



Institut für Föderalismus, Universität Freiburg
Institut du Fédéralisme, Université de Fribourg
Institute of Federalism, University of Fribourg

Fiscal Decentralisation in Switzerland

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Sean Müller, Research Fellow

Institute of Federalism, University of Fribourg, Switzerland

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I. LOCAL GOVERNMENT AND DECENTRALISATION IN SWITZERLAND

A. The System of Local Government in Switzerland

Legal Framework

Local Self-Governments or Local Governments (LG) are, legally speaking, “creatures” of the canton they belong to (*Dillon’s Rule* in the U.S.). The 26 cantons are, together with the Swiss people, the constitutive elements of the Swiss Confederation (*Schweizerische Eidgenossenschaft, Confédération Suisse, Condeferazione Svizzera, Confederaziun Svizra*).

While Switzerland is a federation – bi-cameral, consociational, collegial presidency, and with extensive direct-democratic instruments –, the cantons are unitary states. No Swiss canton can be federal of itself because of the following principles established by the Federal Constitution (BV):

- “Cantons are sovereign insofar as their sovereignty is not limited by the Federal Constitution.” (BV art 3)
- “Federal law takes precedence over contrary cantonal law.” (BV art 49.1)
- “Every Canton shall adopt a democratic constitution. The cantonal constitution must be approved by the people, and must be subject to revision if a majority of the people so requires.” (BV art 51.1)

Besides the direct-democratic requirement on any Cantonal Constitution (KV), there is a second, more subtle element in this. Direct democracy is when the people are involved directly in the process leading to collectively binding (i.e., political) decisions. This can be applied antecedent or posterior to parliamentary proceedings. The instrument of the popular initiative is an example of the former, while the obligatory and facultative referenda are examples of the latter.

On the other hand, requiring KVs to get the assent of a majority of the people excludes the possibility for mechanisms similar to the double majority on the federal level (cf. *infra*). In other words, KVs cannot be based on a majority of people and municipalities, as this could possibly nullify a simply, popular majority.

Distribution of Powers

The Federal Government possesses only those powers ascribed to it by the cantons (enumerative principle). Authoritative legal document in this regard is the BV. Any amendment to the BV must be agreed upon in a nation-wide popular vote.

In this vote, two majorities are required: amendments must be accepted by a majority of people and a majority of the 23 cantons.¹ The vote of a canton is the vote of its popular majority; the people consist in an electorate of approximately 4.7 million.

The cantons are the holder of residual powers: whatever is not “federalised” (delegated “upwards” to the Federal State) is cantonal power. But federal rule outweighs cantonal rule, if rightly based on the BV. So the division of power between the federal and the cantonal level is one of “partial sovereignty” or – symbolically less overloaded but scientifically more accurate – of “autonomy”.

Subsidiarity is an essential element of federalism, which in turn is a normative principle establishing a certain degree of diffusion of certain powers (shared rule) while retaining others (self-rule). But subsidiarity is not exclusively confined to federations, which are states applying the federal principle.

Subsidiarity pushes for the fulfilment of tasks at the lowest level possible due to efficiency considerations, and smaller jurisdictions can also much easier hold their governments accountable, which in turn increases their legitimacy.

Municipalities in Switzerland profit from two dynamics. First, the “autonomy”-relation inherent to federalism finds its functional, if not legal equivalent in the KV. Due to the right of the cantons to organise themselves independently, the nature and role of municipalities varies from one canton to another. For example in Zurich, LGs are the bearer of *complete* residual power, meaning that „political communes are responsible for all those public affairs for which neither the Confederation nor the Canton is responsible.”² In Glarus, the residual power is *confined* to “local” affairs,³ while LGs in Fribourg have only those functions that are *delegated* to it by a legal act.⁴

Second, there is the common practice of decentralising the *execution* of federal tasks to cantonal governments, called “executive federalism” (*Vollzugsföderalismus*). This delegation is then simply reproduced at the cantonal level: LGs are charged with the execution of cantonal and even federal tasks.

¹ Of the 26 Cantons, 6 have the status of „half-cantons“, which means that “their” voice counts only half in nation-wide popular votations. Also, they have only one seat in the States’ Council (Senate), while “full” cantons have two seats each. Always two half-cantons geographically and historically belong together: Ob- and Nidwalden, Basel-City and -Countryside, and Appenzell Inner-Rhodes and Appenzell Outer-Rhodes.

