of strictness, depending on the intensity of subsequent infection waves (Figure 1.7). In March 2021, in the wake of the second wave, the government gradually started lifting the most restrictive containment measures, once the vaccination campaign gathered pace and the number of infections and hospitalisations fell significantly. Yet, in November 2021, Switzerland entered a fifth pandemic wave, with a steep rise in infections and hospitalisations and an increased uncertainty from a new Omicron virus variant. The latter prompted the authorities to reintroduce targeted temporary travel bans and further tighten health barrier measures, such as broadening the use of the sanitary pass. The risk of stricter measures impacting economic activity also rose considerably. The pace of vaccinations, which slowed markedly over the summer, accelerated towards the end of 2021 thanks to booster shots, but the share of vaccinated persons remains below many OECD peers.

The main epidemiological objective in Switzerland has been to avoid lack of capacity in the health system. The number of patients in intensive care has remained under control throughout the pandemic (Figure 1.7). Supported by high trust in the domestic health system, the Swiss authorities chose to implement epidemiological measures that were less stringent than in many other OECD peers (Figure 1.7), avoiding prolonged full lock-downs. This contributed to the less severe economic downturn. A policy priority now should be to ensure that all resources necessary are used to fully deploy vaccinations – including booster shots - as quickly as possible to protect lives and limit the need for economically harmful containment measures.

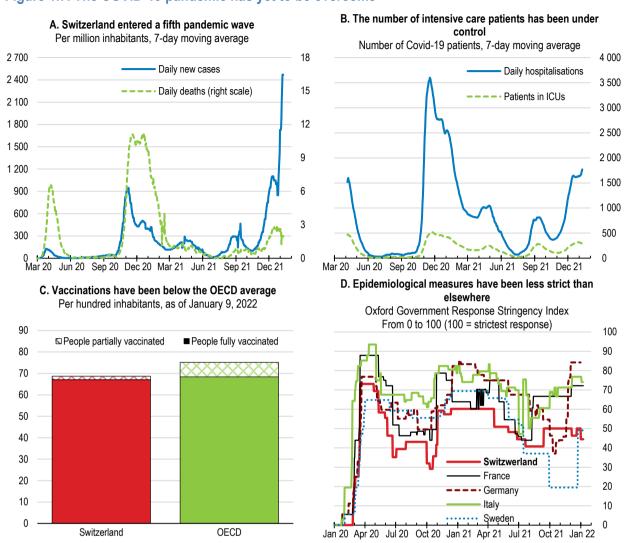


Figure 1.7. The COVID-19 pandemic has yet to be overcome

Source: OECD calculations based on Our World in Data; Federal Office of Public Health; Oxford COVID-19 Government Response Tracker, Blavatnik School of Government, University of Oxford.

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Unprecedented policy support helped sustain incomes and employment through the pandemic

As the first wave of the pandemic hit, strict containment measures led to severe restrictions on activity in various sectors, notably services relying on close contact (hospitality and entertainment). Private consumption collapsed while high uncertainty dampened private investment.

The federal government rapidly extended generous policy support to sustain incomes and employment. It vastly expanded the short-time work compensation (STWC) scheme, offered income support to the self-employed and parents who stayed at home to look after children, and made unemployment insurance more generous. Cantons also quickly started offering financial support to affected sectors and firms. Monetary policy remained accommodative and the government issued guarantees for commercial loans to companies to sustain access to liquidity. As the second pandemic wave undermined the recovery from the third quarter of 2020, the authorities prolonged most of the emergency support measures into 2021 and introduced new grants, loans and guarantees. These included the "hardship" support for companies that had a 40% drop in sales due to the containment measures, and targeted support measures for firms

in sports, culture, tourism and transport. In December 2021, the legal basis of most extraordinary measures was extended until end-2022.

Overall, in 2020, Swiss GDP fell by 2.5% (in real terms, calendar-adjusted), one of the smallest contractions in the OECD. Less strict lock-downs and lower reliance on the hospitality sector in the economy played a role. The extensive fiscal and monetary support helped keep the business sector afloat and contributed to the strong rebound in economic activity in the third quarter of 2020, following a partial lifting of pandemic restrictions. Similarly, in the second and third quarters of 2021, after pandemic restrictions from subsequent waves were largely lifted, the economy recorded a broad-based recovery. Notably, parts of the services sector - hospitality and entertainment - that faced particularly severe restrictions for a prolonged period, recorded large increases. Private consumption also saw a large upturn. In contrast, in Q3 2021, global supply chain disruptions started to have an adverse impact on segments of the manufacturing sector and private investment.

The labour market has been recovering. During the crisis, the unemployment rate rose to 5.2% in 2020 Q4, up by roughly one percentage point from 2019 Q4. Thanks to public support measures, this rise was much lower than suggested by the extensive spare capacity in the economy (Figure 1.8) (see Chapter 2 of this Survey). The number of registered unemployed and the number of workers on short-time work schemes have steadily declined since early 2021.

Inflation remained negative during 2020 on the back of safe-haven pressures on the Swiss franc and low core inflation. In early 2021, headline inflation edged up due to rising commodity prices and currency depreciation. Headline inflation turned positive in April 2021, for the first time in more than a year.

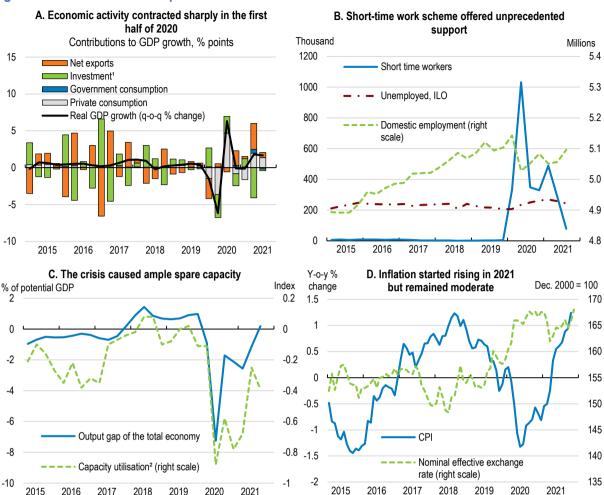


Figure 1.8. Economic developments

1. Including stock building.

2. Current utilisation of technical capacity / business infrastructure compared to a normal level. A positive (negative) index value signals utilisation is higher (lower) than normal.

Source: OECD Economic Outlook databases; SECO; KOF Swiss Economic Institute; OFS; SNB.

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The economic recovery will continue, but the protracted pandemic increases uncertainty

The gradual lifting of pandemic restrictions along with the rollout of vaccines has triggered a rebound in activity, starting in the second quarter of 2021. The global supply chain disruptions and the fifth pandemic wave will slow the recovery at the end of 2021 and in early 2022, but no new major containment measures are assumed. Thereafter, improving prospects and the low cost of capital will underpin a recovery in investment. Recovering external demand should foster exports. Improvements in labour market conditions and consumer confidence, and the normalisation of households' high savings will support consumption. However, further decline in unemployment is projected to be gradual, reflecting the eventual removal of policy support and an expected pick-up in bankruptcies. Inflation will remain moderate. In particular, temporary pressures on annual inflation from high prices of energy and materials are assumed to subside in the course of 2022. The Swiss real GDP has caught up with the pre-crisis levels in Q2 2021, but will remain markedly below what was forecast in late 2019.

Table 1.1. Macroeconomic indicators and projections

Annual percentage change, volume (2015 prices)

	2018	2019	2020	Projections		
	Current prices (billion CHF)			2021	2022	2023
Gross domestic product (GDP)	719.8	1.2	-2.5	3.5	3.0	1.8
Private consumption	372.2	1.4	-3.7	2.4	3.8	2.1
Government consumption	79.9	0.7	3.5	6.0	0.4	-2.2
Gross fixed capital formation	184.0	0.6	-1.7	2.9	3.0	1.9
Housing	22.7	-3.9	-6.5	0.0	-0.6	0.5
Business	139.9	0.7	-2.0	3.2	3.9	2.3
Government	21.4	4.3	4.7	3.7	0.7	0.9
Final domestic demand	636.1	1.1	-2.3	3.0	3.1	1.5
Stockbuilding ¹	-6.0	0.7	1.3	-3.7	-0.9	0.0
Total domestic demand	630.1	1.9	-0.8	-1.1	2.1	1.5
Exports of goods and services	476.6	-0.8	-6.4	9.5	4.6	5.0
Imports of goods and services	387.0	-0.2	-4.4	2.5	3.5	5.4
Net exports ¹	89.6	-0.4	-1.8	4.6	1.2	0.6
Other indicators (growth rates, unless specified)						
Potential GDP		1.4	1.3	1.3	1.3	1.3
Output gap²		0.8	-3.0	-0.9	0.8	1.3
Employment		0.7	-0.2	-0.2	1.0	0.4
Unemployment rate (% of labour force)		4.4	4.8	5.1	4.8	4.6
GDP deflator		-0.1	-0.5	1.4	1.4	1.0
Consumer price index		0.4	-0.7	0.6	1.1	0.8
Core consumer price index ³		0.4	-0.3	0.3	0.7	0.8
Household saving ratio, net (% of disposable income)		17.4	23.1	23.0	20.1	18.7
Current account balance (% of GDP)		4.9	1.2	7.0	7.7	7.4
General government financial balance (% of GDP)		1.3	-2.8	-2.3	0.2	0.8
Underlying government primary financial balance ² (% of GDP)		1.0	-1.3	-1.8	-0.1	0.3
General government gross debt (% of GDP)		41.0	43.9	46.9	47.3	47.0
General government net debt (% of GDP)		-16.3	-17.2	-14.1	-13.7	-14.1
Three-month money market rate, average		-0.7	-0.7	-0.8	-0.8	-0.8
Ten-year government bond yield, average		-0.5	-0.5	-0.2	-0.2	-0.2

Note: This set of projections has been prepared by the OECD desk, following the latest update of GDP numbers, without the OECD-wide update in projections. The table is therefore based on the OECD Economic Outlook 110 database with updates to selected variables.

Source: OECD Economic Outlook database.

Uncertainty is high. The renewed fast-paced surge in infections could require drastic measures and weigh on the economy. Potential lower efficacy of vaccines on new variants would have a similar effect. The willingness of the population to be vaccinated is becoming an increasingly important factor. On the upside, further progress in vaccination could be more rapid than assumed or the pandemic could retreat more quickly than expected. Also, a faster rundown of accumulated savings could result in higher consumption and activity. As a very open economy, Switzerland is at risk of being significantly affected by potential trade disruptions due to renewed pandemic waves, geopolitical tensions or new trade barriers, including in the trade with the EU. The continued rise in imbalances in the domestic real estate market raises vulnerabilities.

^{1.} Contribution to changes in real GDP.

^{2.} Percentage of potential GDP.

^{3.} Consumer price index excluding food and energy.

Table 1.2. Low-probability events that could lead to major changes in the outlook

Shock	Possible Impact
Renewed major global pandemic wave with a virus variant resistant to existing vaccines	This would trigger renewed containment measures, with adverse impact on incomes and employment. Pressures on public finances could lead to defaults abroad and result in tightened financing conditions in Switzerland, due to safe haven pressures on the franc and rising risk premia.
International corporate debt crisis	Amid high and rising levels of corporate indebtedness globally, a downturn could lead to debt-servicing problems for highly leveraged companies and repricing of risk with reverberations through international financial markets. Safe-haven flows could push up the exchange rate, reducing Swiss exports, hurting confidence and raising deflation risks. Internationally active banks could also be exposed.
Intensification of global trade tensions	As a small open economy, Switzerland would be severely affected by a major increase in barriers to trade and capital flows.
Major house price correction and sudden rises in interest rates	A large correction in housing prices coinciding with a further economic downturn could expose vulnerabilities in the financial system, causing a crisis in the financial sector that could feed back to the real economy. In addition, sudden rises in interest rates would sharply increase debt-servicing costs for highly leveraged households and investors, raising the risk of defaults.

Monetary policy remains accommodative

Monetary policy has been expansionary since the global financial crisis. The policy interest rate has been stable at -0.75% since 2015, the lowest in the OECD (Figure 1.9). However, the negative interest rates put pressures on interest margins and weigh on bank profitability. In order to ease pressures on banks, in March 2020, the Swiss National Bank (SNB) raised the exemption ratio (i.e. raised the threshold factor from 25 to 30), thereby reducing the share of reserves on which banks earn negative interest. With this, the SNB can still successfully steer money market rates close to the targeted policy rate without unnecessarily penalising banks (Maechler and Moser, 2020), strengthening their role as credit providers during the crisis. In addition, to facilitate further credit activity by banks, the Federal Council deactivated in March 2020 the countercyclical capital buffer targeted at mortgage loans financing residential real estate (previously 2%).

