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VIEWS OF THE EFTA COUNTRIES

RECOVERY AFTER THE PANDEMIC, IDENTIFYING THE CHALLENGES AND OPPORTUNITIES

EFTA ECOFIN MEETING

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Views and priorities of the EFTA States

Recovery is underway in the EFTA States after eighteen months of fighting the health and economic effects of the COVID-19 pandemic. An unprecedented policy response on the back of healthy fiscal buffers, together with broad vaccination coverage that enabled easing of containment measures, has paved the way for normalisation of economic activity. In 2020 the EFTA States experienced economic contraction of between -0.8% and -6.5%, with the service sector, in particular tourism, transport, hospitality and culture most badly hit. The differences between EFTA States can largely be explained by variation in economic structures and dependencies on the tourism sector, but differences in infection and national measures may have played a role. Currently, there is increasing optimism among businesses and households. This year the EFTA countries expect economic growth, between 2.6% and 3.8%. The growth will mainly be driven by an increase in exports and private consumption. Inflation varies markedly between the EFTA economies, but inflationary pressures are expected to fade next year. The EFTA economies will have reached their pre-crisis GDP levels this year or early 2022.

The labour markets are regaining strength with a sharp fall in unemployment that rose at the start of the pandemic. Demand for labour has bounced back in parallel with the lifting of COVID-19 restrictions and normalisation of social life, leading to a labour shortage in some industries and a high number of job vacancies. In all EFTA States the unemployment rate is close to pre-pandemic levels. However, a larger share of long-term unemployment remains a more structural concern in some EFTA countries, especially within vulnerable groups. Even though the focus has been on protecting jobs and incomes throughout the crisis, there will probably be a need for reallocation of production factors considering a changing demand following the pandemic once the support wanes. How smoothly this intersectoral reallocation occurs will determine the strength of the recovery and the medium-term economic growth. Skill mismatch between the demand for labour and employees can occur. This can lead to a situation where higher unemployment than before the pandemic exists alongside unfilled job vacancies. The EFTA States are well equipped to tackle this challenge due to their relatively flexible labour markets.

All the EFTA States entered the pandemic from a solid fiscal position. This has allowed for a strong and effective fiscal response. Strong automatic stabilisers and discretionary measures played a vital role in improving confidence, supporting demand, and preserving production capacity by mitigating the shock on households and businesses. Also, monetary and macroprudential policy responses were accommodative. Without the strong policy response, the economic contraction would have been larger and the recovery weaker.

As the necessary containment measures that protected health and lives, and thereby also the economy, by intention hindered economic activity, strong economic measures were warranted. Along with the easing of COVID-related restrictions and the return to normal social activities, it is equally important to withdraw discretionary support. In the EFTA States, most such support will be phased out by the end of 2021. However, initiatives to increase employment and reduce long-term unemployment, boost innovation and public investment will continue where needed.

The EFTA States underline the importance of sustainable and responsible fiscal policies. The pandemic has highlighted the importance of having fiscal space to deal with economic shocks. In that respect it is important to provide room to mitigate future economic shocks, to build up buffers and lower public debt. The EFTA countries' main strategy for securing sustainable public finances is to pave the way for a robust and resilient recovery in order to reduce the debt to GDP ratio.

The short-term outlook remains dependent on how the pandemic evolves globally. Global vaccine inequality is not only an ethical issue, but it also risks causing virus mutations that could bring about economic instability even in countries with high vaccination rates such as the EFTA States (rates between 60 and 80%). The EFTA States acknowledge the need to support low-to-middle-income countries for equitable access to vaccines and other COVID-19 tools, for example via ACT-A and its COVAX facility. However, it is likely that further outbreaks will have a more limited impact on economic activity than before as economic agents have taken up new habits and learned from past experience. It seems likely, that the new normal will be increasingly digitally driven.

Further ahead, the extent of economic scarring will be the main risk for growth and inclusiveness. However, there is evidence suggesting that production capacity has been well preserved. Bankruptcies remain few, labour participation has recovered, unemployment is low even though in some EFTA States the long-term unemployment is higher than prior to the pandemic. Business investment fell last year due to less activity and uncertainty about the outlook but is expected to rebound this year. In some cases, strong government investment contributes to the increase in capital formation. Furthermore, banks are well capitalised and as such with capacity to lend to businesses and households.

The EFTA States perceived the COVID-19 pandemic as an opportunity to foster structural changes to make economies more resilient to future shocks, thus pursuing a greener, more inclusive, and resilient economy after the recovery. The EFTA countries are fostering digitalisation, promoting decarbonisation, innovation and social inclusion in their attempt to reinforce long term growth potential. This entails tax incentives, financial support for development, research and innovation, carbon taxing and other regulatory measures. International cooperation is pivotal to this end. Not the least in terms of reducing greenhouse gas emission. Pricing carbon, via taxes or tradeable emission quotas, is an important instrument. Iceland, Liechtenstein, and Norway participate fully in the EU Emissions Trading System, while Switzerland has linked its Emissions Trading System with the one of the EU. However, these efforts will be less effective if economies outside the EU and EFTA do not have the same ambition. Lack of cooperation can result in carbon leakage and undermine the reduction in global emissions.

The EFTA States share the concerns and objectives of the European Commission in reducing the risk of carbon leakage to countries outside the Single Market. The EFTA States take note of the Commission’s proposal for a Carbon Border Adjustment Mechanism (CBAM) as a tool to reduce carbon leakage and appreciate that the proposed regulation explicitly states that the mechanism does not apply to goods originating in the EFTA States. However, the potential removal of the allocation of allowances free of charge in the EU Emission Trading System will directly affect EEA EFTA countries. It is important that a CBAM would comply with the WTO and international rules.

The EFTA countries continue to stress the importance of open markets and rules-based international trade. As for enhanced strategic autonomy, the EFTA States believe that this is best secured through open, fair, and rules-based trade relations as part of a global level playing field. International trade has driven a massive increase in prosperity worldwide even though we see growing challenges to established norms and the international rule-based system. The EFTA States acknowledge that the pandemic has raised the awareness of vulnerability that comes with trade and global value chains, in particular if the dependence on certain trading partners becomes too great and buffers are too small. However, the EFTA States believe that stemming the COVID-19 pandemic, preventing further pandemics, bringing about economic recovery, and addressing climate change will all need more international cooperation, not less.

Annex 1: Iceland

Economic situation and outlook

The economic recovery is gaining momentum in Iceland, notably in exports and the labour market. Tourist arrivals are now 60% of their number in 2019 and unemployment is already down to pre-COVID levels. This year, gross domestic product is expected to increase by 2.6% and 4.8% next year. As such in 2022 GDP will exceed its 2019 level. It is now likely that this will happen sooner as the Marine and Freshwater Research Institute released advice October 1 on a historically large capelin fishery for the upcoming winter fishing season (2021/2022).[1]

The economic contraction due to the COVID-19 pandemic amounted to 6.5% in 2020 which was milder than anticipated. The Icelandic economy proved resilient during the pandemic with national expenditure decreasing by only 1.9% despite a severe hit on the country's large tourism sector.

The policy response in Iceland was timely and effective allowing for less stringent containment measures and less disruption of economic activity. Approximately 75% of the total population and 88% of 12 years and older are fully vaccinated. Effective vaccine distribution and a high vaccine acceptance rates mitigate risk from further waves. The fiscal support was sizable and targeted and monetary policy was accommodative. The resilient domestic demand reflects the success of both health and economic policies in addition to a much strengthened economic policy framework over the past decade.