² „Die politischen Gemeinden nehmen alle öffentlichen Aufgaben wahr, für die weder Bund noch Kanton zuständig sind.“ (Article 83 KV Zurich)

³ „Die Gemeinden besorgen alle örtlichen Angelegenheiten, für die weder der Bund noch der Kanton zuständig ist. (Article 119 KV Glarus)

⁴ „Die Gemeinden erfüllen die ihnen durch Verfassung und Gesetz übertragenen Aufgaben.“ (Article 133 KV Fribourg)

Financing of Public Services

Article 127 of the BV states: “the general principles of taxation, particularly the circle of taxpayers, and the object of the tax and its calculation, shall be established by statute. Intercantonal double taxation is prohibited.” Direct taxation is a joint taxation of the Confederation, the cantons and the communes.⁵

In General, the assignment of fiscal authority departs from the cantons. They were and still are the primary holder of tax authority. Switzerland is probably the only country in the world without a *permanent* direct income tax. The article establishing the federal income tax (“the Confederation may raise a direct tax [...] of at most 11.5 percent on the income of natural persons”; article 128.1 BV) is included in the BV with transitory provision – the “federal” mandate given to the Swiss Confederation has to be renewed on a 10-years base, i.e. a new transitory provision has to pass the constitutional double majority.

It is the cantons who “assess and collect the taxes”. (Article 128.4 BV) There is, by the way, an example of how “executive federalism” is reproduced on the cantonal-municipal level: the municipalities are actually collecting the taxes for both the federal and the cantonal governments.

Furthermore, “three tenths of the gross tax yield shall fall to the Cantons; at least one sixth of this amount shall be used for financial equalization among Cantons.” (Ibid.) Other incomes of the cantons are their own taxes. They are free to impose *their* tax on personal income and wealth, as well as levy additional taxes.

The canton of Berne (article 103 KV), for example, levies taxes on:

- Income and wealth of persons;
- Profit and capital of enterprises;
- Capital gains;
- Inheritance and donations;
- Motor vehicles; and
- Other expenditure and traffic.

Municipalities, finally, can raise taxes wherever neither the canton nor the federation are exclusively responsible. They commonly also levy taxes on income and wealth of persons; profit and capital of enterprises; and capital gains. (E.g. article 113 KV of Berne)

For these taxes, federal and cantonal levels define the tax base while the LGs set the local tax rate (“piggybacking”), subject to direct-democratic approval.

⁵ Bernhard Dafflon (1999): Fiscal Federalism in Switzerland – A Survey of Constitutional Issues, Budget Responsibility and Equalisation. Updated 2001 and assessed on November 2006 on <http://www.unifr.ch/finpub>.

B. Conditions of Efficient Decentralisation

Institutional

Every local government is required to be democratically organised. They all have, at least, a municipal assembly, consisting in all the Swiss people having the right to vote that live in the jurisdiction of the municipality.

Bigger municipalities may provide for a municipal parliament, but the direct involvement of the population is secured through instruments like the popular initiative and the facultative and obligatory referenda.

The executive of every municipality is also directly elected. The municipal council consist in between 3 and 11 persons, and is based on the collegial principle, i.e. the “president” is not more than *primus inter pares*.

Chief local officers on the local level are either appointed by the municipal parliament or its council; judges for example may be even directly elected by the people.

Financial

Education, culture, sports and recreation, health, environment, transportation and roads generally remain the responsibility of the cantons and the LGs. An assessment of *all* public expenditures (federal, cantonal, municipal), according to functions, reveals the following:⁶

- The municipalities have the highest share in the budget items: environment (63 %), culture, sports and recreation (58 %), administration (44 %);
- The cantons in: public order (67 %), health (56 %) and education (54 %);
- The Confederation has an exclusive position in foreign affairs (100 %), a dominant position in defence (90 %) and assumes more than half the public expenditure in economy (52 %).
- Although the cantons and the municipalities together spend more, the centre has the largest *single* share in the following functions: finance (49 %), social affairs (44 %) and transportation (46 %).