To help companies bridge liquidity shortages during the COVID-19 crisis, the government introduced a guarantee programme for corporate loans (COVID-19 credits), available between end-March and end-July 2020. As a complement, the Swiss National Bank (SNB) set up the SNB COVID-19 refinancing facility, enabling banks to access the required liquidity at the SNB policy rate. The programme is estimated to have reached 20% of all Swiss firms (Fuhrer et al., 2020) with a total size of the programme at 2.4% of GDP. Moreover, the programme successfully reached young and small firms that tend to be more financially vulnerable during crises.

The SNB intervened heavily in the foreign exchange market in the first half of 2020 to stave off appreciation pressures on the Swiss franc caused by safe-haven capital inflows and resulting deflationary pressures. The pressures on the franc subsequently eased and interventions subsided, but overall, the Swiss franc gained roughly 6% between December 2019 and November 2021 (Figure 1.9).

The SNB remains committed to foreign exchange interventions if needed. Due to negative interest rates and a relatively small domestic bond market (reducing scope for asset purchases) the exchange rate is one instrument that helps steer monetary conditions and fulfil the mandate of price stability. However, high accumulated foreign reserves expose the central bank balance sheet to the risk of sizable valuation losses.

Box 1.1. Monetary policy framework

According to article 99 of the Federal Constitution and the National Bank Act (art.5 para.1), the mandate of the Swiss National Bank (SNB) is to ensure price stability, its primary objective, while taking due account of economic developments.

The SNB's monetary policy strategy, in place since 2000, sets out how the SNB implements its mandate. Price stability is stated as the CPI inflation standing below 2% annually, while remaining positive. Deflation, i.e. a protracted decline in the price level, is regarded as a breach of the objective of price stability. The SNB does not react mechanically to temporary deviations from the price stability objective. For example, if inflation temporarily exceeds the 2% ceiling as a result of one-off factors, monetary policy does not necessarily need to be adjusted. The same applies for short-lived deflationary pressures.

Conditional inflation forecasts for the next three years serve as the main indicator for monetary policy decisions. The SNB considers also a range of indicators on domestic and international economic and financial developments.

The SNB implements its monetary policy by setting the SNB policy rate. The SNB seeks to keep the secured short-term Swiss franc money market rates close to the SNB policy rate. In the current negative-rate environment, it does so by charging banks and other financial institutions interest on part of their sight deposits with the SNB. Given that the policy rate cannot be lowered indefinitely, the SNB also intervenes in the foreign exchange market as necessary to influence monetary conditions. Besides the negative rate on sight deposits and the FX interventions, policy is implemented with traditional open market operations (e.g. repos) and standing facilities.

The monetary policy stance is reviewed quarterly, and monetary policy decisions are taken quarterly by the SNB Governing Board (or more frequently if necessary). The decisions are announced in press releases. In June and December, the members of the Governing Board also explain the monetary policy decision at a press conference.

The SNB's expansionary monetary policy provided favourable financing conditions and contributed to ample supply of credit and liquidity to the economy. Despite a steep drop in GDP in the first half of 2020, liquidity was maintained and annual growth in bank lending remained robust, even after the COVID-19 credit guarantee programme ended (Figure 1.9). Private sector companies surveyed in Q1 and Q2 2021 reported that there had been hardly any delays in payments on the part of their customers and practically no bad debt losses (SNB, 2021a and 2021b). This said, prospects for inflation remain moderate and long-term inflation expectations remain well-anchored (SNB, 2021b), while risks and uncertainty are still elevated. Monetary policy should therefore remain accommodative, until the domestic economy is firmly on a sustainable recovery path.

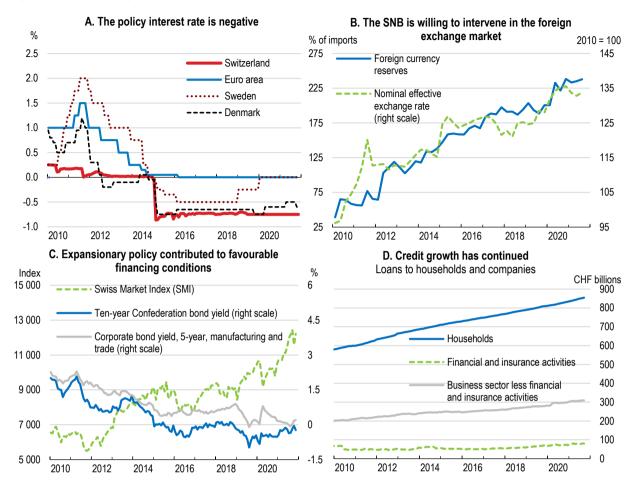


Figure 1.9. Monetary policy remains accommodative

Note: On 13 June 2019 a new monetary policy rate was introduced and the reference rate became the SARON. Prior to this, the SNB set a target range for the three-month Swiss franc LIBOR with the latter used as the policy reference rate (shown in Panel A). Source: Refinitiv; OECD Economic Outlook; SNB.

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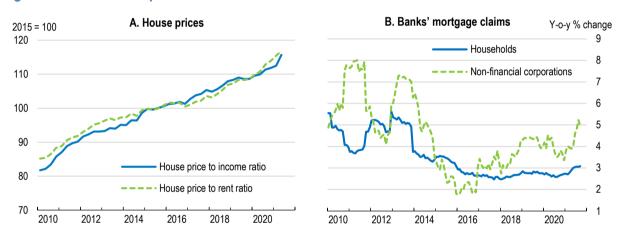
Risks in the financial sector have risen during the crisis, as also recognised by the financial sector supervisor FINMA in its publication the Risk Monitor (FINMA, 2021 and 2020a). Thanks to adequate capital and liquidity buffers the Swiss financial system was able to withstand the challenges. The share of non-performing loans and the level of impaired claims have increased slightly, but remain low by historical standards (SNB, 2021c). However, credit defaults and market corrections may materialise only with delay once the extensive policy support at home and abroad is withdrawn. Stress tests by the SNB (2020a and 2021c) and FINMA (2020b) show that most institutions would be able to cope with a further deterioration in economic conditions without seriously impairing their lending capacity. Nevertheless, a number of individual institutions face a risk of their capital being more seriously depleted in adverse circumstances (SNB, 2020a and 2021c).

Close monitoring of risks and adequate buffers should be maintained. The authorities should consider reactivating the countercyclical capital buffer targeted at residential mortgage loans. There is also further progress to be made on managing risks from "too-big-to-fail" banks. Big losses incurred by Credit Suisse (more than USD 5 billion) and UBS (several hundred million) from exposures to a US hedge fund (Archegos Capital Management) highlighted how significant shocks can occur even without a macroeconomic or system-wide financial shock. The three domestic systemically-important banks are yet to prepare effective emergency plans, with the two global banks (Credit Suisse and UBS) having done so successfully in 2019.

However, the latter two still need to become fully resolvable, so that in the event of a crisis they can be restructured or liquidated without endangering financial stability (FINMA, 2020c). A recent review has also found that there is room to strengthen liquidity requirements of the systemically-important banks to cover liquidity needs in an emergency (Federal Council, 2021a). Continued vigilance, effective regulation and risk oversight are also needed in the fintech sector.

The build-up of imbalances in the residential real estate market has also continued, partly as a side effect of low interest rates. Growth in real estate prices and in mortgage loans has remained largely unabated (Figure 1.10), despite the economic slowdown. The mortgage-to-GDP ratio is already very high by international standards and has continued growing, indicating growing vulnerabilities. In the residential investment property segment, price rises continued in spite of high vacancies (SNB, 2020a and 2021c). These imbalances expose debtors and creditors to shocks to the interest rate or further economic deterioration that could adversely affect mortgage repayments and rents. According to an assessment by FINMA (2021), a real estate crisis involving sharp price corrections could lead to large losses, and capital in a number of banks would be significantly depleted. This would have adverse consequences for financial stability.

Figure 1.10. The build-up of imbalances in the residential real estate market has continued



Source: OECD, Analytical House Price Indicators database; SNB.

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To prevent a further build-up of imbalances in the housing market, the Swiss Bankers Association, with effect from January 1st 2020, tightened self-regulation for mortgage loans on the investment property market, by requiring higher down-payments and faster mortgage repayment. These changes were recognised by FINMA as binding minimum standards (FINMA, 2019). Switzerland would however benefit from a broader toolkit of macroprudential measures that take into account affordability, for instance debt-to-income and debt-service-to-income limits on mortgage loans. In addition, as recommended in previous Surveys (OECD 2017a and 2019a), the framework for setting macroprudential rules should be strengthened, with SNB and FINMA given clear and strong mandates to propose and calibrate the tools. Currently, the rules are set in agreement with the Swiss Bankers Association, which may impact timeliness and stringency (IMF, 2019).

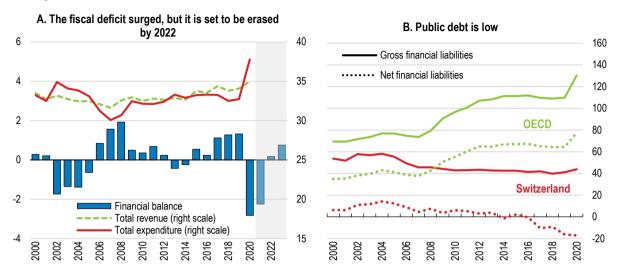
Fiscal policy should avoid premature tightening

Extensive emergency spending and markedly lower fiscal revenues pushed public finances into a deficit. After five consecutive years of surpluses, the general government deficit reached 2.8% of GDP in 2020. A slightly smaller deficit is expected in 2021, at 2.3% of GDP, and a surplus in 2022, at 0.2% of GDP (Figure 1.11). The total cost of pandemic-related extraordinary fiscal measures is estimated at CHF 17 billion in 2020, and just slightly more in 2021, about 2.4% of GDP each year (FFA, 2021a). The federal

government also provided guarantees to companies, in the amount of CHF 17.5 billion outstanding at the end of 2020 (FFA. 2021b).

Figure 1.11. Emergency fiscal measures pushed public balance into a deficit

General government, % of GDP



Source: OECD Economic Outlook database.

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The fiscal loosening was appropriate given the severity of the crisis and available fiscal space. Gross general government debt at 44% of GDP in 2020 remains low in international comparison (Figure 1.11). Moreover, net debt is negative (i.e. positive net financial assets, at 17% of GDP) and interest rates on issuing new debt remain at historically low levels. Between mid-2000s and 2019, a frugal fiscal policy led to a marked decrease in Swiss public debt, in contrast to many other OECD economies (Figure 1.11). This was achieved within the framework of the federal debt brake rule (and cantonal fiscal rules) that aims to use fiscal policy as a stabilisation tool over the economic cycle as well as pursue fiscal sustainability by keeping nominal debt stable (i.e. a declining debt-to-GDP ratio) (Box 1.2).

However, the existing federal debt brake framework risks tightening fiscal policy too soon. The debt brake sets an annual expenditure ceiling based on expected ordinary fiscal revenues adjusted for cyclical factors, ensuring the counter-cyclicality of fiscal policy. Ex-post, over- or under-spending within the "ordinary" budget is either debited or credited to a compensation account, but positive balances from underspending can only be used to reduce debt. Additional flexibility is possible in exceptional circumstances via extraordinary expenditures that are not bound by the limits on the "ordinary" expenditure ceiling. Extraordinary spending is accounted for on the so-called "amortisation" account, whose deficit then needs to be eliminated within 6 years after the end of exceptional circumstances. However, Parliament can extend this period. The authorities estimate that the negative balance on the amortisation account resulting from COVID-19-related extraordinary expenditures could rise to CHF 25 billion (3.5% of GDP) by the end of 2021 (FFA, 2021c). Closing this gap in 6 years would entail a structural consolidation of 0.6 percentage points of GDP per year over the 2022-2027 period. This would come on top of the limits on ordinary spending growth prescribed within the debt brake framework due to the gradual cyclical improvement of the economy.

Box 1.2. The debt brake rule

The debt brake rule is a central element of the Swiss fiscal framework at the federal level. It subjects the Confederation's fiscal policy to a binding rule. Its principles have been accepted by popular vote on December 2001 and its core provisions are enshrined in the Federal Constitution (article 126). Details are set out in the Financial Budget Act.

The debt brake is designed to ensure that fiscal policy remains sustainable over the long term by aiming to keep nominal debt stable (i.e. a declining debt-to-GDP ratio). The rule also takes into account the economic cycle in order to help smooth growth fluctuations. It is a structural deficit rule that limits expenditures to the amount of structural (i.e. cyclically adjusted) revenues. Thus, the debt brake does not require budgets to be balanced on an annual basis, but only over an entire economic cycle. Within this mechanism, total federal government expenditures are kept relatively independent from the cycle whereas tax revenues act as automatic stabilizers. Actual deviations from the limit set by the rule result in a credit or debit to the so-called "compensation account". Deficits in this account must be considered when setting the new expenditures ceiling for the following year and eliminated in the subsequent years. Moreover, in principle, positive balances from underspending can only be used to reduce debt.