The purchasing power of households' disposable income grew by 4% y-o-y in 2020 and 6% in 2021 Q1 due to both increased transfers, not least through the unemployment benefits, and a special withdrawal from 3rd pillar pensions. The domestic economy was supported by the onshoring of private consumption as foreign travel halted and consumption reoriented to some extent from foreign to domestic goods and services. Households' strong incomes and balance sheets contributed to the robust demand.

Fiscal policy has been used decisively to lay the ground for a forceful recovery. Deficit of the general government overall balance was 7.1% in 2020 and estimated at 11.4% in 2021 as a result of strong automatic stabilisers and discretionary measures. Public debt as a share of gross domestic product is expected to reach 54%[2] this year. The figures will be revised due to better than expected fiscal outturns,

[1] Key economic indicators are being revised after news of a large capelin quota and a much stronger recovery overall than expected. A new official forecast is expected later this year.
[2] Maastricht definition of debt.

mainly stronger revenues. The robust recovery now allows for unwinding COVID-related support measures, thus improving the fiscal balance and the debt position.

Tourism led the recent economic expansion in Iceland; its share in GDP more than doubled between 2011 and 2018 to reach 8%. When the pandemic hit, almost 15% of the workforce was employed in tourism and the industry supplied 35% of export revenues in 2019. In 2020 the tourism sector suffered immensely with tourist arrivals decreasing by over 75%. Relaxation of border containment measures fostered a swift recovery in tourism largely driven by travellers from the United States. Travelers from the States were nearly 45% of all travellers last summer. In 2019 the ratio was nearly 30%. The number of tourist arrivals grew fast last summer and reached 60% of its 2019 level in August. Foreign travellers arriving to Iceland are staying longer and spending more than before the pandemic.

The recovery in tourism has contributed to a forceful recovery and prevented elevated unemployment from becoming permanent. Unemployment peaked in January at 11.6% but is now down to 5% in September. Thus, the unemployment rate is back to pre-pandemic levels but slightly higher if adjusted for seasonality. Unemployment hit immigrants and people with little formal education particularly hard, groups that are now vulnerable to long-term unemployment.

A sharp increase in exports contributes the most to the economic growth in GDP this year after a 30% contraction in 2020. The current account balance is expected to be positive by 0.9% of GDP this year. The Icelandic króna has been rather stable; it depreciated by 3% in the first nine months of the year. The real exchange rate is close to its historical average and has declined since 2018, supporting growing export sectors. Terms of trade are expected to improve this year and the next, led by international price increases of aluminium products and a recent increase in sea food prices.

Inflation has remained above target despite the negative output gap and measured 4.4% in September. Rising housing prices have been an important driver behind the persistently high inflation over the past year. Excluding housing, inflation was 2.9% in September. The authorities have responded to rising house prices by lowering loan-to-value ratios and implementing a debt service to income ratio for the first time. The central bank has responded to elevated inflation and the improved economic outlook by raising the policy rate by 75 basis points. Short-term inflation expectations have recently exceeded the 2.5% target, but inflation is expected to decrease towards target in 2022.

Challenges and opportunities

The key challenges to the recovery are the extent of economic scarring and the effect of policy support in hindering necessary reallocation of capital and labour. Both of these challenges will become clearer further into the recovery. There is evidence suggesting that the pandemic's lasting effect on output is less than initially feared. Rapid recovery is now underway, driven largely by the tourism sector, where production capacity seems to have been largely preserved despite the severe revenue loss during the heights of the pandemic. However, the industry is still nowhere near normality and it seems likely that the crisis will leave some permanent scars.

The government implemented a broad range of policy measures aimed at supporting domestic demand and decreasing the extent of economic scarring. This was mainly done via targeted support to heavily effected businesses (grants, guaranteed loans, and tax deferrals) and by maintaining employment relationships and creating jobs (part-time unemployment benefits and hiring grants), preserving the purchasing power of households (unemployment benefits and a special withdrawal from 3rd pillar pensions), stimulating demand (VAT refund), increasing investment in infrastructure and R&D and protecting vulnerable households.

Fiscal measures aimed at safeguarding firms and households seem to have been effective. The purchasing power of households has increased in all income groups, with the biggest proportional increase among those with the lowest income. Most sectors excepting tourism and related activity have had y-o-y revenue growth. Bankruptcies remain few, even in tourism, and new business registrations have started to rise. However, it remains to be seen if the targeted policy support delayed or hindered reallocation of factors of production into sectors that have bigger potential in the post-COVID era.

In late spring, firms' demand for labour increased rapidly. Unemployment decreased fast and is now back to pre-pandemic levels, however, the share of long-term unemployment is historically high. Almost all individuals that exit unemployment enter jobs; very few exit the labour market. Employment has increased by more than what can be explained by flows from unemployment. As a result, labour participation is now at pre-COVID levels (approximately 80%) which bodes well for production capacity.

The containment response has been effective allowing for less restrictions on economic activity. This in turn contributed to less contraction in domestic demand and mitigated economic scarring. School closures were seldom implemented and learning losses due to COVID-19 are thus minimal in an international comparison.

Icelandic banks are very well capitalised and in a strong position to support growth. Early in the pandemic the Central Bank of Iceland decided to reduce the countercyclical capital buffer on financial institutions from 2% to 0%. Capital adequacy ratios of systematically important banks are well above requirements and the banks have ample liquidity to support the economy even though the countercyclical capital buffer has been increased. As such, the lending capacity of banks to businesses and households is still plenty.

The COVID-19 pandemic has put into clear focus the importance of economic diversification. The economy had become very reliant on tourism. The industry had a high share in the country’s GDP, its export revenue and total employment. Thus, Iceland was very exposed to shocks such as a worldwide pandemic. Opportunities in the recovery involve pursuing a more diverse and resilient economy that reduces vulnerability to future disasters.

The public investment initiative is the largest single fiscal measure related to the pandemic. It has provided a significant boost to the economy and is estimated to have employed around one thousand people. Most of the investment is in infrastructure, R&D, construction, and digitalisation. There is already strong growth in the research and development sector and firms and government entities have been going through a digital transformation which bodes well for future economic growth.

Residential investment remained strong in 2020, supported by policy measures. Business investment grew in some sectors, notably information technology and R&D. Overall investment decreased by 8.7% last year and is expected to increase by 5% this year.

The Icelandic government has an ambitious climate action plan. Putting into focus the importance of long-term environmental sustainability of the Arctic. Iceland's emissions profile is in many ways unusual. Almost all heating and electricity generation is provided for by renewables, hydro and geothermal energy. The government’s climate action plan is affected by the fact that almost all energy in Iceland is already renewable. Thus, the government’s focus has been to support transformative changes in important emissions sectors, notably land transport, fisheries, and geothermal power plants. Various government measures support reaching the established emission target, many of which are tax related. Iceland boasts one of the boldest pricing regimes OECD-wide, with 57% of carbon taxed at 60 euros/tonne or more through the combined effect of the trading system, a carbon tax and excise taxes on energy use.

As an effort to align finance with climate targets the government is looking into issuing green bonds. Public entities in Iceland have been issuing green bonds since early 2019. There is increasing demand for green investment and thus a growing incentive for firms and government entities to finance green.

To reduce emissions from land transport there have been tax incentives for purchases of eco-friendly vehicles, active means of transport and for charging stations. Electrification of the Icelandic car fleet is now among the fastest in the world with nearly half of new car registrations being electric vehicles. Other tax incentives support green investments and green transformation in companies. Such as authorisation to calculate a special 15% surcharge on the purchase price of green assets that depreciates taxable income. In order to be covered by the authorisation, assets must be considered environmentally friendly and promote sustainable development.