Local governments and cantons may borrow directly from the market. But for the cantons and the communes, taxation of individual income and wealth, and of corporate business profits and capital, is the major source of revenue: 43 and 47 per cent, respectively, of all their revenues consist in resources from direct taxation. For the communes, revenues from public property (7 %), user charges from local public services (mainly: water, sewage and

⁶ Dafflon (1999), op. cit.

purification plants, garbage collection) and indemnities (28 %), are in sum the second most important revenue sources.⁷

In consequence, reliance on intergovernmental transfers is only minor: in 1999, payments from the federal government to the cantons were 7 710 million SFr. or 17 per cent of total federal expenditures. This amount corresponded to 14 per cent of total public resources of the cantons.⁸

C. Conclusions

The federal character of Switzerland certainly contributes to promoting decentralisation in its devolutionary form. Federalism may indeed be understood as “an extended system of self-government among overlapping human communities.”⁹

Federalism is, on the one hand, a rationale for decentralisation in the sense that it supports the diffusion of power based on area (territory) and function (the delivery of different public services). The Federal Constitution outlines that division of power for the federal and the cantonal level, while the cantons are – in *their* constitutions – free to accord more or less autonomy to the municipalities.

Size is another factor, as citizen’s involvement is facilitated on a small-scale base – municipal assemblies are possible, for example. As a consequence, cantons and municipalities are accountable for the powers they possess, regardless of whether the competency itself rests on their residual power (e.g. police for the cantons, waste collection for the LGs) or is delegated to them (general execution of federal law for the cantons, tax collection for the LGs).

But the small-scale nature of Swiss governance has become, over time, also a rationale in favour of more centralism. Cases of bankrupt municipalities have brought the issue also to the attention of public debate. One solution to this problem has been, in the last years, the merger of municipalities in order to create economies of scale. While for example the canton of Fribourg had, in 1999, 249 municipalities, there were, in 2007, only 169 left.¹⁰

Another solution could be the re-centralising of governmental functions to the cantonal government, or even a delegation to the federal government. Or the tax base could be expanded, which is possible only based on the consent of the local population (for local taxes), or of the cantonal population (for cantonal taxes).

⁷ Ibid.

⁸ Ibid.

⁹ “Federalism in America – An Encyclopedia”, ed. by Joseph Marbach, Ellis Katz, and Troy Smith, Greenwood Press 2006, p. 449.

¹⁰ <http://admin.fr.ch/scom/fr/pub/index.cfm>

In general, however, horizontal mechanisms are preferred to operate within the federal-decentralised framework. They involve, most prominently, inter-local and cantonal-local cooperation agreements. The canton of Vaud, in article 156 of its KV, even allows the municipalities to create, amongst them, “federations”.

II. EXPENDITURE ASSIGNMENT IN SWITZERLAND

A. Overview

Talking about expenditure assignment in a decentralised polity pertains to the functions the different levels of governance fulfil. As state actions in general, expenditure needs a legal basis, in Switzerland often subject to direct-democratic approval. There are three relevant governmental levels: the national or *federal* level, the regional or *cantonal* level, and the local or *communal* level. Overall expenditures [in Million Swiss Francs] from 2000 to 2005:

Function	2000	2001	2002	2003	2004	2005
General administration	7'886	8'848	8'818	9'204	8'855	9'011
Public order	6'829	7'185	7'514	7'872	7'970	8'097
National defence	5'408	5'338	5'162	5'066	4'979	4'909
Foreign affairs	2'274	2'691	2'373	2'365	2'427	2'449
Education, of which :	22'803	24'074	25'786	26'560	27'684	27'415
<i>Public schools</i>	11'716	12'307	12'959	13'389	13'397	13'693
<i>Vocational training</i>	2'934	3'125	3'406	3'206	3'251	3'266
<i>Higher education</i>	4'768	5'377	5'976	6'390	7'256	6'726
Culture, sport and leisure	3'851	4'170	4'187	4'212	4'249	4'237
Health	15'636	16'856	18'047	18'839	19'326	19'826
<i>Of which : Hospitals</i>	14'372	15'520	16'623	17'334	17'834	18'317
Social affairs	23'544	24'187	25'411	26'481	27'742	28'729
<i>Of which : Social insurances</i>	15'667	16'606	17'487	18'009	18'774	19'457
Transportation	13'009	14'097	14'671	14'024	14'411	14'842
<i>Of which : Roads</i>	6'579	6'766	6'807	6'918	6'954	7'114
Environment	4'824	4'938	4'909	4'897	4'907	4'901
Economy	6'760	7'134	7'058	6'466	6'344	6'206
<i>Of which : Agriculture</i>	4'206	4'453	4'541	4'389	4'363	4'230
Finance	10'788	10'448	10'317	9'825	9'486	9'525
Total	123'612	129'966	134'253	135'811	138'379	140'147

