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Local debt: from budget responsibility to fiscal discipline

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1 Introduction

There are two ways for considering local debts: ex ante and ex post. Ex ante looks at the conditions and financial context in which local government may support deficits and incur debts. Ex post refers to debt management that is how to organise loan credits and savings in order to minimise financial costs. This paper is positioned ex ante.

According to article 9 paragraph 8 of the European Charter of Local Self-Government (Council of Europe, 1985), "*for the purpose of borrowing for capital investment, local authorities shall have access to the national capital market within the limits of the law".* The subsequent explanatory Report (Council of Europe, 1998) does not give policy guidance as to how this paragraph was first intended (Annexure I, Box A) – simply we can infer from paragraph 8 that
(i) loan finance should be reserved for capital investment and not for current expenditures,
(ii) local authorities should have direct access to the capital market, and that
(iii) the higher government layer can restrict local borrowing by law.

Following the European Charter, the political economy of local debt has been extensively developed and debated. Yet, contributions to the theory of subnational balanced budget and debt control were highly academic and not really framed for the preoccupations of policy-makers (Rossi and Dafflon, 2002). The literature describes either institutional restrictions on borrowing (rules for balancing the budget, regulatory framework for local borrowing, accounting and reporting requirements, collaterals, administrative control, rating agencies), or the consequences of excessive debt and sanctions (bailout grants, administrative procedures).

Twenty years after the Charter, the political economy of balancing the budget and controlling debt at the local level is not adequately perceived. In 2004 and 2005, the Committee of Ministers at the Council of Europe made two series of Recommendations to member states on financial and budgetary management at local and regional levels (Box 1). They contain proposals for the funding of investment expenditures (Annexure I). In 2009, the Centre of Expertise for Local Government Reform, Council of Europe, edited the "Local Finance Benchmarking Tool" which added several prescriptions on local debt finance. These documents are at the core of the present paper: we look at the issues from a practical point of view in terms of policy implementation.

Box 1 European Recommendations on borrowing and debt

1985	European Charter of Local Self-Government	Art. 9
2004	Recommendation (2004)1 of the Committee of Ministers to member states on financial and budgetary management at local and regional levels	Rec 24, 71
2005	Recommendation (2005)1 of the Committee of Ministers to member states on financial and budgetary management at local and regional levels	Rec 73, 74, 75, 76
2009	Benchmarking Local Finances", Toolkit Benchmarking for Public Ethics and Local Finance, Centre of Expertise for Local Government Reform, Council of Europe, Strasbourg,	VI Borrowing

Referring to these documents, we look at the issues in terms of policy implementation. The paper is divided in four further sections. Section 2 recalls the differences between budget responsibility and fiscal discipline. While the channelling of local government behaviour by the centre is indispensable for the development of sound debt management practices at the local level, the focus at the instruments of discipline and control invariably places the role and responsibility of the central state in the forefront and makes local government performance appears as a dependent variable. The present study drops the traditional analytical perspective of *fiscal discipline* and turns towards *budget responsibility* first. Debt is a legitimate means of financing capital investments. Compliance with the legal norms is necessary but not a sufficient condition for a commune to incur debt. Success in the overall financial management of the local government level requires a more proactive attitude. Thus section 3 starts revisiting the "golden rule" of balancing the budget by adding the "pay-as-you-use" rule for investment financing. Respect of the revisited golden rule does not tell whether the local debt is too important with regard to the financial capacity of the commune. Section 4 addresses this issue and selects internal ratios in indebtedness that a commune can introduce for its own debt management and control. Section 5 finally analyses how soft-to-hard budget constraints can built up on the revisited golden rule. It observes how rules of fiscal discipline have been implemented, their content and success. Section 6 concludes.

2 Budget responsibility versus fiscal discipline

In the past thirty years, local governments in most European countries have been granted at least limited access to borrowing. The rules in force include limitations on the amount of borrowing and/or debt service, restrictions on the purpose of debt and on borrowing from foreign institutions and/or from the central bank. The description of these rules and sanctions constitute the thrust of several academic studies on local borrowing and debt. What are the ingredients that make it work efficiently? Fiscal discipline is not a simple question of having or not rules limiting deficits and debt. From "soft" to "hard" budget constraints, there are various degrees of severity. Dafflon (1995, 1996) proposed a catalogue of ten key issues that might help local policymakers examine their budget management practices upon whether they promote budget responsibility or not. The catalogue also permits to qualify the budget constraint from "soft" to "hard" whether it is self-imposed or imposed top-down. These issues were extensively studied for the twenty-six Swiss cantons in Novaresi (2001). Originally, the catalogue was conceived to facilitate comparison between ten selected West European countries[1] with similar preoccupations and questions, such as (i) the existence of any legal requirement for a balanced budget, (ii) the control from higher government levels on local budgeting and borrowing and (iii) the implementation of the Maastricht convergence criteria for local public finance (Dafflon, ed. 2002). Swianiewicz (2004) adopted this catalogue for Central and East European countries.[2] Parallel, a major inspiration was provided by Ter-Minassian and Craig (1997) for 53 countries worldwide. They distinguished four models: reliance on market discipline, co-operative approach, rules-based approaches and direct (administrative) control. The most frequently used approaches are rules-based control and direct control, sometimes accompanied by sanctions for the case of non-compliance.

Although a minimum of regulation is necessary in order to prevent massive defaults of subnational units with serious repercussions on the national economy, both rules-based control and administrative control have their limitations. Rules-based approaches generally lack flexibility and incite local governments to get around the rules, as has occurred in a couple of countries (Ter-Minassian and Craig, 1997; and Rattsø, 2002). The instruments of administrative (direct, preventive) control make subnational governments excessively dependent on the support by central authorities and induce moral hazard problems insofar as they impose a moral commitment on the latter to provide a bailout in the case of local government default (Rossi and Dafflon, 2002: 36-37).

In our view, however, and from the perspective of the borrowing government entity, rules and sanctions are necessary but not sufficient conditions of a sound budget and debt management. By their very nature, rules are *ex ante* restrictions that local governments must respect before taking any decision on borrowing, whereas sanctions are *ex post* reactions to situations of excessive indebtedness. The influence of the centre on local government behaviour is clearly indispensable for the development of sound debt management practices at local levels. However, the existing literature that underlines the importance of budget discipline, i.e. the compliance with rules for fear of a sanction, places the centre of gravity on the central government and treats local performance as a simple dependent variable. While rules and sanctions may be efficient in preventing local governments from excessive borrowing and thus in protecting the central government from fiscal imbalances that the local public sector can potentially induce, they cannot guide local decision-makers on what to do in order to fully benefit from the advantages of debt finance without running the risk of insolvency.

Based on these arguments, we consider *budget discipline* as a negative approach to obtaining a balanced budget at decentralised levels. The corresponding positive approach is then viewing the balanced budget as a result of a prudent and proactive budget policy through which local governments adjust their investment policy to their real fiscal capacity and assess costs and benefits of each capital programmes in advance, in order to avoid excessive debt. We call this approach budget *responsibility* (or *self*-discipline). Box 2 summarizes the arguments.

[1] Austria, Belgium, Denmark, England, France, Germany, Italy, Norway, Switzerland and Spain.

[2] Czech Republic, Estonia, Hungary, Poland, Rumania, Russia, Slovakia.

Box 2 Budget responsibility versus budget discipline: definitions

Budget *responsibility* ⇒ self-assessment	
• Self-control:	of local government finances and a more proactive attitude;
• Best practices:	in planning and managing local investment programmes;
• Capacity and cost measurements	measuring the real financial capacity, and the future (operating and maintenance) costs related to the investment;
• Morphology of government budgeting:	the budget is not an exercise of liability management and accountability, but is first and foremost a mirror of the public policies (expenditures and revenues) pursued by the local government.
Budget *discipline* ⇒ rules and sanctions	
• Institutional restrictions on borrowing:	balanced budget rules, deficit ceiling, regulatory framework of local borrowing, accounting and reporting requirements, instruments of administrative control, collaterals;
• Bailout grants, sanctions:	against excessive debt, forced administrative procedures aiming at the correction of local government budgets in which deficit and debt is accumulated.
While rules and sanctions may be efficient in preventing subnational governments from excessive borrowing and thus in protecting the national government from fiscal imbalances deriving from the local public sector, they cannot "tell" local decision-makers what to do in order to fully benefit from the advantages of debt finance without running the risk of insolvency.	

Shifting the emphasis from budget *discipline* towards budget *responsibility* does not imply that a regulatory framework is unnecessary or that credit rating do not count for borrowers' discipline. Rather, sound financial management requires that similar rules and sanctions be established in the interior of the local government organisation as well, upon the rational deliberation and voluntary decision of local policymakers. This is already a matter of course in federal countries where central regulations are kept at a minimum while regional and local governments can voluntarily introduce self-made rules and sanctions in their own legislation. In unitary systems, by contrast, the central government has been so far the only authority to impose rules and administrative procedures concerning borrowing and debt.