The way forward

As before, domestic and international economic developments will largely depend on how successfully the pandemic is contained. Although a large part of the population has been vaccinated, uncertainty abounds. It is nonetheless likely that effective vaccine distribution and high vaccine acceptance rate mitigate risk of any further severe surges of coronavirus.

The robust recovery in Iceland now allows for unwinding COVID-related support measures. Most of the targeted measures expire by the end of 2021 while some, such as the investment initiative and labour market measures, are ongoing. Support is thus transitioning from mainly life-line support to badly hit households and firms to encouraging job creation and investment. Policy now has an especially important role in preventing long-term unemployment, supporting investment and thus, ultimately, contributing to potential growth. As the overall support winds down there might be some reallocation of labour or capital resulting in a number of bankruptcies, especially in tourism. Such creative destruction is likely inevitable and the result of long-term changes in demand due to the pandemic. As such it should be good for economic growth as factors of production move to more profitable firms and sectors.

The COVID-19 pandemic has emphasised the importance of strong macroeconomic buffers, including low public debt, strong external balance, and the anchoring of inflation expectations. An objective of economic policy is the preservation and, if necessary, restoration of these buffers. This includes an eventual adjustment of fiscal policy to ensure that government debt remains low enough to provide room to mitigate future economic shocks. Therefore, while the government debt-to-GDP ratio is forecast to rise in the coming years, an aim is set in the 2022–2026 Fiscal Plan to stabilise it no later than in 2025.

Key figures for the Icelandic economy

(Percentage change from previous year unless otherwise noted.)

	2020	2021f	2022f
Private consumption	-3.0	2.3	4.1
Public consumption	4.5	1.1	0.7
Gross capital formation	-8.7	5.0	4.3
Exports	-30.2	10.3	16.8
Imports	-22.5	8.7	12.5
GDP	-6.5	2.6	4.8
Current account balance, % of GDP	0.9	0.9	2.1
Unemployment, % of workforce	6.4	7.8	6.4
Consumer price index	2.8	3.2	2.4
General Government net lending, % of GDP	-8.5	-11.4	-7.5
General government Maastricht debt, % of GDP	48.3	54.0	57.7

2021 and 2022 values are forecasts.
Sources: Statistics Iceland macroeconomic forecast, March 2021; Ministry of Finance and Economic Affairs.

Annex 2: Liechtenstein

Economic situation and outlook

As in 2020 the year 2021 was a difficult one due to uncertainty related to the COVID-19 pandemic especially about the duration and extent of its economic consequences. However, in terms of the impact on employment, Liechtenstein appears to remain crisis-resistant so far and the economic recovery is in progress in Liechtenstein.

The business cycle index named KonSens is a quarterly indicator for Liechtenstein's business cycle pattern and consists of 16 individual economic indicators. It was created by the Liechtenstein Institute, a Research Institute in Liechtenstein. Actually, the KonSens show, that Liechtenstein’s economy continued its strong recovery from the corona shock. Compared to the 1st quarter of 2021, the KonSens has improved by 0.3 index points to +0.9 in the 2nd quarter of 2021. The positive KonSens values of the past four quarters indicate that Liechtenstein’s economy has grown again consistently since the first half of 2020 and that in each of these quarters even above average in a long-term comparison. Even if the international economic signals are still positive, the economic development in the current third quarter will continue to depend on the course of the pandemic.

Liechtenstein’s economy is characterised by a small domestic market and is therefore heavily reliant on exports. The most important product groups for Liechtenstein’s exports in 2020 were “Fabricated Metal Products” and “Machinery”. Another important export group were the “Motor Vehicles, Trailers and Semi-Trailers” and “Electrical Equipment” with a share of more than 10% of total exports. Consumer goods only play a subordinate role.

Due to the COVID-19 pandemic, Liechtenstein’s direct goods exports (excluding trade in goods with Switzerland) declined sharply in 2020. The annual decrease of real good exports amounted to -13.5% (2019: -2.2%). However, Liechtenstein still has a large trade surplus in exports/imports of goods. In 2020, the goods trade surplus was at 73% compared to 72% in 2019. This high trade surplus was also influenced by a decrease of the goods import of about 12.7%.

In the first half year 2021, the direct goods exports increased by 39.3% compared to the period of the previous year. Also, the number of overnight stays in the accommodation establishments (all types of accommodation) increased by 12.2% in the first half year of 2021 compared to the same period of the previous year. Despite this positive development business hotels still suffer as a result of the COVID-19 pandemic.

In 2020, according to the results of the Office for Statistics the number of people employed in Liechtenstein decreased from 40.605 to 40.328, which is a reduction of 0.7% or 277 people. In the previous year, an increase in employees of 2.4% was calculated. In contrast the average unemployment rate in 2020 could be kept at a low level of 1.9% compared to 1.5% in 2019.

Liechtenstein’s industry is highly dependent on the smooth functioning of the global value chain. At the end of 2020 the 40.328 employees were standing at 42.758 full and part-time jobs available. Compared to 2019, this is a reduction of 0.5%. We assume, that this is a result of the global COVID-19 pandemic. Nevertheless, the number of companies increased by 2.6% to 5.179 companies in 2020. 88.6% of the companies had fewer than 10 employees, 9.2% between 10 and 49 employees and 2.1% 50 and more employees.

Among the sectors most affected by the crisis are the travel and hotel industry, event organisers, cultural businesses and goods manufacturers.

In 2021 (until August) the unemployment rate decreased to 1.5%. Furthermore, open positions in the Liechtenstein job market are increasing. The construction industries and the financial centre are still not showing any negative developments in terms of employment. It is especially encouraging that employment has generally remained stable in large industrial companies and most SMEs. This can be attributed to the well-functioning of the measures in the support package, in particular the extended short-time work scheme. It can also be assumed that keeping well-trained workers, even in economically difficult times, has a mitigating effect during the crisis.

The finance and insurance sector traditionally played an important role for the Liechtenstein economy and contributes around 13% of the country’s gross value added. The structural characteristics of the Liechtenstein banking and financial sector are especially important for guaranteeing stability in times of crisis. In this context, Liechtenstein’s financial sector benefits from high capital and liquidity buffers that increase the loss absorption capacity during the crisis.

The Liechtenstein finance sector has found good solutions for the unusual conditions during the COVID-19 pandemic and was still able to achieve good results in 2020. According to the provisional evaluation of the annual results of Liechtenstein banks, income from commission and service business increased by 4.4% in 2020. The managed client assets of the banks in Liechtenstein grew by 2.9% in 2020 according to the Liechtenstein Financial Market Authority while in the previous year it had increased by 9.5%. Net new money also developed positively with an inflow of CHF 5.5 billion.

The public budget has achieved continuous surpluses since 2014 and the forecast for 2021 is to remain in positive territory, despite the possibly negative fiscal implications of the COVID-19 pandemic. Due to the delayed impact of the economic crisis on tax revenues, the consequences will mainly be reflected in the central government accounts after 2021. The full effect of the COVID-19 pandemic on tax revenues will be visible beginning with 2021, since the corporate revenue tax in 2020 related to the tax year 2018, the property and income tax revenue related to the tax year 2019 and also the value added tax share from the mutual pool with Switzerland related to years before 2020.

In March 2021 the annual rate of increase was -0.2%. The core inflation rate excluding energy and fuel decreased in March 2021 compared to March 2020 by 0.4%.

Challenges and opportunities

To cushion the economic consequences of the COVID-19 pandemic, the government adopted a package of measures amounting to CHF 100 million in 2020. The primary objective has been to safeguard jobs, secure livelihoods and mitigate the consequences for the economy by bridging liquidity shortages of affected companies. As a result of an extension of the package and additional grants from the municipalities, the total budget for the economic policy measures since 2020 amounts to CHF 130 million (1.93% of GDP).