In extraordinary circumstances (such as severe recessions or natural disasters), the rule's expenditures ceiling can be raised by a qualified majority of both chambers of parliament, whereby a binding rule also applies for the extraordinary budget. Extraordinary receipts and expenditures are recorded on an amortisation account and any deficits on the amortisation account due to extraordinary expenditures have to be covered over the course of six years by means of surpluses in the ordinary budget. In special situations, the parliament has the power to extend the six-year deadline.

Rapid fiscal tightening in the aftermath of the crisis could undermine the recovery and should be avoided. One option is to exceptionally use the positive balances on the compensation account (from previous underspending) to reduce part of the amortisation account deficit. A longer payback period for the amortisation account could also be considered, to ease immediate pressures towards fiscal tightening. In view of the challenges related to fiscal policy in the medium run, the Parliament has tasked the Federal Council to propose an amendment that would allow the debt associated with the coronavirus crisis to be managed without resorting to budget cuts and tax increases.

Over the summer 2021, the Federal Council decided on a balanced (federal) ordinary budget for 2022, and an additional CHF 1.2 billion in extraordinary expenditure in 2022 linked to the aftermath of the COVID-19 crisis. However, these are planned to be compensated by the supplementary distribution of SNB profits in the maximum amount of CHF 1.3 billion, accounted under extraordinary receipts (FFA, 2021c). Subject to the conditions defined in the agreement between the Federal Department of Finance and the SNB (i.e. availability of sufficient reserves for distribution), a supplementary distribution in similar amounts (roughly 0.2% of GDP) will also take place over 2023-2025, helping reduce the COVID-19 debt (Federal Council, 2021b).

Furthermore, in the summer 2021, the Federal Council opened the consultation process for a temporary amendment to the Financial Budget Act in order to help offset the COVID-19 debt. Options include using future surpluses in the ordinary budget (that historically have occurred regularly due to slight underspending) to reduce the debt over the medium term, or, alternatively, using past accumulated surpluses to reduce part of the debt. In early 2022, once the real financial impact on the federal budget will be better known, the Federal Council will decide which solution will be submitted to Parliament and the amendment could thus enter into force at the beginning of 2023.

Reviewing the debt brake also provides an opportunity to improve its implementation in the future. As reported in the previous Survey (OECD, 2019a), revenue forecasts tend to be on the conservative side and persistent underspending (compared to the approved spending ceilings) is the norm. A case in point,

in the exceptional circumstances of the coronavirus pandemic a cyclical/ordinary deficit of CHF 2.9 billion would have been permitted in 2020 at the federal level, but in reality the ordinary deficit amounted to 1.2 billion, leading to a 1.6 billion (0.2% of GDP) "structural surplus" (FFA, 2021b). This resulted in a credit to the compensation account that in principle cannot be transferred to cover extraordinary expenditures (unless budgeted ex-ante). In the current juncture, moving to fuller use of available fiscal space would support economic recovery as well as lower the burden on monetary policy. Moreover, the government would have more leeway to pursue structural reform, for instance by further expanding affordable childcare, reducing inequities in education and training and pursuing a more ambitious investment agenda in green technology and green R&D.

Table 1.3. The fiscal position is strong

General government, % of GDP

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total revenues	32.7	32.9	32.7	33.8	33.5	34.4	33.8	34.1	35.0
Taxes	19.6	19.7	19.6	20.3	20.3	21.0	20.6	20.9	20.8
Social contributions	6.5	6.6	6.5	6.6	6.6	6.6	6.4	6.5	7.0
Other revenues	6.5	6.6	6.5	6.9	6.7	6.8	6.8	6.6	7.1
Total expenditures	32.4	33.3	32.9	33.2	33.3	33.3	32.5	32.8	37.8
Social protection	12.5	13.3	13.0	13.1	13.3	13.2	12.9	12.9	
Education and health	7.3	7.4	7.4	7.5	7.6	7.5	7.4	7.6	
General public services	4.4	4.4	4.4	4.5	4.4	4.4	4.3	4.2	
Economic affairs	4.0	4.0	3.9	4.0	3.9	3.9	3.9	3.9	
Other ¹	4.1	4.2	4.1	4.2	4.2	4.2	4.1	4.2	
Net lending	0.2	-0.4	-0.2	0.5	0.2	1.1	1.3	1.3	-2.8
Primary balance	0.6	-0.2	0.0	0.8	0.4	1.3	1.4	1.4	-2.8
Gross debt	43.4	42.6	42.6	42.5	41.3	42.0	39.8	41.0	43.9
Net debt	3.1	3.9	-1.6	2.2	-0.6	-10.5	-9.1	-16.3	-17.2

^{1.} Defence; public order and safety; housing and community amenities; recreation, culture and religion; environment protection. Source: OECD National Accounts database; Economic Outlook database.

Box 1.3. Potential impact of reforms

Structural reforms can boost economic growth and incomes. Table 1.4 quantifies the impact on growth of some of the reforms recommended in this Survey (quantification is not feasible for all of them) based on the OECD long-term model and OECD estimates of relationships between reforms and total factor productivity, capital deepening and the employment (Égert, 2017). The analysis suggests that if Switzerland implemented the selected set of reforms (see below), per capita income could increase by about 3% in 10 years. The estimates are illustrative.

Table 1.4. Potential impact of structural reforms on per capita GDP

	10 years
Improve the business environment (less state involvement, lower barriers to trade and investment).	1.7%
Boost active labour market policies.	0.9%
Keep expanding the supply of affordable and high-quality childcare facilities.	0.3%
Reform the pension system (lifting the retirement age).	0.3%
Package of reforms	3.3%

Note: Simulations based on the OECD Economics Department Long-term Model. A no policy change scenario is used as the baseline. The following changes in policy/outcomes are assumed. The Product Market Regulation (PMR) components where Switzerland underperforms are reduced to OECD average (reduced state ownership of the economy, less regulation in network sectors and lower barriers to trade and investment). Active labour market policies are boosted to reach the average of five top performers in the OECD (as % of GDP per capita per unemployed person). Family benefits in kind (% of GDP) are increased to OECD average. Pension reform: first equalising retirement age for men and women at 65, then retirement age gradually rises to 67 in 2034, and by half of the expected gain in life expectancy thereafter (to reach 68 in 2058).

Source: OECD calculations.

The following estimates quantify the direct fiscal impact of selected recommendations included in the Survey. The estimates are illustrative.

Table 1.5. Illustrative direct fiscal impact of selected recommended reforms

Reform	Fiscal impact (savings (+)/ costs (-)) (% of GDP)		
Improve the business environment (less state involvement, lower barriers to trade and investment).	Negligible		
Boost active labour market policies.	-0.2%		
Keep expanding the supply of affordable and high-quality childcare facilities.	-0.4%		
Improve the implementation of the debt-brake rule (reduce underspending).	-0.4% (other reforms listed here can be financed from this)		
Make the tax mix more growth friendly.	Fiscally neutral reform		
Reform the pension system (lifting the retirement age).	+1.1% (by 2060)		

Note: Fiscal room of 0.4% of GDP under the debt-brake rule was estimated in the previous OECD Switzerland Survey (OECD, 2019a). Tax reform includes: reducing personal income taxes (for second earners), financed by raising VAT and taxes on immovable property; phasing out environmentally harmful tax exemptions and subsides; phasing out interest deductibility in personal income tax and broadening the base for taxing capital gains. The fiscal dividend of the pension reform is computed by taking a difference between the required increase in government revenues to keep debt-to-GDP ratio stable in "baseline" and "pension reform" scenarios. See also Figure 1.24 below. Based on simulations of the OECD Economics Department Long-term Model.

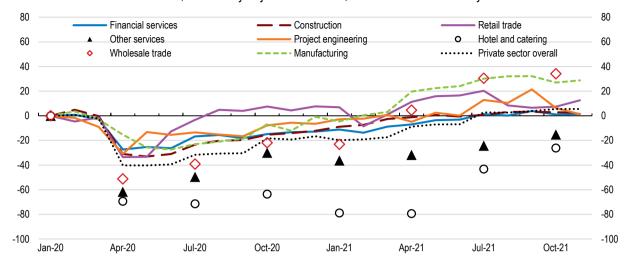
Source: OECD calculations.

Supporting hardest-hit firms and facilitating job reallocation

The crisis had differing impacts across sectors and groups. In the first quarter of 2021, while close to 70% of companies reported that the crisis had a negative impact on their business, about 15% reported a positive impact (SNB, 2021a). Some sectors experienced a boost to their activities and were hiring new staff. The health care and social services sectors and the IT sector displayed more job postings in November 2020 than a year earlier (X28-Novalytica). Also, as reflected in the KOF Business indicator (Figure 1.12), sectors such as manufacturing and construction-related activities steadily recovered towards pre-crisis levels by the end of 2020, as they were able to adapt to changes in working arrangements and sanitary restrictions. The business situation in the retail sector quite closely followed the strictness of lockdowns and recovered relatively quickly after spring 2020 and again after winter 2020-21. In contrast, sectors such as hotels and catering, passenger airlines and wholesale trade remained severely affected for more than a year. For the hardest-hit sectors there is a risk that consumer preferences may have changed and that demand will not recover to pre-crisis level even in the longer term.

Figure 1.12. The crisis had differing impacts across sectors

KOF Business Situation indicator, seasonally adjusted balances, cumulative from January 2020



Source: KOF Swiss Economic Institute.

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Debt financing and credit guarantees have helped to ease immediate financial constraints on companies and contain financial stress. As in several other OECD economies, the number of corporate bankruptcies actually decreased in 2020, by 6.6% year-on-year (FSO, 2021). This can be attributed to public support as well as the easing of bankruptcy regulations for COVID-19 affected companies. It is, however, likely that many companies, especially SMEs, face deteriorating balance sheets due to low profitability and rising debt (OECD, 2021a, Chetty et al., 2020, Gourinchas et al., 2020, Diez et al., 2021). In June 2021, the KOF Swiss Economic Institute (2021) reported that corporate bankruptcies were on the rise in some industries, such as hospitality and transportation, but they have not reached high levels.

Too early withdrawal of support could trigger unnecessary bankruptcies and labour shedding and may result in labour scarring and poverty. Ending crisis-related support measures should be contingent on removing confinement measures that limit doing business in high-contact sectors. Continued support for households and companies therefore remains warranted in certain sectors, but needs to be carefully targeted (OECD, 2021a and 2021b).

Finding a balance between supporting viable firms and phasing out support for other businesses is a challenge. Company financial distress may increase once support is withdrawn. The rapid debt build-up due to the crisis – including as a result of liquidity-support measures - could pose risks to financial stability and result in debt overhang, adversely affecting private investment and growth (OECD, 2021a). On the other hand, too generous public support for too long risks keeping unviable firms artificially alive ("zombie" firms), stripping viable firms of valuable resources, hindering productivity growth and recovery.

In the short term, policy makers could continue to provide liquidity to hardest-hit firms and to SMEs that may not directly benefit from the international recovery. Meanwhile, loan guarantee schemes could be fine-tuned to reduce the risk of moral hazard and adverse selection by reducing the portion of the loan backed by the government guarantee or increasing the fee to access the programmes. To avoid over-indebtedness and debt overhang, policy makers could consider the use of non-debt instruments to support the corporate sector, for example by linking loan repayment to businesses' returns or converting government loans into grants (up to a ceiling and for specific operational costs). Establishing appropriate conditions for early and orderly debt restructuring would also help (Demmou and Franco, 2021; OECD, 2021a).

Effective insolvency procedures will also be crucial to minimise the loss of resources and spur productivityenhancing capital reallocation (Adalet McGowan et al., 2017). Switzerland scores above the OECD average on the strength of the insolvency framework index with low personal cost to failed entrepreneurs, effective provisions for prevention and low barriers to restructuring (Adalet McGowan and Andrews, 2018). However, according to the World Bank's Doing Business indicators based on a stylised case of corporate insolvency, there is ample room for improvement in practice. The recovery rate for creditors, at less than 50%, is markedly below the OECD mean of 70% (World Bank, 2020). Moreover, the procedure takes 3 years on average, while it takes less than two years in the OECD on average and less than six months in best performers (Ireland). As the number of insolvency cases will likely rise in the near future, adequate resources will be needed for the system to work effectively, including for recruiting and training staff.

The impact of the crisis on income and employment also differed greatly between households and groups of workers. Many households experienced a drop in incomes, either because they lost their jobs or because for most workers the compensation on short-time work stood below previous salaries. Survey data shows that short-time work schemes were used more by low to middle skilled and low-wage workers, suggesting that the crisis had a significantly stronger impact at the lower end of the wage distribution (see Chapter 2). Certainly, however, without the short-time working scheme and other protective measures, the adverse impact on employment and incomes would have been much more pronounced.

A key challenge is to provide sufficient support for viable jobs while helping displaced workers find new jobs in other sectors or locations (OECD, 2021b). Chapter 2 of this Survey discusses options to make the short-time work better targeted to hard-hit firms, for instance by asking firms not subject to restrictions to increasingly bear part of the cost of the scheme. Moreover, active labour market policies should be adapted across cantons, to offer displaced workers help in finding new jobs or gain new skills, and a stronger emphasis could be put on employment incentives for the most vulnerable workers. In the medium-term, boosting labour market participation by mothers and older workers would also boost growth.