Obviously, leaving the decision about control mechanisms to the discretion of local governments can work only if the latter are subject to a hard budget constraint, no bailout by the centre and have a strong sense of responsibility for the welfare of their constituency. This is also contained in Recommendation 76 (CoE, 2005 and Annexure I, Box C). What we wish to put forward here, however, is not so much a switch from external (top-down) to internal rules as rather the introduction of internal rules as supplement to external regulations.

3 The "golden rule" revisited

The classical golden rule of public finance is that the budget should be balanced for reason of equity as well as efficiency (Novaresi, 2001; Rossi and Dafflon, 2002, fully develop the pros and cons – which are not referred here). The efficiency argument is that elected members of parliament (or resident citizens in direct democracy) should assume the consequences of their policy decisions. Taxes are the right price-signal. The equity argument is that the generation who benefits from the services should pay for them. This is the essence of Recommendation 73 (CoE, 2005 and Box C below): "*Local authorities should be able to borrow in order to finance their capital expenditure projects. Such projects are intended to benefit future generations, and recourse to borrowing may therefore make possible to spread the burden fairly among generations*." In Buchanan's view, the golden rule has the additional virtue of limiting the size of the state (Buchanan and Wagner, 1978).

Yet, implemented at the local level, the golden rule of a balanced budget contains a major inconvenient. It is too restrictive for financing investment expenditures. Or to put it in another way: the rule is suitable only with large regular and repeated annual outlays in capital expenditures, a condition which is more easily respected at the national than at the local level. This inconvenient can be circumvented when taking into consideration the pay-as-you-use principle of investment financing. Note however that the question whether investments should ideally be financed on a pay-as-you-use (debt) or pay-as-you-go (current revenues) basis has long been a subject of scientific debate. The controversy is summarised in Dafflon and Beer-Tóth (2009).

The combination of the classical golden rule for a balanced budget and the principle of pay-as-you-use finance requires in practice that the current and the capital budgets be clearly distinguished. As a consequence, one important precondition to an effective implementation of the "golden rule" is the separation of current and capital budgets, as well as the adequate definition of key terms such as "investment", "debt service" or "amortisation". It must be noted, however, that both the "golden rule" and the separation of the budgets have their opponents in the current debate on fiscal federalism. Other fundamental divergences relate to the definition and extent of the amortisation versus the concept of depreciation, and to the equivalence between the amount of amortisation / depreciation written in the books and the effective debt instalment (for an overview, see Dafflon, 1998; Novaresi, 2001; Rossi and Dafflon, 2002).

In short, the golden rule revisited prescribes that:

[1] current expenditure must be paid by current resources, mainly taxation and user charges (borrowing for current expenditures is prohibited: Rec 24 (CoE, 2004 and Annexure I, Box B), and Rec74 (CoE, 2005 and Annexure I Box C);

[2] investment expenditures can be financed through loan: Rec 73 (CoE, 2005 and Annexure I, Box C);

[3] interest and amortisation of the debt should be repaid out of current resources, since they are recurrent costs of new projects financed by loans: Rec 71 (CoE, 2004 and Annexure I Box B).

The "golden rule" that requires balance or surplus on the current budget and accepts borrowing only for investment purposes can be expressed by a set of budget equations that give the flavour of the argument. The formulas are not intended to lay the grounds of a mathematical model but simply to draw the attention to certain key issues.

The current budget is given by

(1) $T - G = S$

where
- T current revenue from taxation;
- G current public expenditure;
- S net savings on the current account (according to the European System of National and Regional Accounts [ESA 95], i.e. the primary balance on the current account minus interest payments and amortisation of the existing debt. In adopting the separation between current and capital accounts, we have to "transpose" the words of the ESA 95 in order to respect the same definitions (the ESA 95 does not distinguish between these two budgets). Thus, primary balance is the result of the current account prior to interest payment and amortisation of the debt. Gross savings is the primary balance minus interest payments, and net savings is gross savings minus amortisation (with the "golden rule": amortisation in the books = economic depreciation = actual debt instalment).

If T = G, then the current budget is balanced. In this case, net saving is zero and, as we shall see below, there is no perspective for financing a new investment. In order to make this possible, the result needs to be T>G or S>0.

An additional investment can be financed from a mix of resources:

(2) $\Delta I = \Delta B + F$

where
- ΔI additional investment;
- ΔB additional borrowing;
- F other funding sources related to the planned investment programme (e.g. taxes and fees, domestic and foreign grants-in-aid, donations).

The maximum amount the local government can borrow is then given by the following general formula:

(3) $$\Delta B = \frac{S - [(M + E) - (R + O)]}{i + d}$$

where
- M maintenance costs in a given year, related to the new asset created by ΔI;
- E current costs in a given year, related to the local public service that ΔI allows to offer;
- R revenues from the operation of the asset (e.g. user charges, sponsoring);
- O operating grants received from other government entities for the planned investment programme;
- i interest rate for ΔB (%);
- d depreciation rate of ΔI. It corresponds to the amortisation (instalment) rate of ΔB (%), according to the pay-as-you-use principle. If the useful life of the investment is 20 years, then d = 0.05.

Following from (2) and (3), the additional investment can be calculated as:

$$(4)\quad \Delta I = \frac{S - [(M+E)-(R+O)]}{i+d} + F$$

The message of this equation is the following.

✓ First, the equation starts with S, the net saving in the current account after deduction of the financial costs of the existing stock of capital and the related debt (i.e. interest and amortisation). This suggests that the costs incurred by earlier investments cannot be left out of consideration. The local government can initiate new investment expenditures only insofar as the current account produces a sufficient amount of net saving after payment of the recurrent costs from previous investiments.

✓ Second, the future operating costs related to the maintenance of the new asset (M) and to the public service that the investment allows (E) must be taken into consideration. There is no point in embarking upon a new investment if the budget capacity does not allow the local government to pay for the future costs provoked by ΔI. This affirmation seems trivial at first glance but, in practice, one can find many cases where investments have been initiated without any consideration of the related costs to bear in the following periods. This is also the message of Rec 71 (CoE, 2004 and Annexure I, Box B). In the future budget, these costs will reduce S, thus the residual capacity to pay for i and d. On the other hand, the local government may realise extra revenues either on its own (e.g. entry fees, sponsoring) (R) or via other government entities that subsidise the operation of the asset in later years (O). These revenues will diminish the costs resulting from the investment.

The "classic" example

Take the example of a new cultural centre (ΔI). The net surplus of the current account (S) should be sufficient to cover

- the annual interest payments ($i \times \Delta B$),
- the annual instalment of the debt ($d \times \Delta B$),
- the annual maintenance costs related to the building (wage and social charge of the maintenance team, heating, electricity, insurance etc.) (M),
- the annual current costs related to the cultural events offered in the building (E),
- minus entrance fees, revenues from sponsors (R), annual theatre grants (O), etc.

✓ Third, equation (4) also shows that ΔB brings about additional financial costs (i + d) that must be included in the future current account. If the investment is financed exclusively from debt (F = 0), and there are neither costs nor revenues attached to the project (M, E, R and O are zero), then ΔB is equal to S / (i + d).

The internal borrowing limit in equation (3) is defined in accrual terms and not in cash terms. Thus, it calculates with assets and liabilities instead of revenues and expenditures. Even if national laws continue to require cash-based budgeting from public entities, local governments should better use accrual budgeting at least for preparing their multi-annual investment plans.

4 Ratios of indebtedness

Scrupulously respected, the revisited golden rule of a balanced budget does not indicate a limit to borrowing and public indebtedness. As long as the current budget can support the debt service and debt amortisation, further investment and borrowing are possible (with respect to equation 4 above). A local government could thus ends up in a situation where a too large amount of taxes and other current revenues would be paid into the banks rather than for the provision of local public services. Note that respecting the comprehensive rules given in the previous section, this danger is more theoretical than real since the opportunity cost of an additional investment versus the actual provision of local public policies will restrain loan finance. Nevertheless, there is a demand at the political level that economists deliver formulas for limiting deficits and debts to "acceptable" levels. The present section takes up this issue: its objective is to explain what can be said from the point of view of local public finance policy, and what cannot be inferred from political economy.