In order to avoid possible liquidity shortages, companies could apply for a bridging loan up to CHF 300 000 from the Liechtensteinische Landesbank (LLB). Eligible were companies that had run into liquidity shortages due to the pandemic and the related (partial) lockdown. The loans are limited to five years and interest-free until 30 June 2022. For this purpose, the government issued a default guarantee in favour of the Liechtensteinische Landesbank amounting to a maximum of CHF 35 million. The program ended on 30 September 2020 and has provided over CHF 23 million in loans to 267 companies.

Short-time work is one of the most important measures to compensate for the economic consequences of the COVID-19 pandemic. Under the conditions laid down in a special regulation, companies can claim short-time work compensation for their employees if they suffer a loss of working hours as a result of the pandemic and its effects. This measure has been extended until the end of December 2021 in order to provide planning security for companies.

For self-employed persons and micro-enterprises directly and indirectly affected by the official business closures, a grant program in the total amount of CHF 25 million was put in place.

A special evaluation of the short-time work allowances paid out shows that as of the reporting date of the publication (December 31, 2020), the remuneration was paid for 2.0% of the 34292 full-time equivalents. The arts, entertainment and recreation sectors with 21.1% and the hospitality industry with 18.1% show the highest proportions of short-time working.

By the end of March 2021, 87.7 million state support contributions had been paid out, two thirds of which as short-time work compensation. At the height of the crisis, there were almost 7.000 employees affected by short-time work. This number decreased continuously to around 1.200 employees in February 2021. In May 2021, 66% of the short-time work compensation was paid out in the industrial sector, in February 2021, 86% of the compensation money was paid to service companies.

It is planned that most of the mentioned measures will phase out by the end of December 2021. The government expects that in certain sectors of industry and commerce the effects of the pandemic will only be felt with a delay or, as in the travel and event industry, will last for a long time to come.

Up to now in Liechtenstein there were about 3.557 residents in Liechtenstein who tested positive for COVID-19. The vaccination rate is about 63%. Recently, the Liechtenstein Government has decided new measures and restrictions. The Liechtenstein Government tries to avoid closures of school, shops, restaurants, etc. and to protect the health system. Thus, a certificate (vaccinated, recovered or tested) is needed in many areas.

In 2015, the government issued the new climate strategy for Liechtenstein. The strategy replaces the national climate protection strategy from 2007 and stipulates that specific climate protection measures are interdisciplinary and coordinated in the individual sectoral policies on the environment, energy, construction, transport, agriculture, and forestry. With a view to future international climate finance, the government is setting a new framework for action that expresses the principles of environmental integrity and solidarity. The government sets a qualitative framework for emissions reductions abroad. Furthermore, Liechtenstein is implementing the European Union’s Sustainable Finance legislative package.

The way forward

Most of the measures in connection with the COVID-19 pandemic will phase out by the end of December 2021. The support measures have helped many companies to cope with the consequences of business closures and other official measures. The extended short-time work scheme has been very effective and has so far prevented large waves of layoffs. Although future waves of layoffs or even insolvencies cannot be ruled out, this scenario seems rather unlikely at present. Nevertheless, a high degree of uncertainty remains.

The number of cases in Liechtenstein has risen again since August. The government is relying on increased social distancing, an obligation to wear masks in publicly accessible buildings and an extended obligation for a certificate (vaccinated, recovered or tested) in restaurants, for events and fitness centres.

For a large number of small and medium-sized companies, the COVID-19 pandemic has led to severe cutbacks. This, at least in some cases, fundamentally calls into question previously proven corporate strategies. Far-reaching home office regulations, web-based learning, online meetings and conferences and continuously automated supply chains for example have seen a huge boost. A close connection between the degree of digitisation and competitiveness is also becoming increasingly apparent. While the big tech companies have been able to further expand their market power, many traditional companies are facing major problems.

Furthermore, the Liechtenstein economy is extraordinarily strongly dependent on foreign sales and procurement markets. An assessment of the economic development of Liechtenstein therefore needs to include the development of the most important sales countries such as Switzerland, Germany, and the United States.

Key figures for the Liechtenstein economy

	2017	**2018**	**2019**	**2020**	**2021 (1st quarter)**
Direct exports growth (without Switzerland) *	0.5%	8.5%	1.1%	-16.4%	18.4%
Direct imports growth (without Switzerland) *	1.1%	0.6%	-1.8%	-17.0%	9.1%
Gross domestic product (GDP), m CHF	6 452	6 725	6 643		
GDP change from previous year	5.0%	4.2%	−0.7%		
Consumer price inflation[3]	0.5%	0.9%	0.4%	-0.7%	-0.2%
Employment growth	3.2%	2.5%	2.6%	0.1%	
Share of persons employed by economic sectors:					
- Agriculture and forestry	0.6%	0.6%	0.6%	0.6%	
- Manufacturing	37.5%	37.4%	36.5%	36.1%	
- Services	61.9%	61.9%	62.9%	63.2%	
Unemployment rate[4]	1.9%	1.7%	1.5%	1.9%	1.5%
Unemployed persons under 25[5]	2.6%	2.1%	1.5%	1.8%	1.6%
Public Surplus/ Deficit (+/-), million CHF	189	200	244		
Public Surplus/ Deficit (+/-), in % of GDP	3.1%to	3.0%	3.7%		
Public expenditure quota, in % of GDP	20.5%	20.3%	20.9%		

Source: *Office of Statistics Liechtenstein*

Office of Economic Affairs – Labour Market Service

* Nominal growth rates.

[3] For 2017, 2018, 2019 and 2020: Annual average. For 2021: March compared to March of 2020.

[4] For 2017, 2018, 2019 and 2020: Annual average. For 2021: Rate as of August 31.

[5] For 2017, 2018, 2019 and 2020: Annual average. For 2021: Rate as of August 31.

Annex 3: Norway

General economic situation

The coronavirus pandemic caused the steepest setback in the Norwegian economy since World War II. Over the past few months economic activity has increased rapidly, in line with falling infection levels, increasing vaccination coverage and the reopening of the society. The economic crisis is over, although some businesses in the services sector, particularly in tourism and transport, are still facing difficulties due to the pandemic.

Unemployment has decreased faster than assumed in the Revised National Budget, published in May 2021, and registered unemployment has almost returned to pre-pandemic levels. According to Statistics Norway’s Labour Force Survey (LFS), the employment rate amongst residents is higher than before the pandemic. However, the number of foreign workers on short-term stay in Norway is currently well below pre-pandemic levels. Businesses expect strong growth going forward, and many industries are now experiencing bottlenecks, partly due to labour shortages.

The Norwegian economy is expected to move into a moderate boom next year, with registered unemployment coming down to low levels. This will make the current recession shorter than previous downturns in the Norwegian economy. A rapid pace of vaccination and high vaccination rates has reduced the uncertainty surrounding the economic outlook. We expect a higher rate of economic growth than normal in both 2023 and 2024, and an increase in employment and a further decrease in unemployment.

While expansionary fiscal and monetary policy helped dampen the harmful economic effects of the pandemic, economic policy is now being restructured to prevent the economy from overheating and to avoid a permanent rise in public spending. The economic measures introduced in response to the pandemic are being unwound and fiscal policy is being normalised. Norges Bank raised its policy rate from 0 to 0.25% on 22 September 2021 and has projected further increases going forward.

Activity in the business sector picked up markedly as infection control measures were eased stepwise during the summer and early autumn. In August, activity in the mainland economy (e.g. petroleum and shipping) was 1.6 per cent higher than before the pandemic. However, there are major differences between sectors. Business investment fell markedly during the pandemic but is expected to increase going forward.