Box 1.4. Planned economic policy to aid the recovery after the crisis

In May 2021, the Federal Council discussed the way forward for economic policy once the majority of pandemic restrictions are lifted and the economic situation normalises. Speedy economic recovery is expected, but some companies and sectors will continue to face limited demand. The Federal Council has decided to follow a transition strategy around three policy principles: normalisation, support for structural change and boosting growth through structural reform.

Normalisation: the Federal Council intends to gradually abandon extraordinary stabilisation measures. Short-time work compensation will continue in 2022, but gradual scaling back of the crisis-related extensions to the scheme started in July 2021. Compensation for the loss of earnings linked to COVID-19 and public support to organisers of large events will be maintained until the end of 2022.

Support for structural change: use of standard tools to help workers and firms adapt to structural change, including unemployment insurance, promotion of innovation, tourism policy or regional policy. The current instruments will be reviewed and strengthened if necessary.

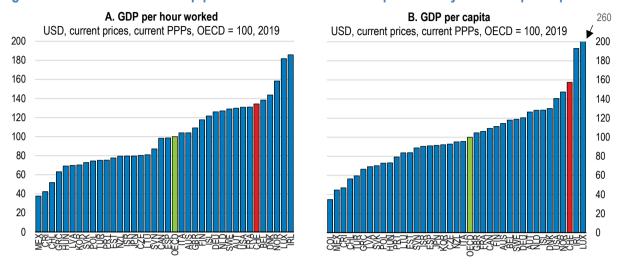
Boosting growth: various targeted measures to strengthen framework conditions and improve growth prospects, including for example, the "digital Switzerland" strategy, promoting decarbonisation, continued funding for investments in infrastructure (rail infrastructure, roads, electricity transmission), and lower administrative barriers to trade and entrepreneurship.

Boosting competition to raise productivity and growth

Switzerland is one of the top OECD performers in terms of labour productivity. Together with high employment rates, this results in very high income levels (Figure 1.13). The stable macroeconomic environment, highly skilled workforce and openness to trade help sustain a globally competitive, high value-added economy. Labour productivity is particularly high in the food industry and manufacturing of

pharmaceuticals, and in a number of service sectors, including wholesale and retail trade, finance and public services (public administration, education and health) (Figure 1.14). The share of high-tech manufacturing in total manufacturing value-added is the highest in the OECD and the share of workers employed in elementary occupations one of the lowest (Figure 1.15). A profitable corporate sector and high human capital contribute to high business investment in R&D and top innovation performance.

Figure 1.13. Switzerland is a top performer in terms of labour productivity and GDP per capita



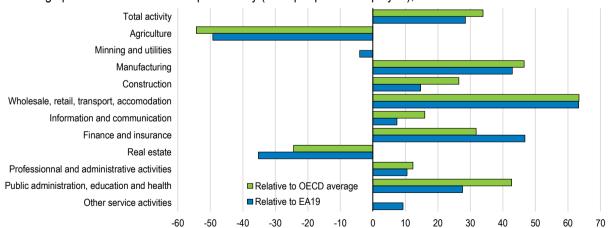
Source: OECD Productivity database.

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With population ageing weighing on potential GDP per capita growth and limits to employment growth, improving productivity and boosting capital investments are key to sustain living standards. Still, productivity growth has slowed down markedly (Figure 1.16). While this tendency has been observed across the OECD, the slowdown began earlier in Switzerland and productivity growth has been mostly below peers over the last two decades (Figure 1.17). Lower barriers to trade and competition and an improved business environment can generate investments that will foster productivity improvements as well as help revive economic growth. As discussed in the previous survey (OECD, 2019a), promoting a more dynamic business environment can also spur faster adoption of digital technologies.

Figure 1.14. Productivity is very high in a number of sectors

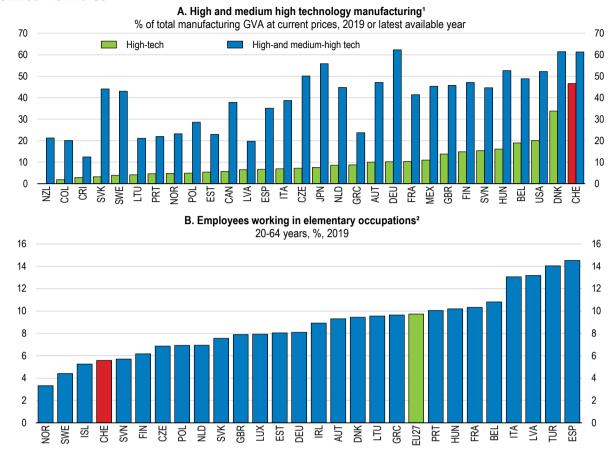
Percentage point difference in labour productivity (GVA per person employed), 2016



Note: Gross Value Added (GVA) is GVA in current prices, current USD PPPs. OECD average include 30 OECD countries. Source: OECD calculations based on OECD National Accounts Statistics.

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Figure 1.15. The globally competitive and high value-added economy is sustained by a highly skilled workforce



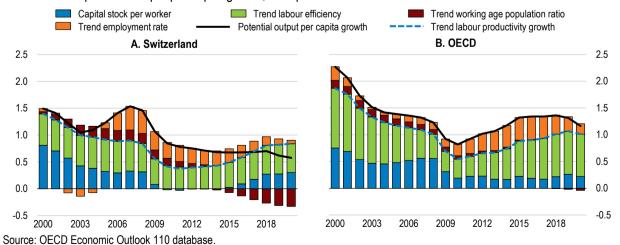
- 1. Based on Eurostat aggregation of the manufacturing industry according to technological intensity, based on NACE Rev.2, 2 digit level.
- 2. Elementary occupations are defined in the ILO's International Standard of Classification of Occupations (ISCO). The occupations consist of simple and routine tasks which mainly require the use of hand-held tools and often some physical effort. The skills required correspond to primary education (around five years).

Source: OECD National Accounts Statistics; Eurostat database [Ifsa eegais].

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Figure 1.16. With ageing, productivity growth will be key to sustain living standards

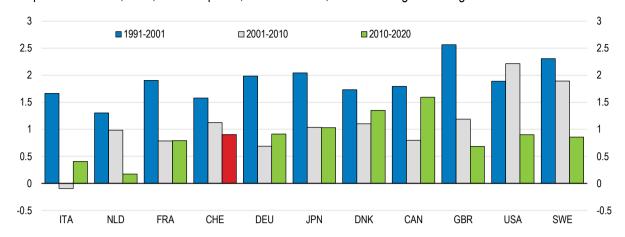
Contribution to potential output per capita growth, in % points



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Figure 1.17. Productivity growth has slowed

GDP per hour worked, USD, constant prices, constant PPPs, annual average % change



Note: Country ranking is based on the whole period.

Source: OECD Productivity database.

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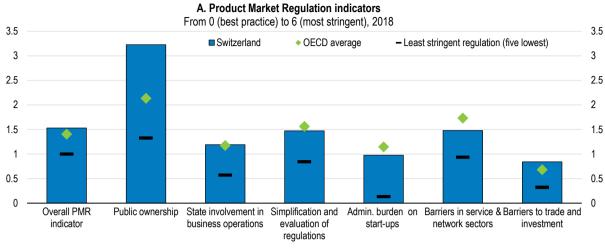
Improving regulatory settings

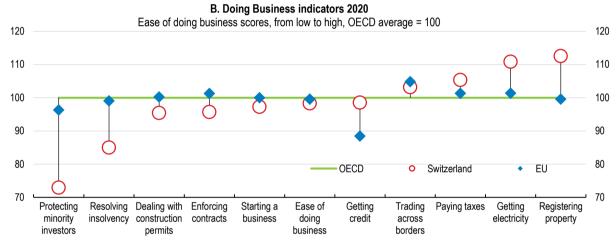
There is room to improve regulatory settings, as suggested by Product Market Regulation (PMR) indicators (Figure 1.18). The administrative burden on start-ups is around the OECD average, but higher than in best performing OECD members. The number of procedures to open a company and the monetary cost to complete them are higher than in OECD best performers and the amount of required minimum capital for limited liability companies is also relatively high.

The World Bank Doing Business indicators (World Bank, 2020) also show a number of weaknesses (Figure 1.18), including relatively more burdensome and time-consuming procedures for starting a business than in most other OECD members. Furthermore, resolving commercial disputes ("enforcing contracts") takes longer than on average in the OECD, and is more costly to businesses. The process for obtaining construction permits is also relatively slow and cumbersome. To build a warehouse, 13 different procedures are required and the process takes a bit above five months, almost a month longer than in the OECD on average (World Bank, 2020). Such delays in planning and issuing permits have repercussions for the wider economy, as they slow down investment and impair entrepreneurship.

Since 2017, a one-stop shop (EasyGov.swiss) has eased markedly the administrative burden on companies. It has been constantly expanding and it should be expanded further, as planned, notably by ensuring the integration of cantonal government services. "Silence is consent" licensing rules, whereby licenses are automatically issued if the competent authority has not acted in a given timeframe, could also ease procedures, as in several other OECD countries.

Figure 1.18. There is room to improve regulatory settings





Note: EU is an unweighted average of EU countries that are members of the OECD. Source: OECD 2018 PMR database; World Bank Doing Business indicators 2020.

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Despite continuous improvements, competition in the domestic market is still hampered by cantonal borders (Competition Commission, 2018). According to the Internal Market Act, all businesses or professions that can successfully operate in one canton must be allowed to operate in all other cantons. To name a few recent examples of potentially hampered internal competition (Competition Commission, 2020), cantons need to recognise professional licences from other cantons without further examination, but there have been barriers in the health sector, for instance. Also, some cantons have imposed "protection charges" (to protect business secrets) in connection with public invitations to tender. The Competition Commission watches over the implementation of the Internal Market Act and works continuously to ensure that new national or cantonal regulations and public procurement processes are in line with the Act and that they do not raise unwarranted barriers. The Competition Commission is also increasingly involved in awareness raising and issuing advisory notes (Competition Commission, 2018, 2019 and 2020).

The merger control framework remains more permissive than in EU countries, but reform efforts have been stalled. Over the last four years, fewer than 10% of merger notifications were investigated after preliminary examination (Competition Commission, 2018, 2019 and 2020), which potentially indicates overly lenient regulation. As recommended in past Surveys (OECD, 2017a and 2019a) and as called for by the

Competition Commission (2018), harmonisation with the European Union's merger control system would be beneficial. In particular, Switzerland should adopt the "significant impediment of effective competition" (SIEC) test of market dominance, which focuses on the changes to effective competition in a market following a merger rather than narrowly on the absolute level of market power (Röller and De La Mano, 2006; Jaag et al., 2017). Studies have shown that introducing the SIEC test would result in a strengthened competitive environment and could facilitate interventions against anticompetitive mergers by the Competition Commission (Jaag et al., 2017; Vaterlaus et al., 2020). In addition, harmonisation with the EU would simplify the examination of cross-border mergers.

Competition in Switzerland could also be boosted by strengthening the Cartel Act in a way that would further deter illegal practices of price collusion and bid rigging. As assessed by the Competition Commission (2019), while the current law provides that victims of unlawful restraints of competition are entitled to claim damages, in practice, such civil action is rare. This is because the hurdles that must be cleared in order to enforce civil claims related to cartels are excessively high (Competition Commission, 2019). Proving a violation of the competition law and quantifying damages is very complex and obtaining required evidence is difficult. The Competition Commission, under administrative law proceedings, can use more powerful investigation instruments (e.g. the power to search houses and business premises) than the civil courts. Moreover, civil claims related to cartels are subject to short prescriptive periods, making it difficult for victims to file a properly substantiated claim in time.

The scope of the civil law on cartels could be expanded so that the option of taking action in the civil courts, currently limited to competitors, would include all those affected by cartels. This would allow all end customers and public contractors, notably the cantons and municipalities, to enforce their rights in civil courts. In addition, the prescriptive period under the private law on cartels should be suspended for the time until the competition authority issues a legally binding decision. Such reforms were proposed by the Federal Council in 2012, but were never passed. In early 2020, the Federal Council announced that it would present to parliament a revised Cartel Act, including with the intention to modernise merger control (introduction of the SIEC test) and to strengthen the civil antitrust law.

State involvement in the economy, according to the PMR indicators, is among the highest in OECD, particularly in network sectors (telecommunications and energy) (Figure 1.18), distorting competition. Services typically provided by private companies in many OECD countries such as distribution of mail and packages, banks and financial services, transport and media, are largely provided by companies belonging to the Swiss Confederation, cantons or municipalities. The most notable examples are a major telecommunications provider (Swisscom, 51% owned by the state), the majority of cantonal banks, as well as energy producing or providing companies (Adler, 2017).

