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How the Swiss 'Debt Brake' Tamed Government

Behold, a good idea from Europe: Spending in Switzerland can't increase by more than trendline tax revenue.

By DANIEL J. MITCHELL

Americans looking for a way to tame government profligacy should look to Switzerland. In 2001, 85% of its voters approved an initiative that effectively requires its central government spending to grow no faster than trendline revenue.

The reform, called a "debt brake" in Switzerland, has been very successful. Before the law went into effect in 2003, government spending was expanding by an average of 4.3% per year. Since then it's increased by only 2.6% annually.

The Swiss debt brake does not require a balanced budget in the traditional sense. Tax receipts, as we know from the American experience, tend to increase rapidly when the economy is doing well and fall off when the economy stumbles. To smooth out the ups and downs, Switzerland's debt brake limits spending growth to average revenue increases over a multiyear period (as calculated by the Swiss Federal Department of Finance).

This feature appeals to Keynesians, who like deficit spending when the economy stumbles and tax revenues dip. But it appeals to proponents of good fiscal policy, because politicians aren't able to boost spending when the economy is doing well and the Treasury is flush with cash.

Equally important, it is very difficult for politicians to increase the spending cap by raising taxes. Maximum rates for most national taxes in Switzerland are constitutionally set (such as by an 11.5% income tax, an 8% value-added tax and an 8.5% corporate tax). The rates can only be changed by a double-majority referendum, which means a majority of voters in a majority of cantons would have to agree.

Needless to say, that's not very likely. History shows the Swiss are more likely to approve tax cuts than tax increases.

Switzerland's spending cap has helped the country avoid the fiscal crisis affecting so many other European nations. Annual central government spending today is less than 20% of gross domestic product, and total spending by all levels of government is about 34% of GDP. That's a decline from 36% when the debt brake took effect.

This may not sound impressive, but it's remarkable considering how the burden of government has jumped in most other developed nations. In the U.S., total government spending has jumped to 41% of GDP from 36% during the same time period, according to the Organization for Economic Cooperation and Development.

The spending cap has been an effective debt brake. Between 2005 and 2010, when debt levels in the average euro-zone nation jumped to 85% of GDP from 70%, Switzerland's overall government debt declined to 40% of GDP from 53%. Debt is now down to 36.5% of GDP.

The Swiss system isn't perfect. Some social insurance programs are not covered by the spending cap, so outlays presumably will increase in this area as the population ages—though Switzerland is still in good shape since a large share of its health and pension expenses are handled by the private sector.

The United States, by contrast, is a mess. Big spending increases under Presidents Bush and Obama have doubled federal spending in the past 11 years, to an estimated $3.8 trillion in fiscal year 2012 from $1.86 trillion in 2001. The long-run outlook is even more troubling since there is no mechanism to restrain the growth of outlays.

But that may change. Rep. Kevin Brady (R., Texas), vice chairman of the Joint Economic Committee, has introduced legislation that is akin to the Swiss debt brake. Called the Maximizing America's Prosperity Act, his bill would impose direct spending caps, but tied to "potential GDP." Potential GDP is a projection of trendline economic output, assuming full employment and no inflation, and would be calculated by the Congressional Budget Office.

Since potential GDP is a reasonably stable variable (like average revenue growth in the Swiss system), this approach creates a sustainable glide path for spending restraint.

Of course, politicians don't want any type of constraint on their ability to buy votes with other people's money. But people everywhere are starting to realize that business-as-usual is no longer acceptable.

Mr. Mitchell is a senior fellow at the Cato Institute.