Growth in the global economy has been stronger than anticipated and will lead to higher growth in mainland exports than projected in May. Strong global growth has also contributed to an increase in demand and higher prices for commodities. Petroleum investments are expected to increase slightly this year before falling in 2022. The temporary changes in petroleum taxation, which were introduced last year, have incentivised companies to carry out planned investment projects. Easing of infection control measures contributed to a substantial rise in private consumption over the spring and summer. The reopening of society and the high household saving rate give prospects for further growth in private consumption going forward.

Registered unemployment has fallen faster than anticipated and is now well below the average rate of the past 20 years. The decrease is due to a fall in the number of furloughed workers as well as a decline in the number of ordinary fully unemployed persons. Adjusted for seasonal variations, 39.000 fewer people are fully unemployed than at year-end, with 73.300 people being fully unemployed at the end of September. This corresponds to 2.6 per cent of the workforce.

During the pandemic, housing market activity has been strong. House prices have risen markedly, and sales have reached record levels. Price growth has tailed off in recent months, yet sales have remained high. The decrease in house price growth may be linked to expectations of higher mortgage rates. The reopening of society may also have contributed, with prospects of lower savings and a normalisation of household consumption patterns. Record low interest rates and high activity in the housing market have contributed to an increase in the growth rate of household debt over the past year, after having declined over an extended period of time. The household debt burden is at a historically high level and represents a vulnerability to the Norwegian financial system.

Macroeconomic policy framework

The Norwegian fiscal policy framework underpins stability in an economy with large and fluctuating petroleum revenues. By transferring all government revenues from petroleum activities to the Government Pension Fund Global (GPFG) and over time aligning withdrawals with the expected real return on the Fund (estimated at 3%), the fiscal budget is better protected from fluctuations in petroleum revenues. It also ensures that current spending of petroleum income over the budget can be sustained.

The fiscal guidelines place emphasis on stabilising economic fluctuations. Importantly, the automatic stabilisers are allowed to function, since petroleum revenue spending is measured by the structural, rather than actual, non-oil budget deficit. The guidelines also allow the fiscal budget to be used actively to stabilise the economy. In any given year, fiscal policy shall be tailored to the cyclical situation, and spending of petroleum revenue can thereby deviate from 3% of the GPFG's market value. Further, the guidelines specify that the impact on government spending of major changes to the Fund capital shall be evened out over several years.

The coronavirus pandemic gave rise to an urgent need for a fiscal policy response in 2020 and 2021. Appropriations for fiscal measures in 2020 and 2021 (excluding loans and guarantees) add up to NOK 233 billion (see table below), corresponding to 7.3% of 2020 mainland trend GDP. Reduced tax revenues and higher expenses due to the economic downturn (automatic stabilisers) weakened the budget further.

Economic measures in 2020 and 2021 in response to the pandemic[1]

NOK billion at 2021 prices

	2020	2021	Total
Business	69	35	104
Households	19	20	39
Sectors with duties of critical importance	41	38	79
Culture, sports and volunteering	6	4	10
Total	135	98	233

[1]The total amount of NOK 135 billion for 2020 at 2021 prices corresponds to NOK 131.3 billion at 2020 prices.
Source: Ministry of Finance, National Budget 2022, presented by the Solberg Government on 12 October 2021

The withdrawal from the GPFG in both 2020 and 2021 corresponds to 3.6% of the Fund's market value. This is higher than previous years. The structural non-oil fiscal deficit in 2020 and 2021 corresponds to 11.5% and 12.1% of mainland Norway trend GDP.

For 2022, the proposed budget will go a long way to normalise the spending in line with the fiscal guidelines. Reduced spending will contribute to a more stable development of the Norwegian economy. The phasing-out of temporary economic COVID-19 measures should not be seen as tightening of economic policy since its counter-item is the phasing-out of infection containment measures that hold back activity. The spending of GPFG resources in the proposed 2022 budget, as measured by the structural non-oil fiscal deficit, corresponds to 9.5% of mainland Norway trend GDP.

Financial stability and financial market policy

Since the global financial crisis in 2008, Norwegian banks' common equity tier 1 (CET1) capital ratio has more than doubled. At the end of Q2 2021, the banks' CET1 capital ratio was 18.6%, and the leverage ratio stood at 7.7%. Norwegian banks have also become less dependent on short-term market funding in recent years and have built up considerable liquidity buffers in line with the liquidity coverage requirement (LCR) introduced in the wake of the financial crisis. At the end of Q2 2021, the banks held liquidity buffers corresponding to 159% of the requirement.

Banks experienced a decline in profits and return on equity in 2020 following the outbreak of the pandemic, and recorded loan losses for 2020 were at the highest level since the banking crisis in the 1990s. However, banks' performance in the first half of 2021 show signs of returning to normal with a rise in profits and return on equity, and with a substantial decrease in loan losses compared to the first half of 2020. Norwegian banks' capital adequacy ratios increased in 2020 as a result of retained profits.

Norwegian insurers generally maintain a sound margin to the Solvency II requirements. The life insurers' overall solvency coverage ratio, i.e. the ratio of eligible own funds to the solvency capital requirement (SCR), was 235% at the end of Q2 2021. At the same point in time, the pension funds' overall solvency coverage ratio was 178% and the non-life insurers' overall solvency coverage ratio was 225%.

Elevated real estate prices and high household debt are among the most important vulnerabilities in the Norwegian financial system. A number of measures have been introduced in recent years to limit the risks. In addition to the general strengthening of capital requirements for banks, the capital requirements for residential mortgages have been raised. Moreover, the countercyclical capital buffer requirement, which is intended to strengthen banks' resilience to absorb loan losses, was increased to 2.5% from 31 December 2019. In March 2020, it was reduced to 1% to increase banks' lending capacity as a response to the COVID-19 pandemic. The buffer requirement will be increased to 1.5% from June 2022, and Norges Bank envisions it returning to 2.5% in the future. The regulation on new lending secured by a residential mortgage was temporarily loosened in Q2 and Q3 2020 in response to the COVID-19 pandemic, before returning to normal in Q4.

As a consequence of the EEA Agreement, Norwegian financial market regulation is developed in line with new EU requirements. Nevertheless, there will always be a backlog of legal acts not yet incorporated into the EEA, due to structural factors as well as capacity limitations. Norwegian authorities put much effort into both the incorporation of legal acts outstanding into the EEA Agreement, and the implementation of acts into Norwegian law.

Recovery after the pandemic, identifying the challenges and opportunities

The relatively fast upturn in the Norwegian economy indicates that the policy in response to the virus outbreak has been effective. The central government has covered a large proportion of the income loss of households and the businesses, both through the automatic stabilisers and through direct compensation schemes.

The historic high public spending under the pandemic must be reversed once the crisis is over to avoid depleting fiscal buffers, overheating the economy and locking in a too large public sector. If public sector resource use is too high, activity in the private sector may be stifled. Over time, this can impede the ability of the Norwegian economy to grow and adapt.

Long-term analyses show that the room for manoeuvre in Norwegian fiscal policy going forward will diminish and gradually turn to a fiscal deficit.[6] This is partly because of the increasing proportion of elderly people in the population and the expectation that petroleum revenues will decline. A reduction in the inflow of capital to the GPFG will eventually cause the contribution from the fund to diminish.

According to the Labour Force Survey (LFS) the employment rate amongst residents is now higher than before the pandemic. This is mainly due to increased employment in the age group 15-24 years. However, administrative data shows that the number of non-resident employees has fallen significantly since the start of the pandemic. It is too early to judge to what extent the pandemic will have a lasting effect on the supply of labour from non-residents. Although the labour market is returning to normal, the long-term unemployment has increased amongst immigrants, young people and people with low education.