There are a number of comparative ratios which are usually given as benchmarks for indebtedness at the local level: the net debt per inhabitant, the net debt/cash flow ratio, the net debt/own revenues ratio, the burden of debt service are the most common.[3] Rec 20 (CoE, 2004) gives two indications thereabout: "*The assessment of financial risk should comprise prior monitoring and warning mechanisms (such as tables presenting the evolution of … indebtedness and interest rates, …) as well as intervention and supervisory procedures…*" and in "*Rec24. … The level of debt could be established in relation to the volume of the authority's own resources, their extent, stability and foreseeable development*" (CoE, 2009: 230). Let us elaborate on these recommendations taking into consideration one of the possible ratios: debt service in relation to own local revenues. The formulas can be:

$$(5)\ \text{burden of debt service} = \frac{i \times \text{DEBT}}{T}$$

$$(6)\ \text{ACAD} = \frac{i \times \Delta B}{\Delta T} < 1$$

[3] For Swiss local government, the Harmonised Accounting System 2008 proposes the following ratios: (i) the net rate of indebtedness = external loans minus savings in proportion to tax revenues; (ii) the burden of the debt service = (interest of loans minus interest of saving) + amortisation in proportion to current revenues; (iii) the same, but without amortisation; (iv) the net debt per capita. See CDCF, 2008: 92-106.

$$(7)\ \text{RCAD} = \frac{\dfrac{i \times \Delta B}{i \times B}}{\dfrac{\Delta T}{T}} < 1$$

where ACAD Absolute Coefficient of an Additional Debt
RCAD Relative Coefficient of an Additional Debt
i interest rate for ΔB (%);
ΔB additional borrowing;
ΔT additional current revenue from taxation;

Equation (5) is the usual ratio measuring how much passive interest must be paid to the bank for the local debt in proportion to local own resources. As such, this ratio does not give any indication of how much interest paid is too much? For this purpose it is necessary to compare the result with an external benchmark table. It is not an in-built ratio as we shall see for equations (6) and (7): its analytical value depends entirely on the relevance of the external table – which in turn is not founded on economic analysis but on past observations and experiences of what is feasible and what leads to financial difficulties or even bankruptcy.[4] As we develop below, the theoretical interest of the approach from the point of view of political economy is the potential explicative value of the arguments behind formula (5).

Equation (6) compares the interest payment for a new debt with the increased amount of tax yield at disposition. A ratio superior to one indicates that the interest payment will absorb an amount that is larger that the foreseeable increase in tax yield. It means that for respecting a balanced budget and account, a commune would have to count on an increase of its tax bases. If this is not realised, the command variables are either an increment in the annual tax coefficient or the reduction of other local public expenditures. Note that if the new debt finances a new investment, the excess of revenues over current expenditures should be sufficient not only for the interest payment, but also for repayment of the debt (amortisation of the investment), M the maintenance cost and E the current cost related to the new or additional public service (equation 3).

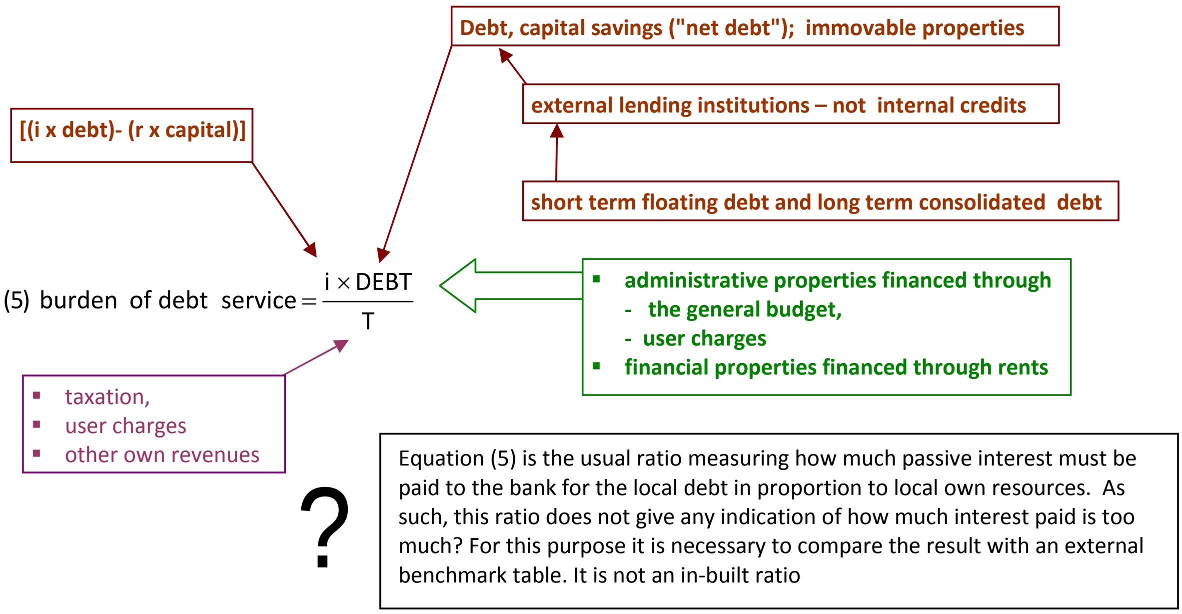
Equation (7) gives the same information, but in relative terms. It compares the relative rate of growth of the additional interest payment to total interest paid with the relative rate of growth of an additional tax yield to total taxation. A ratio higher than one indicates that the nominal growth path of the interest payment is faster than the nominal growth of tax resources, a situation which might creates problem in the near future. Thus Rec 20 (CoE, 2005) is to have warning mechanisms on the evolution of indebtedness and interest rates and payments. Both equations (6) and (7) are in-built and dynamic in the sense that the benchmark value is unity, which fixes the threshold between an acceptable position (<1) and a situation (>1) which could endanger the medium and long terms financial balance of the commune. Note that these

[4] In the Swiss harmonised accounting system for commune MCH2, the reference is that a ratio between 0 and 4% is "good", 4 and 9% is satisfactory and above 10% is "bad". The ratio of debt burden is the proportion of net interest (interest of loans minus interest of savings) to current revenues that includes taxes, user charges, revenues from licence and concessions, grants and financial transfers and revenue sharing – this is the large definition of "current" revenues. See CDCF, 2008: 105.

benchmarks are rather reductive in that they only consider interest payment, but not the other recurrent costs of an additional investment. Thus more caution is needed than the formal result in the two equations.

Let us return to equation (5). Of course, the result obtained can be read from an accounting mechanics and simply confronted to the given benchmark table. But this is not very productive. Or it can be read from the point of view of political economy: this second lecture is much more instructive. Figure 3 sketches the analysis.

Figure 3 The burden of debt service



On the numerator, the given value is [i x DEBT] where "i" is the interest rate of the gross DEBT. But for the formula to be neutral vis-à-vis the management of the debt and the possible combination of debt and capital savings or even the patrimonial assets of a commune, it could also be [(i x debt)- (r x capital)], the net payment of interest. This necessitates to further scrutinise the nature of "i" the passive interest, between short term floating debt and long term consolidated debt, in comparison to "r" the net interest from capital savings, and also to distinguish the formal rate from the real interest rate due to possible inflation. Debt is the amount of borrowing owed by the commune to external lending institutions – not credits that are internal to the commune. "Capital" is a generic term that needs to be detailed: do we consider in the calculation movable capital and immovable properties and for the latter the distinction between administrative properties and financial properties (Dafflon, 2006)? For administrative immovable properties, is it opportune to distinguish between loans corresponding to investment items that are financed through the general budget, and loans for investments that are financed through user charges? Rec 73 (CoE, 2005 and Annexure I Box C) says that: "*As future generations do not have a say in the choice of the projects to be financed, financing through borrowing is mainly suitable for services for which loan will be repaid by means of charges to users.*" But hence which denominator is reasonable?

At the denominator, the usual value is given by T for taxation. Yet, the denominator should be concomitant to the choice of the numerator insofar that one distinguishes between financial properties, administrative properties financed from the general budget and those financed thought user charges. Also, for taxation, it is important to consider local taxes which have a regular yield under normal macroeconomic circumstances from taxes that are irregular due to the specific definition of the base (in small communes, inheritance and gift taxation or taxation on the selling of private immovable properties can present very irregular yields from one year to the other). Also, if communes have partial tax sovereignty – for example in the form of piggyback taxes or in deciding their own annual tax coefficient to be applied on the regional or central tax - precision must be given on whether the ratio is calculated on the basis of the effective tax yield or on the commune's tax potential at 100%.

The quality of the benchmark also is important: it does not suffice that it is transparent, stable, fair and objective. Benchmark values are to be considered as provisional evaluation: they should be subject to adjustment at regular intervals (CoE, 2004: Rec 14; CoE, 2009: 229). It is not the same to admit that the burden of debt service is "reasonable" if it absorbs less than 6% of tax potential when the average tax rate for loans to the commune was around 5 per cent, than when this rate falls down to 2,75% to 3% as it is now the case for Swiss communes.[5]

These questions are not raised simply to exemplify analytical difficulties in computing debt ratios or to cast doubt on their utility in debt management. But one must be very cautious in using debt ratios for benchmarking: within a commune, the time series of comparison must be coherent with the same measurement method through the years; between communes, it is important to compare what is comparable. Our practical experience reveals that this is far from being routine considerations.