When state-owned enterprises (SOEs) are present in competitive markets, their special position can give them unfair advantages. For instance, implicit government guarantees can result in easier access to funding. Also, monopoly rents from regulated activities can be used to cross-subsidise the competitive part of business operations, giving SOEs room for more aggressive market tactics (OECD, 2015a). Furthermore, bailing out SOEs can be costly, as was experienced by several cantons during the 1990s real estate crisis, when a number of cantonal banks had to be rescued (Jäggi, 2018).

Equal treatment in regulatory matters has largely been achieved for SOEs of the Swiss Confederation. Systematic cross-subsidisation between monopoly services and competitive activities is prohibited and public enterprises with a dominant position need to allow non-discriminatory access to network infrastructure (Federal Council, 2017; Jäggi, 2018). Switzerland has also taken on board a number of OECD guidelines on corporate governance of SOEs (OECD, 2015b) and it now ensures that SOEs are managed based on strategic objectives and transparent corporate governance (OECD, 2020a). A recent review (Lienhard et al., 2019) concluded that the system functions well, but recommended further improvements, mostly on transparency. Ensuring regulatory and competitive neutrality however is an ongoing task, as markets and technology are constantly evolving. Regulatory agencies and competition

authorities should be empowered enough to enforce safeguards against market distortions and ensure the full and impartial implementation of all relevant laws and regulation. In addition, the possibility for private action against such distortions of competition could further deter abuse of advantageous position.

The situation with the SOEs at the cantonal level is less clear, in contrast with good progress at the federal level. Even the scope of SOEs at the cantonal level is not straightforward to determine. A report by the Federal Council (2017) finds that for many cantonal SOEs, the separation of ownership, management, regulatory and market watchdog function is not guaranteed. Several cantonal SOEs have politicians sitting on supervisory boards and there are others directly controlled by the executive. Moreover, some regulations, notably in the hospital sector, favour public enterprises and cross-subsidisation cannot be ruled out. Bringing the standards of corporate governance, transparency and regulatory and competitive neutrality for cantonal SOEs to the same level as for federal SOEs would further improve competition and reduce risks from implicit public guarantees.

Maintaining international openness to harness competitive pressures

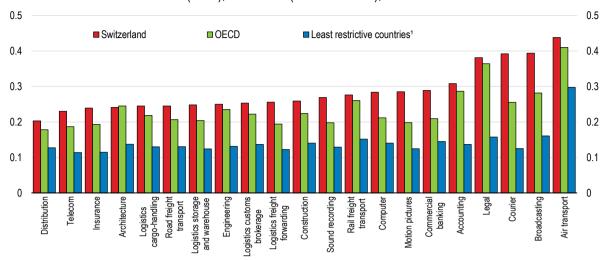
International openness and exposure to foreign competition are essential for productivity growth and innovation activity. For economies with a relatively small domestic market, such as Switzerland, international openness lets the export sector achieve economies of scale while import competition strengthens competition in the domestic market. Evidence (SECO, 2019) shows that the level of sectoral productivity is highly associated with the rate of exports in a given sector, in particular in the manufacturing industries. Productivity growth in domestically-oriented sectors has been weak or even negative, unlike that in export sectors exposed to international competition. It is therefore crucial that Switzerland remains an open economy.

Notably, Switzerland should ensure continued trade and economic partnership with the EU. This will maintain its access and exposure to its most important trading partner. As of now, the bilateral relationship between Switzerland and the EU is governed by a collection of treaties that have been signed over the years. However, some of them may become outdated in the coming years and the EU has shown reluctance to update them individually. In 2014, negotiations began on the Institutional framework agreement with the EU that aimed to provide a unified legal foundation for the future, but in May 2021 the Federal Council officially ended the negotiations without an agreement. Failing to find an adequate alternative raises risks and uncertainties related to the erosion of the Switzerland-EU partnership that could be harmful for Switzerland's external trade and competition.

There is also room to reduce further barriers to trade and to foreign direct investment. In September 2021, Switzerland unilaterally eliminated import tariffs on all industrial products. In contrast, barriers to trade in services – as indicated by the OECD Services Trade Restrictiveness Index – remain higher than the OECD average (Figure 1.19) and should be lowered to spur competitive pressures. Despite some progress on trade liberalisation efforts, restrictions on movement of people remain for independent services suppliers. Relatively high restrictiveness also stems from economy-wide regulatory burdens, as described above, due to relatively cumbersome procedures to register a company and acquire land and the prominent role of the state in the economy. Room for improvement is highest in courier services, broadcasting, motion pictures and sound recording, where relative restrictiveness is the highest (OECD, 2020c).

Figure 1.19. Barriers to trade in services are higher than in most other OECD countries

Services trade restrictiveness index (STRI), from 0 to 1 (most restrictive), 2020



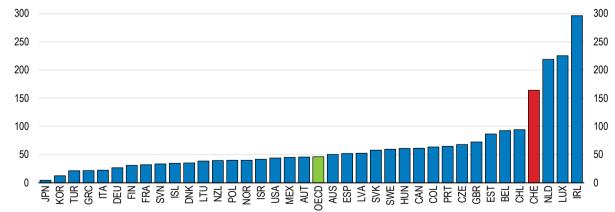
1. "Least restrictive countries" is the average of the 5 countries with the lowest score in each category. Source: OECD STRI Regulatory database.

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According to the OECD FDI Regulatory Restrictiveness Index, Switzerland also imposes some constraints on inward foreign direct investments (FDI), mainly through equity restrictions. Reducing the regulatory burden on FDI has a positive impact on technology transfer, knowledge spillover and eventually on productivity growth. Indeed, Switzerland has benefited substantially from such spillovers as the stock of inward FDI as a share of GDP is one of the highest in the OECD (Figure 1.20). High barriers to foreign investment are present in a few protected sectors, notably electricity, broadcasting and real estate, while barriers in other sectors are mostly below the OECD average. In 2020, under the initiative "Protection of the Swiss economy through investment controls" the Swiss Parliament tasked the government to draw up a legal framework for controlling foreign investments. The stated objective is to have a targeted, effective and administratively lean investment control system, but the purpose and scope of this measure are not yet clear. Unwarranted barriers to FDI can be damaging for investment and productivity growth.

Figure 1.20. Switzerland has benefited from high inward FDI

Foreign Direct Investment, inward position, % of GDP, 2019



Source: OECD International Direct Investment Statistics database.

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Agriculture is still heavily shielded from foreign competition by high import tariffs and other trade barriers. Swiss agriculture also receives high direct support payments, resulting in the total support to agriculture at 150% of sectoral value added, the highest in the OECD (OECD, 2020b). As a result, labour productivity of Swiss agriculture is 50% below the OECD average (Figure 1.14). As recommended in the past (OECD, 2017a, 2019a and 2020b), lower trade barriers and less direct support would raise productivity in agriculture and could also enhance its environmental sustainability (see below).

Table 1.6. Past recommendations on lowering barriers to competition

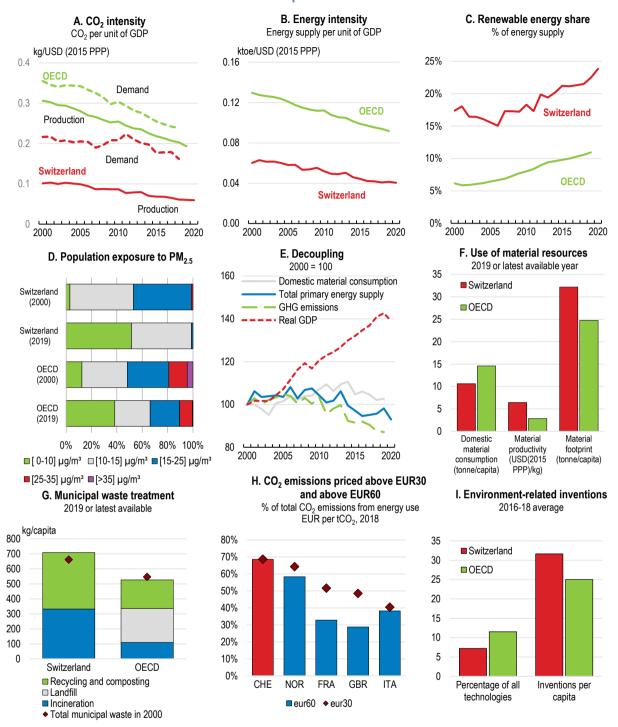
Recommendations in previous Surveys	Action taken			
Lower restrictions on trade in both goods and services, notably in highly protected agricultural products.	Regarding industrial goods, the Federal Council has sent a draft law on the unilateral abolition of all import tariffs on industrial goods to parliament. In October 2021, both chambers passed the law in principle. On 1 May 2019, the Federal Council decided to renew a temporary suspension of customs duties on textile input and intermediary materials from 1 January 2016 and extend its scope. It is expected to stay in force until 31 December 2023, and now covers 522 tariff numbers and is set to reduce import duties by around CHF 3 million per year. By engaging in negotiations on free trade agreements, Switzerland is contributing in lowering restrictions also on trade in agricultural products. On 1 November 2020, the EFTA-Ecuador CEPA entered into force. New agricultural concessions will enter into force on 1 August 2021 pursuant to an updated EFTA-Israel FTA and a new Agreement on Agricultural Products between Israel and Switzerland. For the new EFTA-Indonesia CEPA, as for the updated EFTA-Turkey FTA and new Switzerland-Turkey Agreement on Agricultural Products, the ratification procedures are currently ongoing and entry into force is pending. The agreements entered into force on November 1st and October 1st 2021, respectively. The amendments to the Swiss Federal Law on Processed Agricultural Products in			
	accordance with the relevant decision at WTO's 10th Ministerial Conference from 2015, have entered into force on 1 January 2019.			
Reduce public ownership and remove barriers to entry, including restrictions on the number of competitors, in energy, telecommunications and transport. Remove remaining explicit cantonal government guarantees to their public banks.	The Federal Council is preparing a revision of the Electricity Supply and the Energy Act, including the complete liberalisation of the electricity market. Parliamentary debate is set to start in autumn 2021. No Action taken.			
Modernise merger controls and strengthen sector regulators' powers.	The Federal Council is preparing a revision of the Cartel Act, including a modernization of merger control (introduction of the SIEC test).			
Remove representatives of economic associations from the board of the competition authority.	No action taken.			

Ensuring effective use of resources to raise living standards of all and make growth more sustainable

Environmental performance is good but consumption patterns and resource use still result in environmental pressures

Switzerland is one of the top OECD performers in terms of greenhouse gas (GHG) emissions per unit of GDP, energy supply per unit of GDP (Figure 1.21), and GDP per unit of domestic material consumption. Over the past two decades, Switzerland has achieved the goal of decoupling economic growth from domestic GHG emissions, energy use (Figure 1.21) and from all major air pollutants. The economy's low carbon intensity stems from high shares of renewable energy resources, nuclear energy in the energy mix (to be gradually phased out) and an economy dominated by services (OECD, 2017b, 2020d). Fossil fuels account for less than half of total primary energy supply, well below the OECD share of 79% (IEA, World energy balances 2020).

Figure 1.21. Switzerland has decoupled economic growth from domestic greenhouse gas emissions and material use but environmental pressures remain



Source: OECD (2020), Green Growth Indicators, OECD Environment Statistics (database); OECD National Accounts (database); IEA (2020), IEA World Energy Statistics and Balances (database); OECD (2020), Exposure to air pollution, OECD Environment Statistics (database); OECD (2021), Effective Carbon Rates 2021; Municipal waste, OECD Environment Statistics (database); OECD (2020), Greenhouse gas emissions, OECD Environment Statistics (database); OECD (2020), Greenhouse gas emissions, OECD Environment Statistics (database); Material Resources, OECD Environment Statistics (database).

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Nevertheless, environmental pressures are significant, due to the high standard of living and correspondingly high consumption and resource use. Compared to production based indicators, demand-(consumption-) based indicators point to higher environmental pressures (Figure 1.21) and slower progress in tackling environmental challenges. Furthermore, as an Alpine country, Switzerland is impacted by climate change more strongly than other countries. For instance, annual mean temperatures have risen by about 2 °C since monitoring began in 1864, twice as much as the global mean (Federal Council, 2018). The snowline is expected to rise, while winter snow reserves and glacier volumes will decline further with implications for tourism, water management and agriculture.

The negative environmental effects of Swiss consumption largely occur abroad. According to footprint indicators, in areas such as biodiversity and water consumption, the Swiss footprint is actually worsening, despite progress domestically (Federal council, 2018). A relative lack of domestic raw materials and energy resources necessitate high imports. Domestic material consumption per capita is well below the OECD average, but material footprint per capita that includes materials used in the production of imported products, is above the OECD average (Figure 1.21). It is estimated that between half and three-quarters of the Swiss environmental impact is embodied in the import of goods and services, in particular in relation to food consumption, housing and mobility (Frischknecht et al., 2014, OECD, 2017b). The latest OECD Environmental Performance Review of Switzerland (OECD, 2017b), recommended to promote more sustainable patterns of consumption to further improve Switzerland's resource efficiency in the context of global value chains, as also envisioned by the 2030 Sustainable Development Strategy (Federal Council, 2021c). In addition, Switzerland should better align its trade and environmental policies, including requiring an environmental impact assessment of new trade agreements. For instance, the Swiss administration already conducted the environmental impact assessment of the EFTA-MERCOSUR Free Trade Agreement. Environmental impact assessments are now quite common practice in the US, Canada and the EU (Moise and Rubinova, 2021).