While aggregate demand seems to return relatively fast, lack of demand could be more persistent on a disaggregate level, e.g. caused by a longer lasting shift from international to national tourism and from regular in-store shopping to online shopping. Disaggregated shifts in the demand for skills could raise the challenge involved in matching.

[6] Ministry of Finance, White paper on Long-term Perspectives on the Norwegian Economy 2021 (*Perspektivmeldingen*).

Support measures that hamper reallocation as the overall economy recovers, have to a large extent been withdrawn. During earlier recessions, reallocation of resources has been a source of productivity growth in the longer run, and digitalisation was a source of productivity growth before the pandemic. During the pandemic the pace of digitalisation has picked up. As shown by research by e.g. the OECD, productivity gains from digitalisation have to a large extent, been concentrated in industry leaders. We may hope that an increased pace of digitalisation, in combination with broad investments in digital infrastructure and knowledge, and better international tax rules, may lead to a situation where the productivity gains are more broadly shared. In a highly digitalised country like Norway, the diffusion of productivity gains may be easier to accomplish.

The way forward

During the crisis, measures were introduced in three phases. The first phase involved acute measures to avoid unnecessary bankruptcies and to secure liquidity. The second phase involved specific measures and compensation schemes for sectors, households and industries that were hit particularly hard. Norway is now in the third phase where containment measures are scaled back, social activity is normalised, and economic activity can recover. Going forward the focus must be on stimulating activity and employment.

Labour market and social inclusion

The increase in unemployment caused by the pandemic hit particularly hard vulnerable groups such as youths, immigrants, and people with little formal education. In line with increased activity and demand for labour, the unemployment rate for these groups has decreased substantially since March. The long-term unemployment rate has increased during the pandemic and is now higher than during the fall in oil prices in 2014-2016 and during the financial crisis, but significantly lower than in the early 1990s. Several measures were used to aid long-term unemployed and other vulnerable groups to return to work. Spending on active labour market measures increased significantly in 2021 and is accompanied by support measures directly targeting youths and long-term unemployed. It was also made easier to combine unemployment benefits with education, especially for the unemployed who want to complete high school or take vocational higher education. A wage subsidy scheme was introduced to induce employers to take back furloughed workers. This scheme expired in August.

Climate change

High ambitions, collective effort and urgent action are needed to speed up the transition to a sustainable, climate neutral and environmentally friendly future. Combating climate change and promoting climate neutral growth is a defining task. Norway shares the European Commission’s vision for a European

Green Deal. It wants to be a partner and contribute to its implementation. Norway and the EU enjoy a particularly close relationship. It shares a common regulatory framework within the Single Market, Schengen and the EU Emission Trading System (ETS), and cooperates extensively as a likeminded partner in foreign and security policy. The EU has high climate ambitions and has put forward proposals for how their 2030 emission target is to be achieved through the Fit for 55 package. Parts of the legislative proposals in this package will fall within the scope of the EEA Agreement. Norway has contributed to the development of these initiatives and will seek to play an active role in the further process.

Last year, Norway submitted an enhanced target under the Paris Agreement. Norway is now committed to reduce emissions by 50-55% in 2030, and the goal is to reduce emissions by 90-95% by 2050, compared to 1990. It should be noted that Norway’s target does not directly compare with the EU’s target. The EU’s enhanced climate target of a 55% reduction includes greenhouse gas removals through land use and forests. The Norwegian targets mainly concern emissions, not carbon uptake from forests. The carbon uptake from Norwegian forests is considerable, and it has increased since 1990. If Norway's enhanced 2030 target was calculated to include the forestry and land use sector, it would lead to a less ambitious target than our current one.

The EU and Norway have an agreement from 2019 to cooperate to fulfil our former 2030 climate targets. The cooperation enables Norway to reduce its total emissions more efficiently. Norway participates in the ETS and joint fulfilment of emission reductions in sectors outside the ETS. The Norwegian government wishes to cooperate with the EU on its enhanced 2030 target.

The main climate policy instruments in Norway are economic instruments that put a price on emissions, such as taxation of greenhouse gas emissions and participation in the ETS. Today, approximately 85% of Norwegian emissions are either covered by tax, emission trading or both. In 2021, the carbon tax rate is at NOK 591 (around EUR 60) per ton CO_2 and covers approximately 67% of all emissions. Both the scope and level of Norwegian carbon taxes are among the highest in the world. In January 2021, the Norwegian government presented a white paper describing its new Climate Action Plan. The plan presents a roadmap to achieve our ambitious climate goals. Policy instruments in the plan are taxation of greenhouse gas emissions, regulatory measures, financial support for the development of new technology, and initiatives to promote research and innovation. The main measure presented in the plan is to increase the taxes on emissions outside the ETS to NOK 2 000 by 2030.

The European Union and Norway share the view that a price on carbon emissions in general is the most cost-efficient way to reduce such emissions and have a common carbon pricing tool in the EU ETS. If international partners do not share the same climate ambition, there is a risk of carbon leakage and Norway's efforts to reduce emissions in Europe will not result in a similar reduction in global emissions.

The Norwegian government shares the concerns and objectives of the European Commission in reducing the risk of carbon leakage to countries outside the Single Market. Key features of the EU ETS directives such as free allowances and the framework for compensation of indirect CO_2 costs to exposed industries, are designed to reduce the risk of carbon leakage.

In order to prevent the risk of carbon leakage, the Commission has proposed a carbon border adjustment mechanism (the 'CBAM') for addressing greenhouse gas emissions from the production of certain goods in territories outside the EU. The Commission has proposed that the mechanism gradually should replace the free allowances in the Emission Trading System.

The EFTA EEA countries are not a part of the customs territory of the Union and therefore outside the scope of the CBAM. Furthermore, the proposed regulation explicitly states that the mechanism does not apply to goods originating in EFTA EEA countries. The potential removal of the allocation of allowances free of charge in the EU Emission Trading System will affect EFTA EEA countries and could potentially lead to carbon leakage from the EFTA EEA countries.

The Norwegian government supports the EU sustainable finance agenda and have endorsed the objectives of the sustainable finance action plan from 2018. The Climate Benchmark Regulation was implemented in Norwegian law in 2020. In June 2021, the Government submitted to Parliament a legislative proposal for a new sustainable finance act. The proposal incorporates the EU Sustainable Finance Disclosure Regulation and the EU Taxonomy Regulation in Norwegian law.

For financial markets to successfully channel capital to sustainable projects, better disclosure from companies is key. Companies should disclose how they are affected by climate change – and how their activities impact the environment. The Norwegian government welcomes the European Commission's proposal for a new Corporate Sustainability Reporting Directive, which aims to improve corporate disclosures on climate and other sustainability-related issues.