5 Fiscal Discipline

In theory

The next step in controlling deficits and limiting local indebtedness is fiscal discipline. Fiscal discipline is characterised through the existence of a rule in the constitution and/ or the financial law that requires balancing the budget and prescribes the conditionality for new loans. The pros and cons of fiscal discipline have been largely debated elsewhere (Ter-Minassian and Craig, 1997; Novaresi, 2001; Dafflon, 2002; Swianiewicz, 2004). This is not the issue here: what is at stake is not whether rules of fiscal discipline are founded in economic theory or not. They exist for various reasons (CoE, 2009: 270, Rec 75). What we analyse in institutional economics is the design of the legal measures for controlling deficit and debt.

[5] The average nominal annual rate of interest for loan to the communes in Switzerland increased from 5.35% in 1989 to 7% in 1992, then regularly fall down to 5.5% in 1995, 4.12% in 2000, 3.21% in 2005 and 2.75% in 2010. It was 4.75% in nominal value on average for the last 20 years.

Rules of control can be imposed top-down on communes by the next government level (Province, Region, canton, Land) or the Centre. In the view of the Council of Europe, "*restrictions should be fair and discussed with local authorities*" (CoE, 2009: 270, Rec 75). But, as it is the case in Swiss cantons, it can also be self-decided by the canton's electorate in order to contain the inclination of parliamentary politicians to spend more and more and engage in logrolling in order to please their own clientele. In other words, at one point of time, citizens are responsible and wise enough to respect somehow the revisited golden rule of local public finances, but they fear that this could not be the case in the future: and therefore they decide themselves to fix rules for the future management of their finance in the form of a hard budget constraint. In the Swiss cantons, this is normally coupled with legal rules concerning the financial referendum (Novaresi, 2001). There are two additional points that desserve attention:

(i) In a federal system, it important that with top-down fiscal discipline, the government layer which imposes a hard budget constraint and debt limits on its sub-level entities also respect the same rules for itself. Vertical accountability cannot be that a constraint is imposed on one government layer, but relaxed for the others. For example, in the Euro zone, the distribution of the Maastricht criteria limits between the national government, the regions and the communes, was not discussed in the early years (Dafflon ed., 2002) and is far from being explicitly fixed nowadays. It is a real problem not simply from the point of view of national macroeconomic policies, but also for the respect of local budget autonomy and accountability. This is not the case with the Swiss cantons. First, the federal government cannot impose deficit and debt brakes on to them. They are sovereign in this respect and must decide for themselves (self-discipline, as we called it in section 2. Second, the cantons have imposed deficit and debt brakes to the communes, but not harder than the one decided for themselves, and most often in close discussion with local government representatives.

(ii) Rule of fiscal discipline must contain a penalty clause in case of non respect and an absolute clause of no bailout. For the Council of Europe: "*In order to make decision-makers more accountable, the central authority should not offer guarantees for loans raised by local authorities, save in exceptional circumstances* (Recommendation 76).

One can debate almost endlessly upon the "best" design and the economic underpinnings of a "good" budget constraint. What are the ingredients that make it work efficiently? Fiscal discipline is not a simple question of having or not rules limiting deficits and debt. From "soft" to "hard" budget constraints, there are various degrees of severity. Following proposals by Dafflon (1995, 1996), Novaresi measured the "soft-to-hard" budget constraints of the cantons on a continuous scale ranging from 0 (no constraint) to 100 points (hard) according to eight criteria. The catalogue permits to qualify the budget constraint from "soft-to-hard" and also consider whether it is self-imposed or imposed top-down. (1) Is the requirement of a balanced budget written in the constitution or in a law? (2) Submitted to referendum; compulsory or facultative? (3) Is the balance required for the budget only or for the budget and the account? (4) Is the current budget / account distinct from the investment budget / account? (5) If yes, are the amortisations included in the current account; do amortisations and debt repayment coincide? (6) Is the balance requirement in the current account annual, short term, medium term? (7) How is the "short" or "medium" term defined? (8) What is the sanction if the balance is not respected exceptionally, repeatedly? Originally, the catalogue was conceived to facilitate comparison between ten selected West European countries (Dafflon, 2002: 3-4). Swianiewicz (2004) adopted this catalogue for Central and East European countries.

There are nine possible outcomes which are illustrated in Box 4.

Box 4 Possible outcome in the current budget / annual account

		account		
		surplus	**balanced**	**deficit**
budget	**surplus**	1	2	3
	balanced	4	5	6
	deficit	7	8	9

Outcomes 1, 2 4 and 5 do not create problems of deficit and debt capping. However, outcome 1 and 4 are interesting in analysing (i) the nature of the surplus: structural or due to economic upturns, and (ii) the use of the net result: additional debt repayment, additional expenditure policies, reduction of taxes (which), or financing a rainy-day fund? Outcomes 7 and 8 create problem in that they engage the deficit and debt brake – but this is not confirmed by the results: how will politicians react to (repeated?) pessimistic budget forecasts which turn to be false alerts? Outcomes 3 and 6 necessitate to distinguish the ex ante budget from the ex post result and account procedure. In the first place, the situation does not claim for any restraint measure in the budget process. Yet the outcomes are not adequate and require remedy and sanctions. Outcomes 3 and 6 require a very precise and detail legal framework if budget discipline is to be respected – which means that from the point of view of political economy, there cannot be a unique and uniform legal rule for budget and account: ex ante rules for outcomes 7 and 8 are distinct from ex post legal regulation needed for outcome 3 and 6. Outcome 9 is the worse scenario. It means that the measures which the budget necessitated to restore the balance have not been sufficient. Outcome 9 needs a hard solution in form of a recovery plan with fixed commitments and terms in order to restore the medium and long terms sustainability of the local public finances. In practice, the logic of "no deficit" expressed in the golden rule revisited which underpins the possible outcomes of Box 3 requires fine tuning in the legal design of the rule.

In practice

One can also be pragmatic, using "process learning" through scrutinizing successful practices in order to understand the policy process and, when possible, to contextualise it to new national circumstances (Blindenbacher and Watts, 2003: 16-20). In the present economic circumstances of heavy public deficits and indebtedness in many OCDE countries, Switzerland is the prominent exception with an overall deficit of the three government layers and the social security below the Maastricht 3 percent GDP criteria and a total debt also lower that the 60% GDP limit. Figures 5 and 6 cast the general budgetary and accounting environment for the three government layers. Annexure III gives the detail tables. Figure 5 illustrates the situation for the annual accounts for the period 1970-2007. It is remarkable to note that since the end of the 1990s, the communes in general have recovered healthy position in their public finances with no annual deficit since 2000. Years 2003 and (1995) were exceptions: the total public deficit was -5.996 (7.270) millions SwFr. which corresponded to -1.14% (-1.95%) GDP. Figure 6 gives the debt position of the three government layers. 2004 was the record year with a total debt of 246.389 millions SwFr. or 55% of GDP. Note again the remarkable position of the local government layer: its total debt has been slowly increasing in nominal terms from 1970 to 1995, but has stabilised thereafter.

The time series are divided in three policy periods. Prior to 1990, public deficits and the resulting public debt (in nominal terms) were not increasing so much that the public finances of the three government layers would be endangered. It is worth noting that this is a period when many cantons introduced rules of self-discipline in their budget and debt policies. The second (1990-2000) period was a time of roaring deficits, but mostly under control at the cantonal and local levels thanks to the deficit and debt brakes previously implemented. At the federal level, the situation deteriorated rapidly and led to three urgent programmes of expenditure brake in 2001, 2003 and 2004 and finally a constitutional rule of budget discipline in 2001.[6]

In the face value of these annual results, cantons and communes have in general a good command over their budgets and indebtedness. However, the individual positions of the cantons, and the incidence of the cantonal position on the communes, differ in relation to the nature of their budget constraint and the financial referendum process (Novaresi, 2001).

In 2001 (December 2), the federal electorate voted the introduction of a limit to federal deficits and debt; it has been fully implemented since 2007. Figure 6 shows that the progressive introduction of the "brake to federal deficit and debt" first slowed down the rapidly growing trend registered between 1990 and 2002, then managed since 2006 to reverse the tendency.

6 The successive programmes for recovering a balanced budget were entirely based on the reduction of public expenses. The "Budget objectives 2001" followed a change in the Constitution, accepted in the vote of June 7, 1998 by the federal electorate [70.7% of approval], with a view of balancing the budget horizon 2001. The constitutional "debt brake" decided by vote of the federal electorate on December 2, 2001 [85% of approval] was gradually implemented between 2003 and 2006 and has been enforced fully since 2007. In the meantime, the federal Parliament decided two three-years programmes of reduction in public expenditures, the "Programme d'Allègement Budgétaire 2003" (Expenditure Lightening Programme) et PAB 2004, for the budget 2004-2005-2006, and 2006-2007-2008 respectively.