Source: Federal Office of Statistics, <http://www.bfs.admin.ch>

With regard to the three levels, some 32% of all public expenditures were done, in 2000, on the national level. In turn, the Cantons accounted for 40% of all public expenditures, and the Communes for only 28%.¹¹ Let us now look at the expenditures per function *and* tier of government, in Million Swiss Francs and for 2000:¹²

¹¹ Bernhard Dafflon: Accommodating Asymmetry through Pragmatism: An Overview of Swiss Fiscal Federalism. In: Fiscal Fragmentation in Decentralized Countries – Subsidiarity, Solidarity and Asymmetry. Ed. by Richard M. Bird and Robert D. Ebel, IBRD/World Bank, Cheltenham/Northampton 2007, 114-165.

¹² Dafflon, op. cit., 130-131.

Function	Confederation	Cantons	Communes
General administration	1'650	3'000	3'420
Public order, of which :	550	4'830	1'830
<i>Police</i>	150	2'240	750
<i>Fire fighting</i>	0	60	490
National defence	5'000	290	250
Foreign affairs	2'270	0	0
Education, of which :	3'460	14'670	9'280
<i>Public schools</i>	16	5'550	7'070
<i>Vocational training</i>	45	2'540	790
<i>Higher education</i>	2'210	3'100	12
Culture, sport and leisure	570	1'240	2'160
Health	210	9'800	7'390
<i>Of which : Hospitals</i>	8	7'560	5'290
Social affairs	12'270	10'700	6'010
<i>Of which : Social insurances</i>	6'000	5'700	1'400
Transportation, of which :	7'400	6'200	2'910
<i>Roads</i>	2'860	4'530	2'330
<i>Railroads</i>	3'200	0	0
Environment, of which :	750	1'410	3'530
<i>Water</i>	0	40	280
<i>Garbage collection/disposal</i>	50	160	890
Economy	4'650	4'000	850
<i>Of which : Agriculture</i>	3'730	2'740	115
Finance	9'410	3'960	2'960
Total	48'200	60'150	40'590

B. Sectoral Policies

The three levels have different sectoral priorities. On the federal level, largest expenditure sectors are Social Affairs (25%), Finance (20%) and Transportation (15%). For the Cantons, the most important fields are Education (24%), Social Affairs (18%) and Health (16%). The Communes, lastly, spend mostly on Education (23%), Health (18%) and Social Affairs (15%). With regard to the individual sectors, the table reveals the following:

- Exclusive or near exclusive national functions are Foreign Affairs and National Defence, where 100% and 90%, respectively, of the expenditures are done by the Confederation.
- Competencies shared by the Confederation and the Cantons on nearly equal basis are Social Affairs, Transportation and Economy: here, the Cantons account for 37% (Social Affairs), 38% (Transportation) and 42% (Economy) of the sectoral expenses, whereas the Confederation pays most of the remaining (42%, 45%, and 49%, respectively).
- The regional governments are the main service deliverer only in the Public Order sector, where the Cantons come up to 67% of all the expenses (Communes: 25%; Confederation: 8%).

- The local governments, in turn, are the main service deliverer in the Environment sector, where 62% of the costs are covered by the Communes (Cantons: 25%; Confederation: 13%), and to a minor extent with regard to Culture, leisure and sports (54% Communes against 31% Cantons and 14% Confederation)

National standards and sectoral policy objectives exist only for those functions that have been federated, i.e. transferred from the regional/cantonal level onto the national realm. The Federal Constitution, in articles 54 to 125 lists, these competencies according to the enumerative principle. Some competencies are divided into sub-functions, and here implementation may be left to the Cantons, accompanied by certain minimum requirements. For example on National Highways, where a threefold distinction is made between decisions, actual construction and maintaining, and financing:

Article 83 National Highways

¹ *The Confederation shall ensure the construction of a network of national highways and the utilization of these highways.*

² *The Cantons shall build and maintain their national highways according to the rules established by the Confederation and under its high supervision.*

³ *The Confederation and the Cantons shall bear the costs of the national highways jointly. The costs to be borne by each Canton shall be allocated by taking into account the burden falling on them due to the national highways, their interest in these highways, and their financial resources.*

Let us now shortly revise the sectors most commonly ascribed to the national level in an exclusive way, social affairs and national defence.