Key figures for the Norwegian economy

	Billion NOK[1]	% volume change from previous year		
	2020	2020	2021	2022
Private consumption	1 496.4	-6.9	4.0	11.1
Public consumption	905.6	1.7	3.9	-0.2
Gross fixed investment	907.0	-3.8	0.9	-0.4
Of which: Petroleum extraction and pipeline transport	180.8	-4.1	1.0	-14.4
Business sector Mainland Norway	313.6	-6.1	0.9	4.4
Housing	190.7	-4.0	4.2	4.1
Public sector	216.4	-1.0	-2.5	-0.2
Demand from Mainland Norway[2]	3 122.7	-3.9	3.4	6.0
Exports	1 110.0	-0.5	5.2	7.1
Of which: Crude oil and natural gas	353.0	10.1	3.5	4.8
Goods and services from Mainland Norway	637.0	-8.2	6.4	9.9
Imports	1 125.3	-11.9	3.7	10.6
Gross domestic product	3 413.5	-0.8	3.8	4.0
Of which: Mainland Norway	3 043.0	-2.5	3.9	3.8
Employment, persons		-1.3	0.8	1.4
Unemployment rate, LFS (level) [3]		4.6	4.7	4.1
Unemployment rate, registered (level)		5.0	3.2	2.4
Annual wage		3.1	2.8	3.0
Consumer price index (CPI)		1.3	2.8	1.3
Underlying inflation (CPI-ATE)		3.0	1.8	1.6
Crude oil price, NOK per barrel (level)		407	568	559
Crude oil price, USD per barrel (level)		43	68	67
Three-month money market rates, %.		0.7	0.5	1.1
Import-weighted exchange rate (yearly change)[4]		6.3	-6.4	-0.3
General government net lending as % of GDP		-2.9	1.0	5.8
Structural, non-oil fiscal deficit as % of mainland trend GDP		11.5	12.1	9.5

[1] Provisional figures from the national accounts at current prices.
[2] Excluding change in stocks.
[3] Break in the data series from 1 January 2021 due to changes to the Norwegian LFS.
[4] A positive figure indicates a weaker Norwegian krone.

Sources: Statistics Norway and the Ministry of Finance, National Budget 2022, presented to Parliament by the Solberg Government on 12 October 2021

Annex 4: Switzerland

Economic situation and outlook

After a historic decline in the first half of 2020 (-1.6% in the 1st and -6.2% in the 2nd quarter), Switzerland's GDP recovered strongly in the second half of 2020. The vigorous uptick in the 3rd quarter (+6.4%) was attributable to the loosening of various COVID-19-related restrictions, enabling domestic demand and parts of the service sector to recover significantly. The recovery then interrupted in the 4th quarter (-0.1%) due to reinstated containment measures mainly affecting the Swiss services industry. For the year 2020, Switzerland recorded negative GDP growth of -2.4%.

The second wave of the pandemic caused a 0.4% drop in GDP in the 1st quarter of 2021. The decline in GDP was less pronounced due to more carefully targeted containment measures (e.g., less closure of firms) and a markedly positive development of the manufacturing sector. The substantial GDP increase of 1.8% in the 2nd quarter resulted primarily from the strong recovery of the service sector in the wake of the relaxed containment measures. With the easing of the sanitary safety measures from March, private consumption recovered rapidly (+4.1% compared to 1st quarter), following marked declines in the winter half-year. Particularly in the stationary retail, hospitality and leisure sectors, spending increased abruptly following the reopening of establishments.

In international comparison, the restrictions in Switzerland turned out to be less stringent which explains a part of the rather modest decline in GDP. Another important aspect was also the favourable industry structure, namely a comparatively low share of contact intensive sectors such as tourism and a high importance of the chemical/pharmaceutical industry that stabilised the development. The unemployment rate (national definition based on registered job seekers), peaked at 3.7% at the end of January 2021, decreased to 3.2% at the end of April before falling to 2.9% at the end of August. Employment growth in the 2nd quarter of 2021 was mainly driven by the positive employment trend in the tertiary sector. The coronavirus pandemic has had a negative impact on the labour market since March 2020, although the severity of the impact has varied significantly between sectors. Particularly the hospitality, construction and the watchmaking sectors were severely affected in the 1st half of 2021. It is mainly due to the use of the supportive short-time work compensation (STWC) that the unemployment rate did not rise more sharply.

Following the easing of pandemic measures at the beginning of March, the domestic economy recovered as expected from the setbacks of the winter half-year. Economic activity is likely to have exceeded pre-crisis levels during the summer. Globally, however, the recovery is likely to be somewhat less vigorous in the short term. Capacity bottlenecks are currently limiting the growth of global industrial production, which leads to price increases, and the services sector is hampered by stricter coronavirus measures in some countries.

The economic recovery is set to continue as expected, though growth is initially less dynamic than forecast previously. The federal expert group on business cycles has lowered its growth forecast for 2021 to 3.2% (adjusted for sporting events). This is nonetheless significantly above average for the Swiss economy. In 2022, the growth rate is set to rise to 3.4%. The ongoing recovery is having a clear impact on the labour market. Short time working can now gradually be reduced, and unemployment is expected to fall sharply. The experts forecast an annual average unemployment rate of 3.0% for 2021, with a further decline to an annual average of 2.7% in 2022.

Budgetary situation

As the COVID-19 crisis continues this year, the general government fiscal balance will again show a deficit in 2021. Due to the prolonged pandemic, the central government as well as the cantons and municipalities continued to implement extensive measures to cushion the economic impact in 2021 as well. These measures are likely to amount to 17 billion francs for the general government. In view of the simultaneous decline in tax revenue of the cantons and municipalities the burden on these levels of government will remain very substantial. However, considering the generally low level of government debt in Switzerland, especially in international comparison, the situation is sustainable (see also "Corona-related debt" below). The deficit for the general government is expected to reach 2.2% of GDP in 2021.

At the federal level, projections in June show a deficit of 2.4 billion francs in the ordinary fiscal balance in 2021 and 17.4 billion francs including the extraordinary budget. This high deficit mainly consists in extraordinary expenditures due to the COVID-19 crisis, in particular additional spending on social welfare, including the extension of the STWC and a new subsidy scheme for the sectors affected by prolonged lock-down measures ("hardship cases"), as well as health expenditures for tests and vaccines.

As the economy continues to recover, the financial situation of most levels of government should return to normal in 2022. The budgets of the central government, the cantons and social security funds are likely to return to positive territory, with a surplus of 0.6% anticipated for the general government as a whole. According to the budget passed in August 2021, the central government expects a balanced budget in 2022. COVID-19 measures amounting to about 3 billion francs are planned in the budget. The financial plan also foresees small surpluses for 2023 and 2025 and a small deficit for 2024.

Economic Policy – Recent Developments

The pandemic has shown how pan-European coordination and cooperation can be crucial in a moment of difficulty. In the pandemic's aftermath, acting cooperatively and keeping the markets open will be central and in the interest of both Switzerland and the EU in order to overcome the economic fallout and recover swiftly. Especially the cooperation in research and innovation are of great importance and should not be impeded by differing political agendas. Switzerland's bilateral partnership with the EU remains among the foundation stones of its economic policy – this has not changed with the Federal Council's decision of 26 May 2021 to terminate the negotiations for an institutional framework agreement with the EU. Substantial differences between Switzerland and EU had persisted, which meant that the conditions for the signing of the agreement were not met. Since then, Switzerland has sought to maintain and intensify its contacts with the EU and EU Member States in order to exchange on a way forward. The Federal Council has also proposed that the Swiss Parliament release the funds for the implementation of Switzerland's second contribution to certain EU Member States, which was approved by the Parliament on 30 September 2021. The Federal Council has furthermore launched an assessment of discrepancies between EU and Swiss law, with a view to determining whether autonomously reducing these discrepancies could be worthwhile. Finally, Switzerland proposes to set up a structured political dialogue with the EU to develop and pursue common goals and to tackle specific problems.

Switzerland is participating actively in the OECD/G20 Project on international corporate taxation. Due to the erosion of the international consensus on corporate taxation, many states have already introduced unilateral measures or are planning them in case the OECD project fails. Those measures carry the risk of over-taxation and could harm much needed sustainable growth - especially in the wake of the pandemic. A new international consensus would ensure tax certainty and clarity for jurisdictions as well as global companies.