Figure 5 Switzerland: annual result 1970-2007 in Millions SwFr. (nominal value)

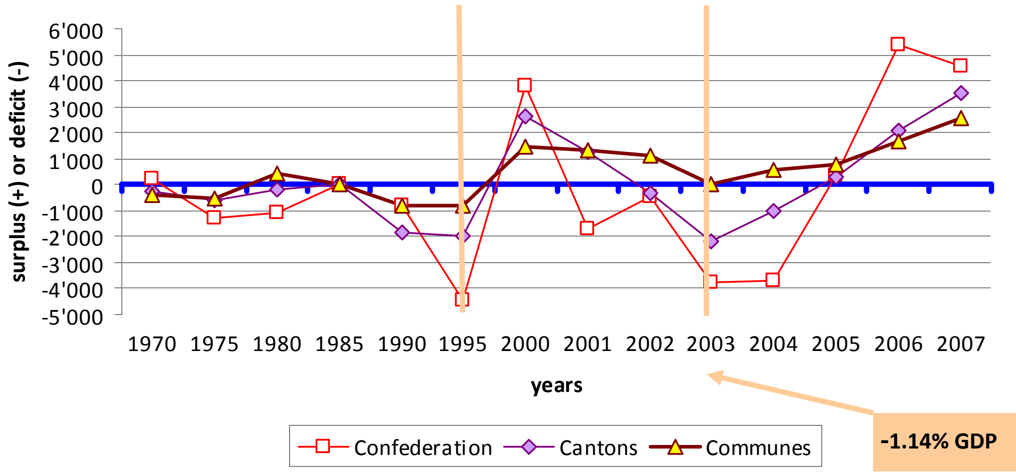


Figure 6 Switzerland: public debt 1970-2007 in Millions SwFr. (nominal value)

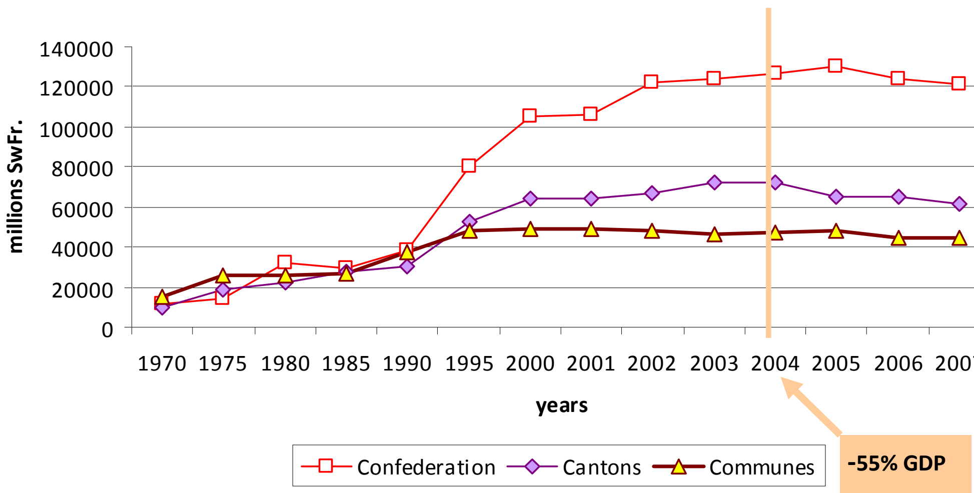
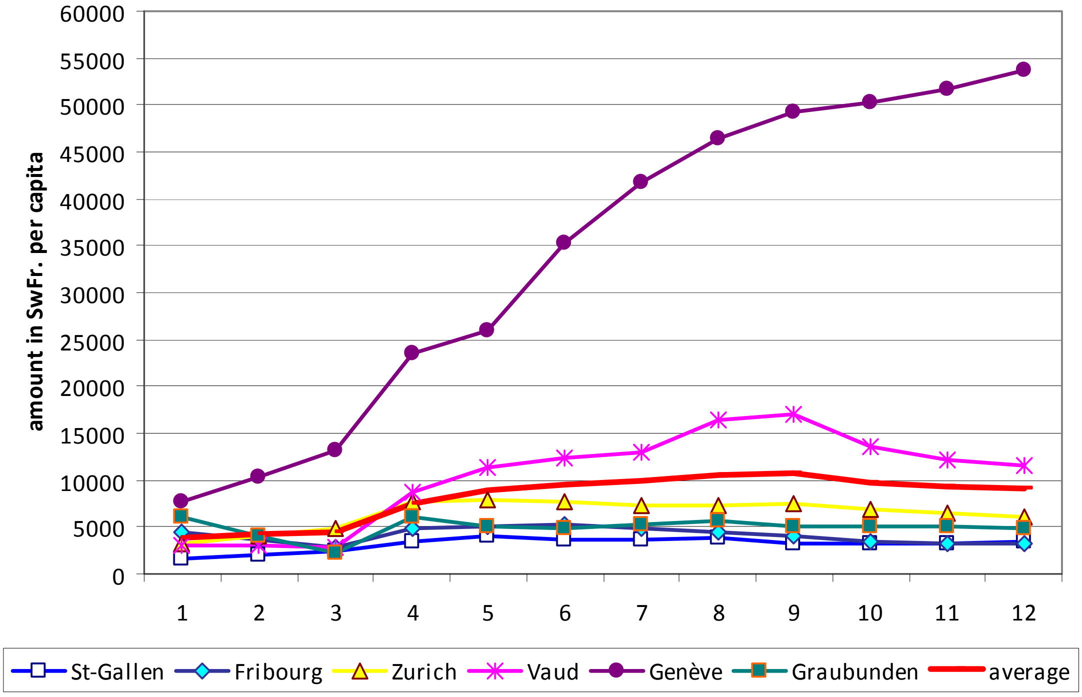


Figure 7 Selected Swiss cantons: debt per capita, in SwFr., 1980 - 2007



The cantons, for themselves and the communes have a longer tradition of budget constraint. Fribourg introduced a legal limit to deficits in 1960 already; it was reinforced in 1994 and 2005. Graubünden followed in 1971. In 1987, nineteen cantons had introduced rules of deficit and debt limitation; most of them reinforced the rules during the following decade. Valais (2002), Vaud (2003), Neuchâtel (2005) and Jura (2009) were the last cantons to adopt deficit and debt brakes. Today, the twenty-six cantons have introduced more or less soft-to-hard budget constraints for balancing the budget and controlling debt. Figure 7 illustrates the situation for selected cantons.[7] We have chosen to describe the hard budget constraint in the canton of Fribourg – which is by large the same for the cantonal and the communal layers.[8]

[7] The cantons were selected on the basis of two criteria. First, the year of introduction of the budget constraint: Fribourg is the pioneer, followed by Graubünden; Zurich introduced it in 2001 in a period where the public debt had exploded. Vaud was chosen because the canton is among the last to introduce a brake to deficit. The second criteria stems from Novaresi's research (2001). He considered five arguments to measure the "soft-to-hard" quality of the cantons' budget constraints and gave them a classification from 0 (soft) to 100 (hard). Graubünden, with 87 points, St-Gall 77 points and Fribourg 75 points are ahead; Vaud (46) and Zurich (44) are in the average bracket and Geneva, with 28, has the poorest result. Geneva has a rather hesitant approach to this problem: between 1999 and 2010, the cantonal Parliament changed six times the articles on deficit and debt in the financial law. The selection offers a good comparison of the cantonal situations. There is no such a study at the local level. But the general rule which applies is that the cantonal requirement for the communes is the mirror of the cantonal constraint. A canton cannot be severe at the local level if it is lax for its own regard.

[8] The hard budget constraint of St-Gall, the other successful story in the Swiss context, is given in Kirchgässner (2009) "Institutionelle Möglichkeiten zur Begrenzung des Staatverschuldung in föderalen Staaten", Jahrbuch

In Fribourg,[9] the budget system distinguishes between current and capital accounts; and also between real monetary outlays and revenues from pure accounting charges and entries. The current budget is annual. There is a budget procedure for ordinary times and one for exceptional economic situations. "Exceptional" is clearly defined and explicitly limited in access and time. The budget constraint adapts to the two procedures in different ways and sanctions. Annexure II illustrates the 2010 situation.