Switzerland's consumption patterns are reflected in high municipal waste. At 705 kg per capita (in 2018) it is among the highest in the OECD and remains higher than 15 years ago, contrary to a number of OECD members, such as the UK, Spain and the Netherlands, that managed to reduce it significantly. Switzerland sends no household waste to landfill and recycles most of it (Figure 1.21), but municipal waste generation has not been decoupled from private final consumption, despite waste disposal fees and other policy instruments. There is considerable room for reducing residual municipal waste and biodegradable municipal waste (OECD, 2017b). A federal waste prevention strategy could help reduce municipal waste and decouple waste generation from rises in consumption.

The Federal Council set the net-zero greenhouse emissions target by 2050 and adopted an ambitious "Long-Term Climate Strategy for Switzerland". The strategy set out climate policy guidelines and established strategic targets for key sectors. In addition, within the Paris agreement, Switzerland has committed to reducing greenhouse gas emissions by 50% by 2030 (compared to 1990). Policy to achieve the 2030 target has been built on the measures and targets of a revised CO2 Act. The latter was passed in parliament in 2020, but was rejected by a popular vote in June 2021. The Federal Office for the Environment estimates that in 2020 the target 20% reduction in greenhouse gas emissions with respect to 1990 was not met (FOEN, 2021). Stronger measures are therefore needed in order not to miss the next set of targets.

Switzerland prices its CO2 emissions at high rates (Figure 1.21) and among OECD countries, it gets closest in aligning its pricing of CO2 emissions to international climate cost benchmarks (OECD, 2018a, 2019b and 2021c). The share of CO2 emissions priced above EUR 60, a midpoint estimate of the carbon cost in 2020, has been on the rise, notably in the housing sector (OECD, 2021c and 2019a). Moreover, the failure to reach the reduction target triggers a rise in the carbon tax from CHF 96 to CHF 120 per tonne of emissions in 2022. Road transport fuels are exempt from the carbon tax, but face high effective rates from fuel taxes and ever stricter CO2 emission target values for new passenger cars and new light commercial vehicles. Since January 2020, Switzerland's emissions trading scheme has been linked to the

EU's Emissions Trading System (ETS), and the emission allocation price has since jumped closer to the EU levels (Hintermann and Zarkovic, 2020). Plans to further raise the carbon tax and introduce a levy on the purchase of air tickets have recently been halted (with the rejection of revised CO2 Act by a popular vote). Going forward, Switzerland should continue its efforts to effectively reduce GHG emissions.

Exemptions to the carbon tax reduce its effectiveness. GHG-intensive companies (not under the ETS) can be exempted from the tax - on competitiveness grounds - if they commit to uninterrupted emission reductions. Still, the previous OECD Environmental Performance Review (OECD, 2017b) assessed that eligibility criteria were lax, as applicants proposed targets themselves based on "economically viable reduction potential". In addition, until 2021, companies that significantly over-performed the agreed targets were eligible to certificates that they could sell to a government fund (subsidies, effectively). The amount of the foregone carbon tax, the "subsidies" and monitoring by the Federal Office for the Environment make this a costly programme and it is questionable whether the benefits outweigh the costs. Evidence shows that emission reduction by companies exempt from the carbon tax have not been larger than of firms paying the carbon tax or being part of the ETS (Hintermann and Zarkovic, 2020). A thorough assessment of the scheme (Swiss Federal Office of Energy, 2016) showed that it did not contribute to significant emission reductions in large companies compared to already planned reductions, while it contributed somehow in small companies. This demonstrates the need to adjust the mechanism in order to help reduce emissions more effectively without introducing a heavy administrative burden. From a climate policy perspective, exemptions to the carbon tax should be gradually scrapped over time as the CO2 levies rise internationally.

Reassessing and eventually removing various environmentally harmful subsidies and exemptions would result in a more coherent pricing and incentive system across sectors and provide a clearer market signal as to the societal costs of different activities. Subsidies and tax exemptions have historically benefited particular sectors such as agriculture, forestry and public transport (OECD, 2017b) and removing them has proved politically difficult. Agriculture policy support, in particular, remains one of the highest in the OECD, and aligning agriculture policy objectives with environmental ones has been slow. As recommended by the OECD Environmental Performance Review of Switzerland (OECD, 2017b) agriculture policy support should be explicitly put at the service of achieving agri-environmental objectives, including by removing remaining sector-specific fossil fuel-related tax exemptions and reductions, e.g. on oil use and on methane emissions.

Boosting green investment and eco-innovation

Switzerland should continue to leverage its internationally competitive financial and corporate sectors, and high saving rate to boost green investment and foster eco-innovation. Taking further steps to promote mainstreaming of environmental and climate-related considerations into business and investment decisions as well as to mobilise private participation in green investment could yield significant environmental benefits domestically and internationally. It could also help revive economic growth.

A voluntary climate compatibility test on a large and representative sample of the Swiss financial sector showed that in 2020, the sector's large investment portfolio was not compatible with Switzerland's climate goals and the aim to become a leading centre for sustainable finance. Using an internationally comparable methodology, the Federal Office for the Environment (FOEN) and the State Secretariat for International Financial Affairs (SIF) conducted climate compatibility tests on 179 financial institutions, including banks, pension funds and asset managers. The results showed that the sector was still heavily invested in oil and coal extraction, and much less in renewable energy or electro-mobility (Spuler et al., 2020). Moreover, while many institutions adopted climate-related investment strategies, implementation was lacking. However, progress had been made and data show that sustainable investment is rising steeply in Switzerland (Swiss Sustainable Finance, 2020). Comparison with a similar climate compatibility testing done in 2017 showed that higher transparency and awareness proved valuable for the institutions involved and many adopted effective climate-related initiatives following the first testing round.

Investment portfolios and corporations are also exposed to climate-related risks that arise from the transition to a sustainable low-carbon economy and from increased frequency and severity of climate-related natural catastrophes. Information on climate-related risks is crucial for ensuring that investors and policy makers understand the exposures. The authorities are preparing the binding implementation of the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) by large Swiss companies in all sectors of the economy. This will introduce an obligation by companies to indicate how they deal with climate risks in the areas of governance, strategy and risk management, as well as show the indicators and targets they use. From July 2021 onwards, FINMA requires large banks and insurance companies to do so. The Federal Council recommends to financial institutions to publish their methods and strategies for taking account of climate and environmental risks in performing their asset management roles. The Federal Council has also tasked the Federal Department of Finance to prepare a proposal by summer 2022, whereby big companies, banks and insurers will be obliged to report on the climate risks and climate impact of their operations. Strengthening the disclosure of climate-related risks should be stepped up, as has been done in other OECD countries.

More ambitious support for green technology and green R&D could yield benefits in terms of the environment as well as economic growth. Switzerland ranks low among OECD countries in the share of environment-related activities in its overall direct government support for research and development (R&D). However, the total expenditures that would include indirect funding via research and innovation programmes of publicly-funded agencies (e.g. the Swiss National Science Foundation and Innosuisse), and the expenditures of research and innovation institutions linked to Swiss universities, are much higher. While the share of environment-related patents is low, in per capita terms the number of environment-related patents is above the OECD average as innovation activity is high overall. It is estimated that energy-related private R&D spending is about four times the size of public spending (IEA, 2015) going mainly to pilot and demonstration projects on energy efficiency.

The revised CO2 Act set the framework for a climate fund with boosted public resources to support environmental technologies. The climate fund aimed to incorporate already existing energy-efficiency buildings programme and the technology fund that provides loan guarantees to companies that develop innovative green products and processes. With planned increased revenues from revised CO2 tax, new aviation levies and other revenues (auctioned emission allowances and sanctions) there was an expected 50% increase in funds for the buildings programme, and more than a doubling of funds for green technology and innovation. With the rejection of the revised CO2 Act, plans in this form have been halted, but efforts to support investment to boost energy efficiency and increase public funds for environmentally-related R&D should continue.

Addressing challenges from population ageing

A substantial pension reform is long overdue, as already argued in the previous OECD Economic Survey, which had an in-depth chapter on population ageing (OECD, 2019a). The statutory retirement age has remained at 65 years for men since its introduction in 1948 despite dramatically changed demographics and bleaker future growth prospects. In addition, Switzerland is among the four remaining OECD members that have not yet equalised the male and female statutory retirement age, which remains at 64 for women. In December 2021, the parliament passed a reform of the first pillar of the pension system, envisaging the statutory age of retirement for women at 65, but the law will likely be challenged at a referendum.

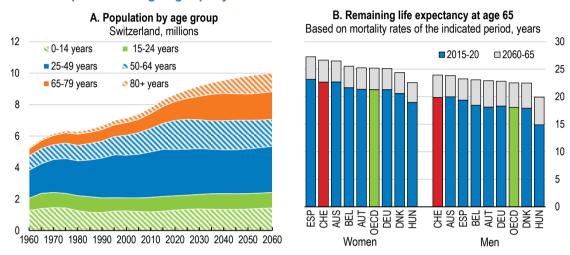
Most workers retire around age 65 and the time in retirement is increasing (Figure 1.22). Remaining life expectancy at age 65 is now close to 23 years for women and 20 years for men, and it is projected to increase by another four years by 2060-65 (Figure 1.22, OECD, 2019c). The number of people aged 80 or over will more than double by 2045. With current policies, the ratio of retirees to employees is set to soar.

Changed demographics can adversely affect growth, productivity and the labour market, where 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 steep decline – to below the OECD average (Figure 1.23). The *Chapter 2* of this *Survey* reviews the labour market aspects of the ageing population.

Ageing also creates fiscal pressures, by lowering revenues and raising costs related to pensions, health-care and long-term care. A significant increase in revenues would be required to counter the rise in expenditures, given the constraints under the debt brake rule. The main driver of rising expenditures is the increase in the size of the older population. Long-term scenarios based on Guillemette and Turner (2018, 2021) show that the ratio of revenue to GDP would need to rise by around 3 percentage points by 2060 to hold the debt-to-GDP ratio steady (Figure 1.24), assuming real spending per capita on non-ageing-related services is maintained. Pension reform can offset a significant part of the increase. Another option would be to crowd out other spending programmes with potentially adverse effects on productivity and equity.

Figure 1.22. Population is ageing rapidly

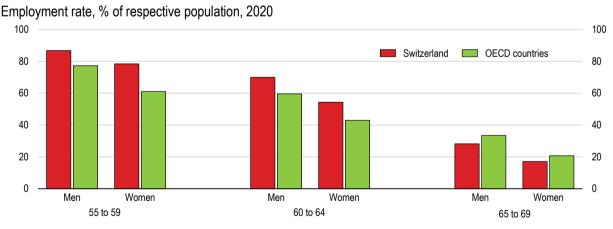


Note: In Panel A, youth are shown in green, 25-64 year-olds in blue and seniors in orange. After 2020 data are from the "medium variant" of UN scenarios.

Source: United Nations (2019), World Population Prospects: The 2019 Revision, Online Edition.

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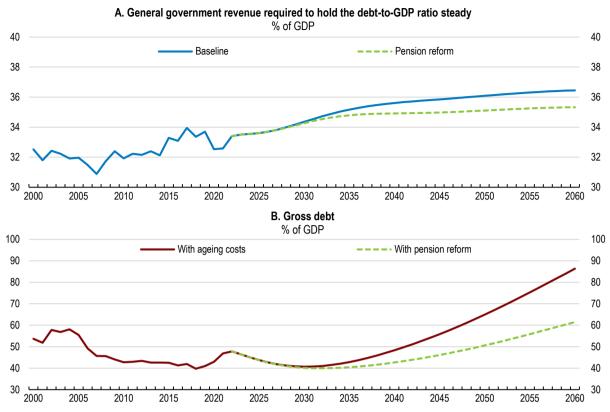
Figure 1.23. Employment rates fall steeply after 65



Source: OECD Employment and Labour Market Statistics database.