COVID-19 crisis in Switzerland

During the pandemic and throughout the containment measures, the Swiss economy was supported by additional economic support measures. In 2020, the Swiss government extended the duration of unemployment insurance benefits for unemployment spells in order to mitigate the economic consequences of unemployment during the pandemic and to maintain purchasing power. It also extended and facilitated the STWC scheme to compensate for a temporary drop in activity and to maintain jobs. The number of people on short-time work reached 1.4 million employees (24% of the workforce) in April 2020, declined to 0.5 million employees (9% of the workforce) in February 2021 and finally reached 257.000 in May 2021.

Furthermore, a loss of income compensation scheme was established for self-employed persons, for quarantined workers and for parents with unforeseen care needs ("Corona Erwerbsersatz"). Up to June 2021, more than 409.000 people have received COVID-19 loss of earnings benefits, for a total amount of about 3.3 billion francs. The benefits were mainly paid to self-employed people who saw their turnover collapse because of government-ordered business closures.

Companies affected by the COVID-19 crisis were also able to apply for bridging credits partly guaranteed by the federal government between 26 March and 31 July 2020 to ensure their liquidity. Credits amounting to 17 billion francs have been granted and over 3 billion francs have been paid back up to date.

For "hardship cases", non-repayable contributions of around 3.5 billion francs and guarantees, loans and sureties of 218 million francs were paid out until the beginning of August 2021. Half of the aid went to the hospitality and gastronomy sectors.

Further measures have been taken, such as specific measures to support the cultural and the sports sector, the possibility of extending payment deadlines for direct federal tax, VAT and other taxes without default interest and deferred payment of social security contributions. The extraordinary spending of 15 billion francs (without the credits) taken in 2020 to counter the economic downturn have corresponded to an important fiscal stimulus of about 2.1% of GDP. The Federal Council has approved further funds for 2021 amounting to 25 billion francs.

Thanks in part to these measures, the Swiss economy recovered continually in summer 2020 and again over the last summer. The index of weekly economic activity as well as consumer sentiment are above the pre-crisis level, the latter currently being at its highest level since July 2010. The Purchasing Managers' Indices (PMI) for services and industry also point to a strong expansion. The economic recovery is also evident in the labour market, as unemployment decreased by over 40.000 people from January until the end of July, with a simultaneous decrease in short-time work. The number of bankruptcies fell by about 7% in 2020 compared to 2019 and has not increased until mid-2021.

Transition strategy

Given the solid economic recovery, the use of exceptional support measures has gradually declined in the wake of the easing and economic recovery. Switzerland’s effective system of automatic stabilisers, including the non-extended short-time work compensation, unemployment benefits and cantonal transfers (including social assistance) continue to apply.

In order to avoid a threatening overload of the health care system, targeted and possibly extended basic measures such as the obligation to wear a mask or social distancing rules could be extended or reintroduced. However, access restrictions should only be provided for persons that cannot present a COVID certificate (i.e. persons who have neither been vaccinated nor recovered and who cannot present a negative test result). Under these conditions, the companies' sales performance in the coming months should only be affected to a minor degree by regulatory interventions. Furthermore, with an increasing percentage of fully vaccinated persons, access restrictions are expected to diminish further.

The Federal Council has launched its COVID-19 transition strategy for economic policy on 18 June 2021, which aims to normalise economic policy (Pillar 1) as well as social and economic life by supporting the recovery (Pillar 2) and increasing the long-term growth potential (Pillar 3). Having contributed to the rapid recovery of the Swiss economy, the exceptional support measures intended to mitigate the economic consequences of COVID-19 restrictions will be phased out by the end of 2021 (Pillar 1). The reason being that the introduction of the COVID certificate doesn’t hinder consumers anymore from buying products and services from companies. Thus, direct financial aid to companies no longer seems justified. In addition, signalling the exit from the extraordinary support measures is important to manage the expectations of the economy, so that no permanent dependencies arise and companies have an incentive to adapt to the new circumstances with possibly permanently changed consumer behaviour.

Various federal instruments have been strengthened to accompany the recovery (Pillar 2). For example, the "Innovative Power Switzerland" 2021/22 impulse program was launched to help companies maintain their innovation activities during and after the pandemic. In addition, the Confederation is launching a pilot program "Continuing Education Coaching for SMEs" in collaboration with interested professional associations in order to help SMEs improve the skills of their staff. In order to support the tourism sector, the Federal Council is also drawing up a recovery plan that involves a more intensive use of the three proven promotional instruments (Switzerland Tourism, Innotour and The New Regional Policy). The aim is to accompany and support the tourism recovery in a targeted manner, with the emphasis on revitalising demand and maintaining innovative capacity. Until the end of April 2022, the Event cancellation fund for public events protects organisers of major events against cancellations by the authorities. This fund greatly reduces the risk of loss in view of the high level of planning uncertainty and thus strengthens the recovery in the event sector, including larger events in the cultural and sports sector. Finally, the funds available to the cantonal implementing bodies for active counselling and support of jobseekers automatically increase in the event of rising unemployment, thus ensuring an adapted funding to needs.

In order to ensure a sustainable recovery, the Federal Council also intends to improve Switzerland's long-term growth potential by exploiting the opportunities of digitisation (through the Digital Switzerland strategy), accelerating the decarbonisation process, as well as implementing other measures to improve the economic framework conditions (Pillar 3). The relevant economic policy measures for the coming years to strengthen growth potential in the long term are currently in the process of elaboration and will be submitted to the Federal Council by the end of the year.

Corona-related debt

In total, additional incurred and approved expenditures due to COVID-19 in 2020 and 2021 now amount to about 39.4 billion francs (further, there were approximately 17.5 billion francs of guaranteed credits). This corresponds to around 5% of GDP in 2020. From 2019 to 2021, the Maastricht debt ratio is expected to rise by 2.2 percentage points to 28.1% of GDP.

The extraordinary expenditures of 2020 and 2021 due to the COVID-19 crisis must be compensated for in the future. The Federal Council first decided to earmark a part of the Swiss National Banks profit distribution to the debt reduction, by considering it as extraordinary revenues. In addition, the Federal Council has opened a public consultation process on two additional proposals to reduce the extraordinary debt. Both proposals foresee the use of future surpluses for the purpose of debt reduction. These measures would eliminate the additional debt due to the COVID-19 crisis within 11 years without burdening the federal budget. One of the two proposals foresees consolidation in 6 years, by additionally compensating COVID-19 generated debt with debt reductions of the past. The required amendment to the law would be scheduled to come into effect on January 1, 2023 or January 1, 2024. Both options can currently be implemented without increasing taxes or austerity measures.

Key figures for the Swiss economy (16 September 2021, next update in December)

(% volume change from previous year)

	2020[1] CHF bn	2019	2020	2021	2022
Private consumption*	360	1.4	-3.7	2.6	4.2
Public consumption*	84	0.7	3.5	6.4	-2.5
Construction investments*	66	-0.8	-0.4	1.8	0.4
Capital investments*	116	1.3	-2.5	4.5	4.3
Exports (without valuables) *	366	1.5	-6.0	6.3	6.7
Imports (without valuables) *	291	2.3	-7.8	4.8	6.3
GDP* (sport event adjusted)	706	1.5	-2.5	3.2	3.4
Inflation (Consumer Price Index)	-	0.4	-0.7	0.5	0.8
Unemployment rate (ILO definition), % of labour force	-	4.4	4.8	-	-
Financial balance of the government sector in % of GDP	-	0.5	-2.2	-0.8	0.1
Government debt in % of GDP	-	13.3	14.7	15	14.4

* *National accounting data are expressed as the y-t-y percentage change in prices of the preceding year (real values)*
[1] *Level at current prices*

Sources: State Secretariat for Economic Affairs (SECO), Federal Statistical Office (FSO), Federal Department of Finance (FDF). The grey shaded values are forecasts.