In "normal" times, the current budget must be annually balanced (art. 40a of the state finance law). Current expenditures (net of accounting charges) cannot exceed current revenues (net of pure accounting entries) by more than 2% (art. 41 paragraph 3). If this threshold is over passed, then the direct tax coefficient[10] must be increased automatically so as to recover the balance. "Automatically" means that the increase is compulsory; the cantonal Parliament has not another choice; no referendum can be demanded. If the resulting account of the same reference year presents a deficit, it has to be compensated within the immediate next five years (art. 40d): that is, compensation of at least one-fifth of the deficit must be written in the following budgets which in turn must be balanced. Again, if the 2% clause is not respected, the tax coefficient is adjusted.[11] The financial law is symmetric in the sense that it constraints results in red figures, but also "especially important" good results. If the account presents an excess of revenues compared to what was foreseen in the budget, then the result must be (partly) used to reduce direct taxation. The tax reduction must be addressed in priority to relieve the tax burden of families with children. "Specially important" is defined when two conditions are fulfilled: (1) the direct tax yield in the account must correspond to at least 106% of the corresponding amount in the budget, that is a 6% net increase in nominal terms; (2) the excess of revenue must exceed current public expenditures by at least 4%.

"Exceptional situations" follow two roads, one in case of economic downturn, and the other in circumstances of exceptional financial needs. Both are strictly codified in the law. Economic

Verwaltungsorganisationsrecht- Staathaftungsrech- öffentliches Dienstrecht, Svvor, Stämpfli Verlag, Bern, pages 59-86.

9 The legal references for the canton of Fribourg are: the law of November 25, 1994 on the State finance RS 610.1 (in French and German) and the application law of March 12, 1996 on the implementation of the 1994 law RS 610.11; for the commune: the law of September 25, 1980 on the communes RS 140.1.

10 The general formulation of the tax system is $T = t \times [B - D_j] \times K$, where t is the tax rate schedule, B the tax base and D tax expenditures, K the tax coefficient. At the cantonal level, t, B and D are written in the cantonal tax law and cannot be changed within the budget process. K is the tax coefficient which is the control variable to obtain a balanced current budget. The reason why t, B and D cannot be changed in the budget process is that the communes also use the same tax system, but are not allowed to change the legal variables. Communes can only proceed by adapting their own coefficient K (piggyback system) to balance their own current budget. If the canton changes t, B or D, it would create tax externalities on the communes and a domino effect on the tax yield in the municipal budgets. This is neither efficient nor acceptable.

11 In 2007, the Fribourg the gross cantonal public debt was 710 millions SwFr., that is around 6% of GDP (12.211 millions SwFr.). A 2% deficit of the current account would correspond to 0.02 x 2.625 millions SwFr. = 53 millions SwFr. that is 0.4% of GDP. At the local level, the legal limit is 5% of the communes' current accounts, that is 5% of 1.248 millions = 62 millions SwFr. or 0.5% GDP. It means that the sum of the cantonal and communal deficits authorised within the hard budget constraints corresponds to 0.9% of the cantonal GDP. Compared to the Maastricht criteria, this would leave the federal layer with a residual deficit limit of 2.1% of GDP in the canton. The same calculation should be repeated for the 25 others cantons.

downturn is recognised when one of the three following conditions is fulfilled: (a) the variation in GDP is negative for two consecutive trimesters; (b) the unemployment rate is higher than 5%; (c) the annual variations of both wages and fiscal revenues are negative. In this case, the rule of a balanced budget can be softened through an authorised deficit limit of 2% over the current revenues (net of pure accounting entries) (art. 40b). Note the overlapping in the text of the law between article 40b and art. 41 paragraph 3, which are not coherent. Article 40b recognises a 2% deficit limit within a qualified situation (economic downturn); article 41 paragraph 3 accepts a 2% deficit limit without specification.

"Exceptional financial needs" are natural catastrophes or unique circumstances which are at the same time (i) out of control of the cantonal authorities, (ii) of major impact on the population of the canton, (iii) unforeseeable and (iv) for which no financial provision has been made. In addition, the resulting costs of the damage must correspond to more that 1% of the current revenues (net of pure accounting entries). When these cumulative conditions are met, the cantonal Parliament may increase the deficit limit (2% + the damage costs) and extend the compensation period from 5 to 7 years. The parliamentary decision must be approved by the absolute majority of its members – not by simple majority vote.

The budget constraint is matched by the referendum rules for financial maters. Any decision of the cantonal Parliament which corresponds to a new public expenditure is submitted to the compulsory referendum if its amount is greater than 1% of the total current expenditures (net of pure accounting charges) as written in the last published official annual account of the state. The referendum is facultative for expenditure between ¼% and 1%. The facultative referendum can be demanded by 6000 citizens[12] or one-fourth of the elected members of the cantonal parliament.

At the local level, the deficit limit is 5% of total revenue (net of pure accounting entries) instead of 2%. If [expenditures > revenue] by 5% or more, the communal coefficient of direct taxation must be increased. The increase must be decided by vote in the local legislative assembly – but this is rather formal since the communes are under the supervision of the cantonal authorities. In case of refusal, the budget has to be modified and passed a second time in the legislative assembly within 60 days. The options are: reduction of expenditures, approval of the tax coefficient increase, a mix of both. In case of a second refusal, the cantonal authorities fix the tax coefficient so as to balance the budget.

The debt limit is supervised differently: each investment that is financed by loan must be decided separately by the legislative assembly on the base of a report that contains (i) a description of the project, (ii) the total investment cost and possible participations or grant-in-aid from the canton or/ and the Confederation, (iii) the service of the debt, amortisation and repayment. If one of the information is missing, the decision can be disputed within 30 days by any resident citizen; the Prefect will have to annul the decision. The loan has to be authorised by the canton, which keeps a register. The canton controls annually that the amortisations in

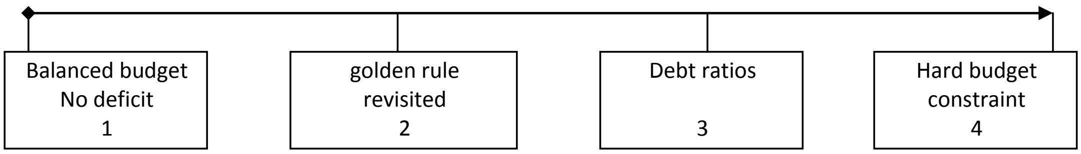
[12] For 181'079 electors in March 2010. Thus 6000 = 3,3% of the electorate. This is a soft requirement in Swiss comparison.

the book correspond to the pay-as-you-use principle[13] and that debt repayments for the corresponding amounts are effective. In case of non respect of the rule, the commune has to present a recovery plan (normally in three years) within a balanced current budget. If necessary, the tax coefficient must be adapted.

In the communes with a general council (legislative elected assembly), investment expenditures, the tax coefficients and user charges are submitted to facultative referendum. In commune with a regime of assembly of the citizens or Landsgemeinde, there is no referendum since citizens have direct decision over the budget items.

6 Conclusion

The political economy of controlling deficit and debt in local finance follows a sequence of reasoning which can be represented in line such as:



The proportions of economic content to normative value judgement of each box vary sensibly from one to the other. Obviously, a strict classical rule of balancing the budget corresponds to a "no deficit no debt" position. It would be very hard on local government since it would probably much reduce its investment capacity – unless investments are financed by financial transfers from the higher layer, which then creates a problem of autonomy. The only own way would be to pre-financed investment. But this would not respect equity in the sense of a judicious distribution over the years of the benefits of investment and its cost.

The second box elegantly solves this dilemma. The golden rule of a balanced budget is applied to the current budget only. Investments are financed by loans on a pay-as-you-use basis. Equations (1) to (4) given in section 3 fix the rules of the game. The economic logic is respected: first, the current account must finance the debt service of the present debt of a commune and support the charge of the economic amortisation of the actual investment items. New investments financed by loan are possible as far as interest, amortisation, maintenance costs and service costs are foreseen in the current budget, which has to be balanced. Equation (4) secures the efficiency of the decision to allocate funds to the new investment; pay-as-you-use finance guarantees the intergenerational equity. It is sound local public finance when respected.

[13] The law on the communes contains the principle of pay-as-you use amortisation. Article 53 of the application law fixes the rates of linear amortisation according to the categories of investment. For example: 50 years or 2% for water reservoir, 33 years or 3% for school building, 25 years or 4% for water distribution network, sewage, waste water purification plant, and so on.

Debt ratios, if carefully chosen, are complementary to and not substitute for the golden rule revisited. The golden rule revisited gives a limit through procedure, not proportion. It stipulate that i, d, M and E in equation (4) must be paid out of current resources, and thus how much debt service is possible, but it does not say a word about how much debt service is acceptable. Debt ratios in Box 3 do this job. There are two problems: one is to select the correct and significant ratios that will be useful for budget and debt management. The second is that ratios do not deliver the information. The information depends on the benchmark which serves as a reference. But benchmarks are not founded on economic theory. They simply represent "best practices". How best these practices are depends on the context of their application and the institutional setting. "Cut and copy" solutions are not advisable. Recommendations are always possible, but the result finally depends on a trial-and-error process.