Social Affairs

In Switzerland, Social Affairs are a good example of shared responsibilities. The Confederation spends 42% of all expenses, the Cantons 37% and the Communes the remaining 21%. However, the homes for old-age pensioners are the responsibility of the Communes nearly exclusively, and individual social aid is equally paid by the Cantons and Communes. The Confederation is in charge of old-age pensions and the insurance for the disabled, but the Cantons are the main provider of illness- and other social insurances. Hospitals are a shared competency of Cantons and Communes.

National Defence

The matter of national defence is more clearly assigned. 90% of all the expenses are done by the Confederation, and only 5% and 4% by the Cantons and Communes, respectively. However, the issue of Civil Defence is decentralised in the sense that, in absolute terms, the Communes paid the most: 200 Mio CHF against 110 Mio CHF of the Cantons and only 90 Mio CHF of the Confederation, in the year 2000.

Public Utilities

Sub-national governments almost entirely assume responsibility of public utilities. The urban Cantons of Basel-City and Geneva being exceptions confirming the rule, the municipalities are normally set up public enterprises for the purposes of water processing, sewage and water purification, as well as garbage collection and disposal.

C. “Budget Orthodoxy”

The regulation and extent of local borrowing is essentially a cantonal matter, as the municipalities are “creatures of their Cantons”, strictly legally speaking. Thus, Swiss municipalities are referred to in the respective cantonal constitutions differently. However, a common minimum perception defines them as territorial corporations of cantonal public law with a legal personality.

In general, “legislative authorities at the federal level, in the 26 Cantons and in every Commune must decide on their budgets for revenues and expenditures before the beginning of the year and keep track of their revenues and expenditures.”¹³ There are, according to Dafflon (2007), two rules pertaining to Communes’ “budget orthodoxy”. The Cantons require:

1. A more or less balanced budget, meaning that a large budget deficit must be accompanied by increased taxation, and loan amortization must correspond to the effective pace of repayment. The “golden rule” states that Communes’ current revenues net of current expenditures must be sufficient to cover interest for any debt incurred and the running costs of past and new investments.
2. Public debt only for financing capital expenditures and only if the communal government has the financial capacity to pay the interest and amortization of the debt out of its current budget.

Equalisation between the Confederation and the Cantons (vertically), and between the Cantons (horizontally) being extensive – accounting to some 6.7 Mio Swiss Francs in 2000 –, there are no provisions currently in force that establish something similar to development funds.

The most efficient means to increase welfare is said to be competition among the Cantons and Communes (“tax competition”), so an inherently individualistic perception of mankind states that citizens unhappy with the level of service delivery, or the costs arising from it, may simply move to another Commune/Canton.

The other option – mentioned only briefly in the beginning of this paper – is, in Albert Hirschman’s terminology, the “voice”-option: citizens’ resistance through direct-democratic

¹³ Dafflon, op. cit., 150.

processes, either posterior (facultative referendum) or anterior (initiative) to financial decisions of parliamentary bodies. Again, all the three levels of the Swiss polity exhibit the same possibilities to express one's concern through well-channelled political processes. This certainly adds to the accountability-criterion of fiscal decentralisation another dimension, if not even a completely different quality.

III. TAX ASSIGNMENT IN SWITZERLAND

A. Overview

The system of tax assignments in Switzerland is essentially three-layered. Both the Confederation and the cantons may levy direct and indirect taxes, as well as charges. The municipalities generally set their own tax coefficient, based on the cantonal tax, to be decided annually and subject to democratic approval.

While the direct taxing power of the national level is limited to personal income and corporate profit, the cantons may also tax personal property and corporate capital. Some cantons also levy a poll tax, but generally at low rates. The tax of casinos' revenues is shared by the national and cantonal level. In turn, direct taxes raised either by the cantons or the municipalities are the gift and heritage tax, lottery gains tax, tax on profit from immovable property, real estate tax and the transfer tax. The only direct tax exclusively communal is the commercial tax, applied in some cantons.