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Figure 1.24. Ageing creates fiscal pressures



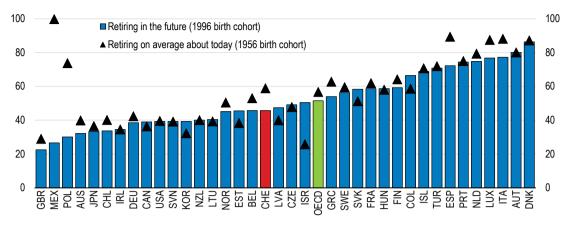
Note: The projections are illustrative and differ from national projections (FDF, 2021). The OECD Long-term model considers demographics but also the Baumol effect – i.e. the tendency for the relative price of services to increase over time. It is also assumed that other primary expenditures (other than health and pensions) are affected by ageing. The assumption is that governments would seek to provide a constant level of services in real per capita terms. This translates into higher fiscal pressure when the employment / population ratio falls. This component adds about 2 pp of GDP by 2060 (see Box 1.1 and Figure 1.13 in Guillemette and Turner, 2021). In addition, the scenarios assume that public pensions will grow at ½ the pace of wages, in line with the current Swiss law. Panel A shows the required increase in public revenues to keep debt-to-GDP ratio steady amid rising costs due to ageing. Panel B assumes that rising ageing costs are financed with deficits (applied on a zero primary balance scenario). In both cases, pension reform entails the following: first equalising retirement age for men and women at 65, then retirement age gradually rises to 67 in 2034, and by half of the expected gain in life expectancy thereafter (to reach 68 in 2058). Source: OECD calculations.

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Pension replacement rates from the mandatory pension system (the first pillar and the mandatory part of the second pillar) are set to drop significantly for average earners (Figure 1.25), from currently high levels. Furthermore, as already discussed in the last Survey (OECD, 2019a), the first pillar's funding faces serious pressures. The compensation fund managing first pillar assets and liabilities has run a deficit (excluding investment returns) since 2014 (Federal Social Insurance Office, 2020).

Figure 1.25. The replacement rate from mandatory pension schemes is expected to fall

Gross replacement rate for mandatory schemes, %



Note: Full-career average earners retiring at the normal retirement age of the respective cohort, men.

Source: OECD (2019), "Will future pensioners work for longer and retire on less?", Policy Brief on Pensions, OECD Publishing, Paris. www.oecd.org/els/public-pensions/OECD-Policy-Brief-Future-Pensioners-2019.pdf

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Reforms have proven difficult and many such efforts were rejected by referendum in the past. A recent reform, effective from 2020, will raise social security contributions by 0.3 percentage points, earmark an additional 0.2 percentage points of VAT revenues to the first pillar, and raise federal government's contribution from 19.6% to 20.2% of total expenses. The reform boosts revenues, delaying the time when the compensation fund will go into negative equity by four years (to 2034) (Federal Social Insurance Office, 2019). However, it does not tackle the problem sustainably. Raising the statutory retirement age and linking it to increases in life expectancy, as well as improving incentives to work beyond that age are key reforms that would raise revenues, ease spending pressures and help sustain growth. This would also help increase replacement rates in the second pillar. Other OECD countries such as Denmark and the Netherlands for example, have already instituted reforms to lift the statutory retirement age and subsequently link it to life expectancy.

The mandatory part of the second pillar faces pressures from unsustainable minimum conversion rates that threaten sustainability and intergenerational fairness. It is a hybrid system (unlike a pure defined contribution system) and the rate at which accumulated capital is converted into an annual pension benefit is set by law. This rate has been unchanged since 2004 despite rising life expectancy and lower investment returns. At 6.8% it is well above an actuarially fair rate, which is estimated at 4.5-5%, depending on expected returns and retirement age (Helvetia, 2020). In response, pension funds have lowered returns accruing to current contributors, resulting in significant intergenerational transfers that are growing over time (Occupational Pension Supervisory Commission, 2019 and 2020). Moreover, many funds lowered effective conversion rates by lowering conversion rates from the extra-mandatory (voluntary) part of the second pillar. To lower liabilities, some funds encourage the insured to take a large part of their pension wealth as a lump sum upon retiring (OECD, 2019a). Some funds that rely mostly on the mandatory scheme even potentially face insolvency.

Based on the proposal by the social partners, the Federal council, in 2020, proposed a reform with the aim to reduce the conversion rate from 6.8% to 6%, together with some measures to cushion the transition and protect low-income workers from the resulting drop in pensions. Lowering the minimum conversion rate and making it a more flexible parameter (not set by law as it is now) is crucial to safeguard the sustainability of the second pillar. Lengthening the contribution period – lowering the starting age below 25 (currently set by law) and extending it beyond 65 - would help maintain adequate benefits while ensuring the sustainability of the pension system.

Making the tax mix more growth friendly

A revenue neutral shift away from taxing personal income towards indirect taxes, including environmental taxes, could boost growth sustainably and reduce the exposure of government revenue to ageing. Switzerland's tax revenues as a share of GDP are relatively low (Figure 1.26). As discussed extensively in a special tax chapter in the 2011 Survey (OECD, 2012), Switzerland relies significantly more on direct taxation – personal income tax, corporate income tax and social security contributions paid to general government (as well as to private sector funds) - than most other OECD countries. Taxes on goods and services, on the other hand, are much lower (Figure 1.26). Such a tax mix is relatively more distortionary and harms growth, as taxing labour acts as a disincentive to work (Akgun, Cournède and Fournier, 2017; Arnold et al., 2011).

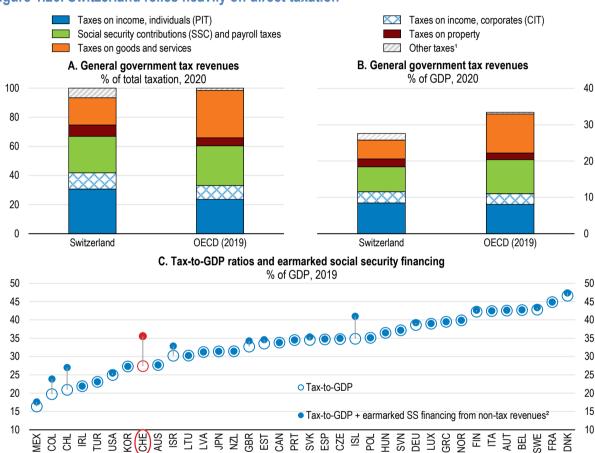


Figure 1.26. Switzerland relies heavily on direct taxation

- 1. Includes not allocable between personal and corporate income tax.
- 2. Earmarked financing of social security from non-tax revenues includes voluntary contributions to government and compulsory contributions to the private sector.

Source: OECD Revenue Statistics database.

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The interplay between the tax and benefit systems results in disincentives to work, notably for second earners, contributing - together with high costs of childcare - to lower working hours and lower labour incomes for women. These issues are discussed in more detail in Chapter 2 of this Survey. There is room to reduce personal income tax, notably by reducing the burden on low-income households and second-earners, and flattening age-related progressivity in social security contributions.

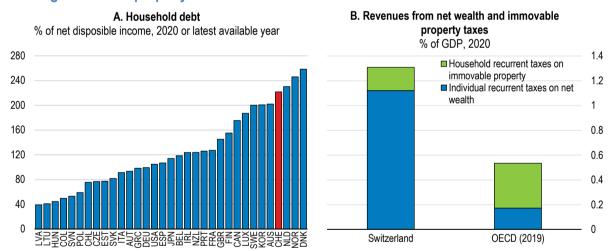
The personal income tax system also generates incentives for households to leverage their wealth. Interest paid on household debt is tax deductible with lax upper limits for deductibility. For instance, tax deductible

mortgage interest and maintenance expenses can exceed imputed rental income from housing. Moreover, a large part of capital gains realised by households is exempt from tax, further reinforcing incentives to leverage wealth. Swiss households have one of the highest indebtedness rates in the OECD (Figure 1.27) despite a low rate of home ownership. Limiting interest deductibility and broadening the capital gains tax base could strengthen equity - as it mostly benefits the wealthy - and help reduce the tax burden on labour or pay for the rising costs of the ageing population and climate change mitigation.

Switzerland raises high tax revenues from the net wealth tax (Figure 1.27), supported by a broad tax base and a relatively high share of wealthy individuals. Most cantons have abolished inheritance and gift taxes for transfers to direct descendants, but Switzerland's wealth taxes are levied on relatively lower levels of wealth (levied on part of the middle class) compared to other countries and can to some extent be viewed as replacing these other taxes. Switzerland could assess the merits of introducing a more broad based capital gains tax and inheritance and gift taxes that have been shown to be more efficient and have higher redistributive effects (OECD 2018b and 2021d). Moreover, net wealth taxes incentivise tax optimising behaviour and further increase incentives to borrow (and invest in assets such as owner-occupied houses or owner-managed businesses) as debt is deductible at face value from the net wealth tax base. A reform to improve the design of the net wealth tax could be considered to make it less regressive or more progressive, to limit debt deductibility and to improve coordination across cantons.

There is also room to increase revenues from the tax on immovable property, which is low in international comparison (Figure 1.27), although it is less distortive than most other taxes (Arnold et al., 2011). Raising taxes on immovable property at the local level can also make tax revenues of sub-national governments less prone to economic shocks and population ageing (Kim and Vammalle, 2012; Colin and Brys, 2019).

Figure 1.27. The tax system contributes to high indebtedness of Swiss households, while reliance on taxing immovable property is low



Source: OECD National Accounts database; OECD Revenue Statistics database.

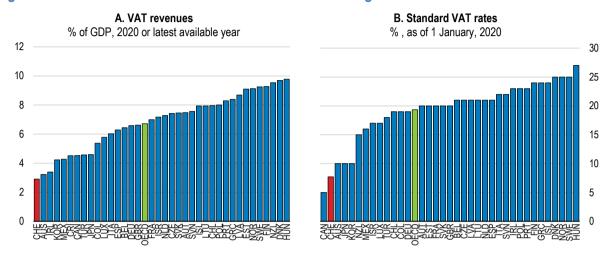
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There is room to raise the standard VAT rate and broaden the VAT base. Switzerland's standard VAT rate (at 7.7%) and VAT revenues in terms of GDP are among the lowest in the OECD (OECD, 2020e) (Figure 1.28). Reduced rates (2.5% and 3.7%) apply to a range of goods and services, such as accommodation services, food and drinks, agricultural supplies, water, printed materials, medicines and cultural and sporting events. According to the VAT Revenue Ratio indicator (OECD, 2020f) Switzerland loses a lower proportion (31%) of its potential VAT revenues than OECD countries on average (44%) due to exemptions, reduced rates, fraud and non-compliance. The use of reduced VAT rates could be further reduced nevertheless, in particular because the standard VAT rate is low. International evidence shows that reduced VAT rates are poorly targeted as they benefit richer households proportionally more (OECD,

2020e). Moreover, in cases such as pesticides and fertilisers they may encourage overconsumption with potentially harmful impact on the environment.

Broadening the base of the VAT and increasing the standard VAT rate – while reducing the personal income tax - would raise efficiency and be growth-enhancing, as recommended in previous Surveys (OECD 2012 and 2019a). Distributional concerns could be addressed through reductions in income taxes or targeted transfers for lower-income households.

Figure 1.28. Switzerland's VAT rate and revenues are among the lowest in the OECD



Source: OECD Revenue Statistics database; OECD (2020), Consumption Tax Trends 2020: VAT/GST and Excise Rates, Trends and Policy Issues, OECD Publishing, Paris, https://doi.org/10.1787/152def2d-en

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A recent corporate income tax reform, approved in the referendum and effective from January 2020, removed cantonal preferential tax regimes and introduced a new set of internationally accepted rules in line with the OECD/G20 BEPS project. The reform entailed the elimination of tax privileges for "status companies" (holding companies, mixed companies and auxiliary companies— also referred to as domiciliary companies) that previously paid a reduced (or null) corporate income tax at cantonal level (OECD, 2021e). The reform entailed the creation of patent boxes and the possibility for cantons to introduce additional deductions for R&D expenditures. Net profits from patents are to be taxed with a maximum reduction of 90% to be set at cantonal discretion. In addition, cantons may provide further incentives for R&D, whereby the enhanced R&D deduction at the cantonal level can reach a maximum of 50% (on top of the 100% baseline tax deduction) of the effective qualifying expenses. The value of eventual tax allowances will depend on the canton-specific corporate income tax rates that remain at the discretion of cantons.

Switzerland is expected to remain internationally competitive post-reform, with effective corporate income tax rates significantly below the OECD average. In response to the reform, cantons have lowered their corporate income tax rates, on average, by about 2-3 percentage points, and some will reduce them more in the coming years (Portmann and Staubli, 2020). In static terms, total tax revenues will fall (FDF, 2018). In the long term, however, the dynamic effects on the total tax revenues are likely to be positive (Daepp and Staubli, 2018) depending on behavioural responses from companies in terms of location, investment and hiring, and depending on the assumed international tax competition. In the short- to medium-term, the reform will therefore bring a revenue shortfall of up to 0.3% of GDP annually (Daepp and Staubli, 2018), putting some pressures on public finances (cantons will be partly compensated for potential revenue losses by higher revenue sharing of direct federal tax). Also, incentives for innovation based on income-based measures such as patent boxes reward existing patents rather than risky investment in R&D with uncertain benefits further in the future. In this, they tend to benefit large multinational companies, against small,

innovative start-ups that are more likely loss-making and credit-constrained (Appelt, et al., 2016). The reform is a step in the right direction nevertheless, as it eliminates unfair tax advantages for internationally active companies and introduces explicit incentives to R&D that did not exist before in Switzerland.