Consider finally box 4. There is no theory of budget constraint that gives the keys for practical policy implementation. Deficit and debt limits are "soft" or "hard" according to the detailed architecture of the constraint. We gave elsewhere ten questions to qualify the budget constraint, but these are guidelines, not a ready-made theory. The success of a budget constraint also depends from the other surrounding legal rules. Is the moderate indebtedness of certain cantons the result of the budget constraint, or the more or less easy access to the financial referendum? What are the respective merits of the one and the other? And in canton with a long tradition of budget constraint, like in Fribourg, is the good financial position of the cantonal and local public finances due to the actual voters' preferences for sound finance or is it the result of the hard budget constraint – or a combination - or are the preferences somehow moulded by the existing rules so that voters have "internalised" the rules without noticing it? Confronted with these normative questions, we have taken the simplest way: compare processes and results, select the most efficient ones and scrutinize best practices. There is still much to be studied by academics and a long way for "university in the city".

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Annexure I

The following abstracts refer to borrowing by local authorities and local debt in relation to the European Charter of Local Self-Government and the guidance that have been thereafter issued by the Committee of Ministers in Recommendations Rec(2004)1 and Rec(2005)1 to member states on the financial resources of local and regional authorities.

Box A European Charter of Local Self-Government

Article 9 – Financial resources of local authorities

…

8 *For the purpose of borrowing for capital investment, local authorities shall have access to the national capital market within the limits of the law.*

Explanatory Report, Article 9 *Paragraph 8*
It is important for local authorities that they have access to loan finance for capital investment. The possible sources of such finance will, however, inevitably depend on the structure of each country's capital markets; procedures and conditions for access to these sources may be laid down by legislation.

Source: Council of Europe, 1985, European Charter of Local Self-Government and explanatory Report, 1998, Strasbourg. http://conventions.coe.int/Treaty/fr/Treaties/Word/122.doc

Box B Appendix to Recommendation (2004)1 of the Committee of Ministers to member states on financial and budgetary management at local and regional levels

24. *In general, local and regional authorities should have the right to incur debts only for the funding of investment expenditure and not for current expenditure. The level of debt could be established in relation to the volume of the authority's own resources, their extent, stability and foreseeable development.*

(Explanations, page 245) The financing of current expenditure by borrowing is unsustainable in the long term and should therefore be prohibited. Exceptions to this principle could include short-term borrowing in order to bridge the gap between cash inflows and outflows, and borrowing by local and regional authorities undergoing restructuring following a financial recovery plan. For example, a deficit may be carried over a limited number of years.

71. *Estimate of investment-project costs should not overlook recurrent subsequent costs (such as staffing, operation, maintenance, etc.), which should logically be incorporated into pluri-annual budget programming.*

(Explanations, page 255) This paragraph states an obvious principle. Nevertheless, the CDLR (Steering Committee on Local and Regional Democracy) has noted that making allowance for the recurrent costs of new projects is often neglected by local and regional authorities (either deliberately in order to avoid opposition to the new projects, or involuntarily because of a lack of adequate professional skills) and that this can cause the authority concerned considerable financial difficulties.

Source: The Council of Europe Handbook on Local Finance, in "Benchmarking Local Finances", Toolkit Benchmarking for Public Ethics and Local Finance, Centre of Expertise for Local Government Reform, Council of Europe, Strasbourg, 2009, pp. 227 – 258.

Box C Appendix to Recommendation (2005)1 of the Committee of Ministers to member states on financial and budgetary management at local and regional levels

7. Borrowing (page 270)
73. Local authorities should be able to borrow in order to finance their capital expenditure projects. Such projects are intended to benefit future generations, and recourse to borrowing may therefore make possible to spread the burden fairly among generations. As future generations do not have a say in the choice of the projects to be financed, however, financing through borrowing is mainly suitable for services for which loan will be repaid by means of charges to users.

74. Except in the case of cash advance and in exceptional circumstances, local authorities should not be allowed to take out loans to finance current expenditure. Current expenditure benefits the current generations and financing through loans would mean that the costs would be borne by future generations. In addition, financing current expenditure through borrowing would make elected representatives less accountable for the financial implications of their decisions.

75. Local authority access to borrowing may be restricted on account of national economic policy constraints, in order to limit the risk of non-repayment and to avoid decisions that would transfer an excessive financial burden to future generations. Any such restrictions should be fair, commensurate with the constraints in question, discussed in advance with the local authorities or their representatives and lifted as soon as the macro-economic situation permits.

76. In order to make decision-makers more accountable, local authorities should be held fully answerable for their decisions to resort to borrowing. The central authority should not offer guarantees for loans raised by local authorities, save in exceptional circumstances.

Source: The Council of Europe Handbook on Local Finance, in "Benchmarking Local Finances", Toolkit Benchmarking for Public Ethics and Local Finance, Centre of Expertise for Local Government Reform, Council of Europe, Strasbourg, 2009, pp. 259 – 273.

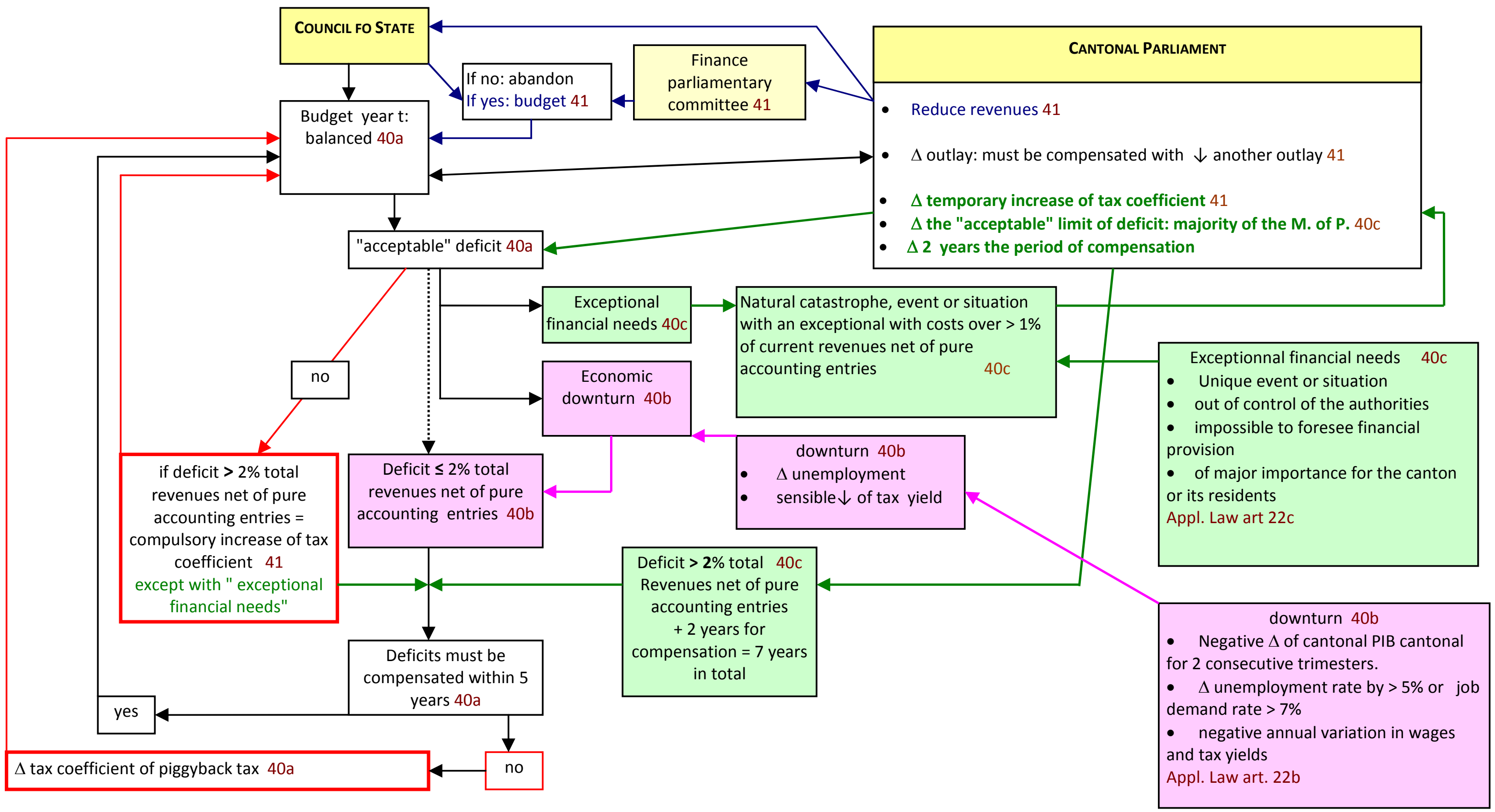
Box D Benchmarks of financial resources of local authorities: Central authorities