Indirect property and excise taxes are, on the federal level, the withholding tax, the tax on casinos' revenues, the tax on exemption from the military service, the value added tax, the stamp tax, several special consumption taxes, customs duties and traffic excises. In the cantons, indirect taxes are the motor vehicle tax, the cantonal stamp tax, lottery tax and the water works tax. Cantonal-communal shared taxes are the dog tax and the entertainment tax.

B. The Federal Level

The national level may raise the following direct taxes, both progressive:

- Tax on personal income: the upper limit fixed by the Federal Constitution (*Bundesverfassung*, BV) is 11.5% (article 128.1(a) BV)
- Tax on corporate profit: the net profit of legal entities is taxed at a rate of 9.8% at most (article 128.1(b) BV)

However, it is the cantons that assess and collect the taxes. Since 1 January 2008, the cantons deliver 83% of the gross tax yield (including fines and interests) to the Confederation, so the sub-national share in this national tax is 17%.¹⁴

Indirect taxes and excises on the national level are the following:

- Withholding tax: This tax is levied at the source and on the revenue from movable capital assets and on lottery gains (35%), on pensions and annuities for life (15%), and on other insurance benefits (8%). (Article 132.2 BV) The withholding tax is collected by the debtors (bank, insurance etc.) and thus directly deducted from the money (e.g. the pensions) that citizens get. However, since the withholding tax is later reimbursed through the canton, the main purpose of this tax is to reduce tax evasion – only people declaring their assets are entitled for reimbursement. The cantons get 10% of the net tax yield.
- Tax on Casinos' Revenues: The 7 Grand Casinos in Switzerland have to pay a tax of 40% on their gross gambling yield, if the latter does not exceed 20 Mio CHF. For every additional one million CHF of revenue, the tax rate rises by 0.5%. For the 12 “minor” Casinos, the tax rate is 20% on their gross gambling yield of up to 10 Mio CHF, and for every additional one million CHF, the tax rate rises by 0.5%. The maximum rate for both is 80%; and the whole tax revenue is earmarked to cover federal subsidies to old age, survivors' and disability insurance. (Article 106 BV)
- Tax on Exemption from the Military Service: Every Swiss man is obliged to render military service, or alternative (civil) substitute. Failure to do so – for any reason – makes the payment of this tax mandatory. (Art. 59.1 & 59.2 BV) Assessment and collection is done by the cantons, normally based on the direct federal tax. It is 3 CHF per 100 CHF of taxable income; the minimum amount of the tax owed is 200 CHF. A discount of one tenth is granted if one has done between 55 and 99 days of military

¹⁴ Previously, 30% of the gross tax yield went back to the cantons: 17% stayed with the canton that collected the taxes and 13% were used for inter-cantonal equalization purposes, based on financial strength and population. (Article 128.4 BV)

services (or 75-149 days of civil service), and an additional tenth for every additional 50/75 days of military/civil service.

- Value Added Tax (VAT): the VAT is a general consumption tax, levied on all phases of production and distribution of a good, on national services and beneficiaries of services from enterprises located outside Switzerland. (Art. 130.2 BV) Exempted are corporations and sports associations up to a certain level and a number of other categories. Currently, there are 312'000 entities obliged to pay the VAT. The standard VAT is 7.6%, hotel services are taxed at 3.6%, and a reduced tax rate of 2.4% is applied for essential goods such as food and drinks, journals, medicaments etc. Again, use of the tax revenue is partly earmarked for social affairs (old age and survivors' as well as disabled insurances), railway infrastructure projects and low income classes.
- Stamp Tax: The Confederation levies a stamp tax on securities, on insurance premium receipts and on other documents of commerce. (Art. 130.2 BV) There is an excise on the emission, mainly on national ownership rights (tax rate 1%) and on national bonds (1.2%); a turnover excise of 1.5‰ and 3 ‰ on the price of national and foreign shares, respectively; and the excise of 5% on insurance premium receipts.
- Special Consumption Taxes: The special consumption taxes are set out in article 131 BV, whereas details are given in the respective laws.
 - The tax on tobacco concerns nationally fabricated tobacco products and cigarette papers; cigarettes are taxed at 9.923 cents/piece plus 25% of the retail price, with at least 17.298 cents/piece. All income from the tax on tobacco and tobacco products entirely flow to the insurances for old age and survivors' and for the disabled.
 - The beer-tax currently lies at 16.88, 25.32 and 33.76 CHF per hectolitre, depending on the gravity of the beer as measured in grade Plato: up to 10°, 10.1°-14°, and more than 14.1° Plato, respectively.
 - The tax on crude, oil and other mineral fuels, as well as natural gas and products obtained from refining them, and motor fuels. Depending on the product and its purpose, the tax rate varies. Also, a surtax of 30 cents/litre is levied on motor fuels. Half of the tax revenue from the gross tax yield and all of the revenue from the motor fuel surtax are earmarked for expenses in relation to road traffic; the rest is for general purposes.