Fighting corruption and money laundering

Indicators of control and perceived risks of corruption in the public sector suggest that Switzerland consistently scores among the best-performing OECD member countries (Figure 1.29). In its fourth evaluation round, the Council of Europe anti-corruption body, the Group of States against Corruption (GRECO) listed twelve recommendations to Switzerland to prevent corruption and improve public integrity in respect of members of parliament, judges and prosecutors (Council of Europe, 2017). Two years later, it found the level of compliance with recommendations satisfactory (Council of Europe, 2019). Notably, GRECO reported good progress concerning prosecutors and welcomed the commitment by the Federal Assembly to compile in a single document all rights and obligations of MPs. Good progress was reported also on the requirement to provide further details of professional activities in the declarations of interests for the members of parliament, but GRECO regretted that the recommendation on including quantitative data concerning MPs' financial and economic interests had not been complied with. There was also a lack of progress with respect to federal judges in improving the recruitment process in terms of quality and objectivity and in the development of the rules of conduct.

Recent efforts have been undertaken to strengthen Switzerland's approach to public integrity and corruption prevention across all branches of government through the Anti-Corruption Strategy 2021-24. Adopted by The Federal Council in November 2020, it includes high-level objectives to prevent and prosecute corruption, with the aim to maintain the reputation of Switzerland as the world renowned business centre with high integrity (Federal Council, 2020).

However, the prominent international position and high export orientation expose Switzerland to a relatively high risk of foreign bribery. Switzerland has one of the world's highest ratios of multinationals to inhabitants and these operate in sectors that are highly prone to foreign bribery including pharmaceuticals and trade in raw materials such as agricultural products, stone and metals, and energy products. Moreover, the international status of Switzerland's financial sector and focus on wealth management make the sector prone to greater risk of use for criminal purposes, particularly through money laundering, including the laundering of foreign bribery (OECD, 2018c).

These risks are acknowledged by the Swiss authorities and indicators show that Switzerland's anti-money laundering measures are quite effective in most aspects (Figure 1.30). According to the OECD Working Group on Bribery in International Business Transactions, Switzerland, through the continued action of the Office of the Attorney General, remains one of the most active countries in enforcing the foreign bribery offence (OECD, 2018c and 2020g). Switzerland has increased resources allocated to the Money Laundering Reporting Office (MROS), as was recommended previously.

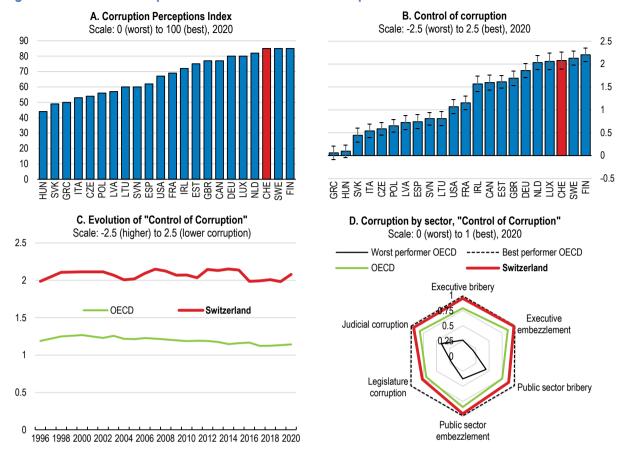


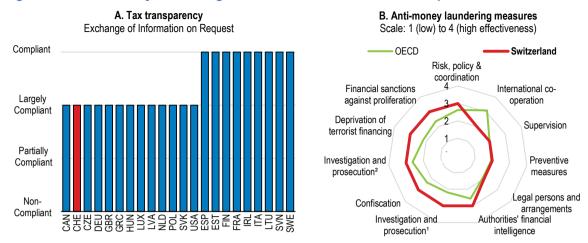
Figure 1.29. Switzerland performs well in control of corruption

Note: Panel B shows the point estimate and the margin of error. Panel D shows sector-based subcomponents of the "Control of Corruption" indicator by the Varieties of Democracy Project.

Source: Panel A: Transparency International; Panels B & C: World Bank, Worldwide Governance Indicators; Panel D: Varieties of Democracy Project, V-Dem Dataset v11.

StatLink https://stat.link/wpsqzj

Figure 1.30. Anti-money laundering measures are effective in most aspects



Note: Panel A summarises the overall assessment on the exchange of information in practice from peer reviews by the Global Forum on Transparency and Exchange of Information for Tax Purposes. Peer reviews assess member jurisdictions' ability to ensure the transparency of their legal entities and arrangements and to co-operate with other tax administrations in accordance with the internationally agreed standard. The figure shows first round results; a second round is ongoing. Panel B shows ratings from the FATF peer reviews of each member to assess levels of implementation of the FATF Recommendations. The ratings reflect the extent to which a country's measures are effective against 11 immediate outcomes. "Investigation and prosecution¹" refers to money laundering. "Investigation and prosecution²" refers to terrorist financing. Source: OECD Secretariat's own calculation based on the materials from the Global Forum on Transparency and Exchange of Information for Tax Purposes; and OECD, Financial Action Task Force (FATF).

StatLink https://stat.link/yp8lzg

Nevertheless, the OECD Working Group on Bribery in its latest assessment from October 2020 (OECD, 2020g) urged Switzerland to address some weaknesses. Action is needed to ensure that sanctions imposed in foreign bribery cases are effective, proportionate and dissuasive. For instance, there are no legislative proposals providing for an increase in the statutory maximum fine for legal persons as was recommended by the OECD (OECD, 2020g and 2018c). Weak progress has also been noted in relation to whistleblower protection. Action should be taken to further strengthen existing protection for whistleblowers in the public sector at the federal level and broaden the legal framework for protection to cantonal officials. In the private sector, whistleblowers continue to expose themselves to criminal proceedings after reporting on corruption and foreign bribery. A bill designed to give protection to private-sector whistleblowers was rejected by parliament in March 2020. A parliamentary initiative on this subject is pending before Parliament but the outcome and timeframe remain uncertain (OECD, 2020g).

Table 1.7. Past recommendations on ensuring sustainable and inclusive growth

Recommendations in previous Surveys	Action taken
Strengthen the relationship between cantonal annual vehicle taxes and pollutants.	The responsibility for the vehicle taxes lies with the cantons. The first chamber of parliament has accepted a motion that asked for a stronger harmonisation of cantonal vehicle taxes. Various cantons promote battery electric vehicles and fuel cell vehicles through significantly lower motor vehicle taxes, and in some cases these vehicles are completely exempt. In addition, various cantons promote electric vehicles through purchase premiums and contributions to the charging infrastructure.
Limit the tax deductibility of mortgage interest so that, combined with maintenance outlays, it does not exceed the amount of declared imputed rent.	There is an ongoing parliamentary debate on a reform to abolish the taxation of the imputed rental value. According to its current version, as passed by the Council of States ("Ständerat"), it would be accompanied by a limitation of the deductibility of interest on private debt to 70% of taxable income from capital.
Increase financial incentives to work longer before retirement.	On 17 December 2021, the Parliament adopted a reform of the first pillar of the pension system (AHV 21 reform). Ongoing reform of occupational pensions (second pillar): On 25 November 2020, the Federal Council sent a reform package to parliament. The reform proposal includes among other measures (e.g. reduction in the minimum conversion rate to 6.0%, compensatory measures) a reduction in the differences in contributions between younger and older insured persons. This aims at reducing wage costs for older workers.
Promote programmes to lengthen healthy working lives, including preventative health programmes.	No action taken.

Recommendations

MAIN FINDINGS	RECOMMENDATIONS
Supporting the eco	onomy to exit the crisis
The COVID-19 pandemic continues to raise uncertainty and challenges. Vaccination slowed markedly over the summer 2021.	Take appropriate measures to accelerate vaccinations.
Inflation is projected to remain low as the economy recovers, with substantial risks and uncertainty.	Monetary policy should remain accommodative until the recovery is firml 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 a residential mortgages. Progress further on managing the risks from "too-big-to-fail" banks, notable with strengthened liquidity requirements and resolution and emergence plans.
The build-up of imbalances in the residential real estate market has continued, exposing debtors and creditors to interest rate and credit risks.	Consider a broader toolkit of macroprudential measures that would take accour of affordability (e.g. debt-to-income and debt-service-to-income limits on mortgag loans). Give the SNB and FINMA clear and strong mandates to propose and calibrat macroprudential tools.
The deficit increased but gross general government debt remains low in international comparison 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 appl 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.
Company distress could increase once support is withdrawn. The resulting rapid debt build-up could pose risks to financial stability while debt overhang in the corporate sector would adversely affect private investment and growth. On the other hand, too generous public support for too long risks keeping unviable firms artificially alive ("zombie" firms).	Continue providing liquidity to the hardest-hit firms in the short term if needed, while reducing the portion of the loan backed by the government guarantee or increasing the fee to access the programmes.
Effective insolvency procedures will be crucial to minimise the loss of resources and spur productivity-enhancing capital reallocation. Switzerland scores well on the strength of the insolvency framework but there is ample room for improvement in practice.	Enhance insolvency procedures by improving early access of debtors and creditors to cost-efficient and speedy insolvency proceedings and by ensuring adequate resources, including for recruiting and training staff.
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	Fully implement the Internal Market Act to ensure equal access to markets i all cantons.
action against cartels is rare due to high complexity and short prescriptive periods.	Harmonise the merger control framework with that of the EU and strengthe 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 i consent" licensing rules. Expand the government one-stop shop (EasyGov.swiss) by integrating cantonal governments' services.
State involvement in the economy is among the highest in OECD, particularly in network sectors (telecommunications and energy). SOEs in competitive market can benefit from unfair advantages, distorting competition.	Reduce public ownership and keep reducing the competitive distortions due to public ownership.
In many cantonal SOEs, the separation of ownership, management, regulatory and market watchdog function is not guaranteed. Some regulations favour public enterprises and cross-subsidisation cannot be ruled out.	Bring the standards of corporate governance, transparency and regulatory an competitive neutrality for cantonal SOEs to the same level as for federal SOEs.
Barriers to trade in services are higher than in most other OECD countries. Switzerland also imposes some 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 i agriculture. Remove the barriers to FDI where applicable and keep them low
Ensuring effective use of re	esources 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.

Environmentally harmful subsidies and tax exemptions remain in place that reduce the effectiveness of environmental policy instruments, notably in agriculture, forestry and public transport.

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 the revised CO2 Act by a popular vote). Exemptions to the carbon tax may reduce its effectiveness.

Reassess and remove environmentally harmful subsidies and tax exemptions -

including in agriculture - to make pricing and incentives more coherent across

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.

More ambitious support for green technology and green R&D could benefit the environment as well as economic growth. Plans to boost public support for energy-efficiency in buildings and green innovation further in the form of a climate fund have been halted.

Continue to promote investment to boost energy efficiency and increase public funds for environmentally-related R&D and green innovation.

Population is ageing rapidly. First pillar funding faces serious pressures and pension replacement rates from the mandatory pension system are set to go down significantly.

Fix the retirement age at 65 for both genders and link it to life expectancy.

In the second pillar, the rate at which accumulated assets are converted to a pension is set by law. The rate is too high, resulting in substantial redistribution within the second pillar from vounger to older workers and retirees. Some pension funds may face insolvency.

Lower the parameter used to calculate annuities ("minimum conversion rate") and make it a more flexible technical parameter set by ordinance.

Switzerland relies significantly more on direct taxation, notably personal income tax, than most other OECD countries. Switzerland's standard VAT revenues are among the lowest in the OECD. The revenue from the tax on Lower the age to participate in occupational pensions (the second pillar).

immovable property is low. The personal income tax system and net wealth tax design generate Improve work incentives by reducing personal income taxes, notably for secondearners. Raise VAT and taxes on immovable property, while addressing adverse distributional impacts.

incentives for households to leverage their wealth. Reliance on the net wealth tax is high, while a large part of capital gains is not taxed.

Limit mortgage interest deductibility in personal income tax and broaden the capital gains tax base.

Switzerland is highly export-oriented and serves as international business hub, including in high-risk sectors for foreign bribery, such as trade in raw materials, pharmaceuticals, and international asset management. In the private sector, whistleblowers continue to expose themselves to criminal proceedings after reporting cases involving corruption and foreign bribery.

Consider reforming the design of the net wealth tax to make it more progressive. limit debt deductibility and improve coordination across cantons.

Increase the statutory maximum fine for legal persons in foreign bribery cases, to ensure that sanctions imposed are effective, proportionate and dissuasive.

Strengthen existing protection for whistleblowers in the private and public sector. including at the cantonal level.

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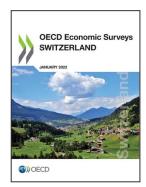
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