VI. Borrowing

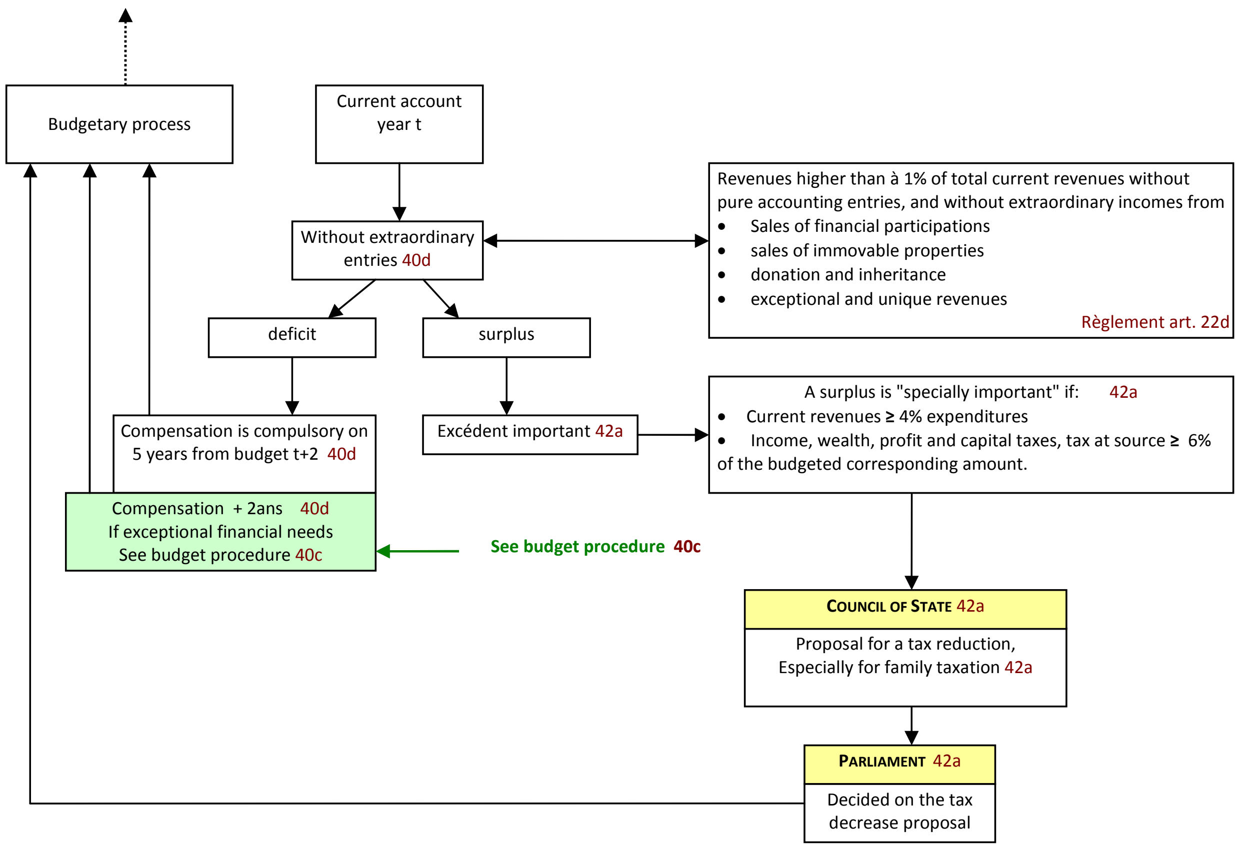
a) Loan should be used for financing capital expenditure (Recommendation 73 in [D] below);
b) Borrowing is preferred in service areas, where loan is repaid by user charges (Recommendation 73);
c) Central authorities should not guarantee local loans (Recommendation 76);
d) Current expenditures should not be financed through loans, except for managing short term cash flow problems (Recommendation 74);
e) National regulations might set limits on local borrowing, but restriction should be fair and discussed with local authorities (Recommendation 75).

Source: "Benchmarking Local Finances", Toolkit Benchmarking for Public Ethics and Local Finance, Centre of Expertise for Local Government Reform, Council of Europe, Strasbourg, 2009, page 144.

Annexure II **Financial Rules of deficit brake in the budgetary process, canton of Fribourg (Suisse)**



Financial rules of deficit brake in the current account, canton of Fribourg (Suisse)



Annexure III Federal, cantonal, communal accounts, 1970 – 2007, in nominal value

Public expenditures, in millions of SwF (in nominal value)														
	1970	**1975**	**1980**	**1985**	**1990**	**1995**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Confederation	7'834	13'670	17'532	22'881	31'616	40'628	48'208	51'136	51'927	51'284	52'656	52'607	53'096	54159
Cantons	9'533	18'494	21'926	29'158	41'116	52'111	60'194	63'935	66'591	67'946	68'893	70'285	71'678	74680
Communes	6'840	13'463	16'476	22'089	30'245	38'427	40'599	41'709	42'498	44'131	44'330	45'079	45'854	46542
Total*	24'207	45'627	55'934	74'128	102'977	131'166	149'001	156'780	161'016	163'361	165'879	167'971	170'628	175'381
Total without double accounting	20'285		47'240	62'773	86'614	110'826	123'612	129'998	134'253	135'811	138'379	140'147		
GDP	90'558		180'305	227'950	327'584	372'250	415'529	422'485	430'527	434'764	451'379	463'673		
% GDP	22		26	28	26	30	30	31	31	31	31	30		
Public revenues, in millions of SwF (in nominal value)														
Confederation	8'044	12'361	16'461	22'881	30'837	36'162	51'994	49'436	51'431	47'511	48'945	52'985	58506	58739
Cantons	9'287	17'879	21'763	29'158	39'264	50'147	62'818	65'191	66'290	65'731	67'913	70'581	73784	78198
Communes	6'412	12'948	16'934	22'089	29'423	37'587	42'068	43'033	43'651	44'123	44'866	45'839	47528	49107
Total*	23'743		55'158	74'128	99'524	123'896	156'880	157'660	161'372	157'365	161'724	169'405		
GDP	90'558		180'305	227'950	327'584	372'250	415'529	422'485	430'527	434'764	451'379	463'673		
% GDP	26		31	33	30	33	38	37	37	36	36	37		
Deficit or surplus in millions SwF (in nominal value)														
Confederation	210	-1'309	-1'071	0	-779	-4'466	3'786	-1'700	-496	-3'773	-3'711	378	5'410	4'580
Cantons	-246	-615	-163	0	-1'852	-1'964	2'624	1'256	-301	-2'215	-980	296	2'106	3'518
Communes	-428	-515	458	0	-822	-840	1'469	1'324	1'153	-8	536	760	1'674	2'565
total	-464	-2'439	-776	0	-3'453	-7'270	7'879	880	356	-5'996	-4'155	1'434	9'190	10'663
in % of GDP	-0.51%		-0.43%	0.00%	-1.05%	-1.95%	1.90%	0.21%	0.08%	-1.38%	-0.92%	0.31%		

Source: Federal Department of Finance, Statistical Series 18, Public Finance in Switzerland, annual, Berne.

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Abstract

In the past thirty years, local governments in most European countries have been granted at least limited access to borrowing. The rules in force include limitations on the amount of borrowing and/or debt service, restrictions on the purpose of debt and on borrowing from foreign institutions and/or from the central bank. The description of these rules and sanctions constitute the thrust of several academic studies on local borrowing and debt. What are the ingredients that make it work efficiently? Fiscal discipline is not a simple question of having or not rules limiting deficits and debt. From "soft" to "hard" budget constraints, there are various degrees of severity. Dafflon (1995, 1996) proposed a catalogue of ten key issues that might help local policymakers examine their budget management practices upon whether they promote budget responsibility or not. The catalogue also permits to qualify the budget constraint from "soft" to "hard" whether it is self-imposed or imposed top-down. Based on these arguments, we consider budget discipline versus budget responsibility. Budget discipline is a forced and constraining approach to obtaining a balanced budget at decentralised levels. The corresponding positive approach is budget responsibility. The balanced budget as a result of a prudent and proactive budget policy through which local governments adjust their investment policy to their real fiscal capacity and assess costs and benefits of each capital programmes in advance, in order to avoid excessive debt.

Keywords

Accountability, fiscal discipline, fiscal responsibility, local public debt, balanced budget, borrowing, golden rule, pay-as-you-use, indebtedness, debt service, debt ratio

JEL Classification

H72, H74

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