- The tax on automobiles and their components is levied since 1997, and at a rate of 4%. Since national production is insignificant, this tax represents a duty on the import of automobiles. Electric cars are exempted from the tax.
- Nationally produced and foreign distilled spirits are treated equally, since 1999, as they are taxed at 29 CHF per litre of pure alcohol. In 2003, Parliament decided a special tax on so-called alcopops – here, the tax on distilled water was raised by 300%, i.e. 116 CHF per litre of pure alcohol. 90% of the tax revenue are used for the social insurances, 10% go to the cantons but must be used to combat problems arising from addictions.
- Customs Duties: According to article 133 BV, legislation on customs duties and other levies on trans-border goods traffic is a federal matter. Detailed rates are set in the annex to the Law on Customs Duties, and normally calculated as X CHF per 100 kg of the imported good. All revenues from customs duties cover general expenses of the Confederation.
- Traffic Excises: Use of national highways requires the purchase of a road tax disc, called vignette, valid for one year at a price of 40 CHF. Revenue from this tax is entirely used for the construction, maintenance and operation of national highways and other expenses related to road traffic. (Article 86 BV) Lastly, a charge on heavy goods traffic related to motor power and consumption is levied by the Confederation. It is rated according to kilometres driven on Swiss territory, gross weights of the transport and emission of the vehicle. One third of the net revenue from the charge goes to the cantons to cover general road expenditure. Of the other two thirds, the Confederation has to cover costs in connection with traffic, nowadays in the form of investment in railroad projects. (Article 85 BV)

Overall, the Confederation had a total tax income in 2007 of 53.3 billion CHF, of which the individual sources were: direct federal tax 15.4 billion, withholding tax 4.2 billion, tax on casinos' revenues 500 million, tax on exemption from the military service 137 million, value added tax 19.7 billion, stamp tax 3 billion, special consumption taxes 8 billion, customs duties 1 billion, and traffic excises 1.7 billion.¹⁵

¹⁵ http://www.estv.admin.ch/d/dokumentation/zahlen_fakten/dok/fiskaleinnahmen/2007/ganz-d.pdf, 4 June 2008

C. Cantonal and Communal Level

Cantons are entitled to raise taxes on matters not exclusively taxed by the federal government. Municipalities, in turn, can levy only those taxes that are assigned to them by the cantonal regulations. Commonly the municipalities raise surtaxes on cantonal taxes (communal tax coefficient) or they get a share in the cantonal tax yield. There are 26 different tax systems, sometimes laid out in cantonal laws, sometimes in communal regulations, and most often both. We reproduce here the regulations of the canton of Glarus:¹⁶

- Tax on personal income: progressive rate between 0.0741% and 19%
- Tax on personal property: the rate is currently 3 ‰
- Tax on corporate profit: the net profit of legal entities was, until 2008, taxed at a rate of minimum 8.5% and maximum 13.5%. In May 2008 it was decided by the people of Glarus to apply a proportionate or “flat” rate of 9%.
- Tax on corporate capital: proportionate rate of 2 ‰ of the taxable own capital

All the given tax rates are set by the cantonal Law on Taxes of 2000,¹⁷ where it also says that the annual coefficient has to be decided by the people themselves. The tax coefficient for the canton is 95% for both individuals and corporations. To give an example for individuals: the taxes on personal income and property added make the “simple tax”, which is, in Glarus, multiplied with 0.95 to make the “simple state tax”. Other direct taxes of the canton:

- Tax on real estate revenue: between 3% und 39% and exclusively levied by the canton.¹⁸ Very short periods of ownership are subject to surtax, long-time ownership is rewarded a tax discount of up to 90%.
- There is no transfer tax, but the land registry demands a charge of 5‰ of the purchase price.
- The gifts and heritage tax lies between 2.875% and 28.75%, including 15% cantonal construction surtax. Spouses and direct descendant are exempt from this tax.
- A cantonal surtax is levied for construction purposes (*Bausteuerzuschlag*): 4% of the “simple state tax” and 15% of the gifts and heritage tax will be used to renovate the cantonal hospital (3% from the “simple state tax” basket and all the 15% from the gifts and heritage tax basket) and a sports centre (0.5% “simple state tax”) and to build a new restaurant in one of the professional schools (also 0.5% “simple state tax”).

¹⁶ http://www.glarusnet.ch/angebot/htm/a_stgl.htm, 4 June 2008

¹⁷ http://www.lexfind.ch/dta/6840/2/gv_vi_c_1_1.pdf, 4 June 2008

¹⁸ In the following cantons the municipalities also levy this tax: Berne, Obwalden, Fribourg, Basel-City, Schaffhausen, Grisons and Jura. In the cantons of Zurich and Zug, only the municipalities levy this tax, but according to cantonal regulations.

The municipality of Glarus, capital of the canton of Glarus, applies a tax coefficient of 30%. This means that an additional 30% of the “simple state tax” has to be paid to the municipality by the resident. This is valid both for individuals (income and property) as well as corporations (profit and capital). (Article 50.2 of the Constitution of Glarus)

D. Discussion

The three-layered structure of tax assignment could render void the benefit principle, especially if, as we have seen, many federal taxes are coupled to equalisation purposes. But because most of the taxes are clearly assigned both to a governmental level and a specific purpose, the public service is indeed produced in such a quantity and quality that the costs do not exceed the benefits.¹⁹

In turn, redistribution is not merely a task of the national level. Due to the fact that the cantons were once sovereign entities, still much of the state-character is found in their attempt to equalise the income on their territory. In a recent judgement, the federal high court even dismissed a cantonal attempt to proportionate taxation of personal income and property, as it would contradict the federal principle of “universality and equity of tax treatment and of taxation according to economic capacity.” (Art. 127.2 BV)

The allocation of resources-task is also not just confined to the central government. Cantons enjoy autonomy in the field of their own taxes, and a substantial tool of bargaining is the issue of tax abatement and non-taxable level, for corporations and individuals alike.

Here, the main problem of Swiss tax assignment is situated: is there too much of a competition between cantons and even municipalities, so that a race to the bottom renders economic gains insignificant? Would not some coordination between the different levels bring profits to all the players?

This is of course a political decision and not easy to answer from this schematic overview. At the end of the day, however, tax competition in Switzerland results from a maximum of sub-national financial autonomy and, since the annual coefficients are decided democratically (cantonal/communal parliaments; or in popular assemblies), from a maximum also of accountability.

¹⁹ Maybe also because expenditures and receipts of the Confederation have to be kept in balance, according to the BV (article 126.1), formulation which is reproduced at the cantonal and communal level.

IV. INTERGOVERNMENTAL TRANSFERS IN SWITZERLAND

A. The System of Transfers in Switzerland

Vertical and horizontal transfers are multiple, overlapping and bi-directional in Switzerland. The Confederation receives money from the cantons and pays them back, to simplify the matter. The same counts for the cantons and their municipalities. At the same time, a horizontal fiscal equalization mechanism plays among the cantons, but also among the municipalities of the same or even different cantons.

As every canton is different in this regard, we will focus in this paper on the national regulations for transfer payments Confederation-cantons (vertical) and general purpose payments from “richer” to “poorer” cantons (horizontal equalization). A whole new set of regulations came into force at the start of 2008, based on an amendment to the Swiss Constitution:

Art. 135 Financial Equalization

- 1 The Confederation shall promote financial equalization among the Cantons.
- 2 When granting subsidies, it shall take into account the financial capacity of the Cantons and the special situation of the mountainous regions.

There are two methods with which the Confederation tries to reach the goal mentioned in the first paragraph. The first is resource levelling and the second is cost compensation. They are both laid out in the Federal Law on Fiscal and Cost Equalization of 2003 (*Bundesgesetz über den Finanz- und Lastenausgleich*, FiLaG). Detailed calculations for 2008 can be found in the respective government regulation of 2007 (*Verordnung über den Finanz- und Lastenausgleich*, FiLaV).²⁰

While for resource levelling the fund is financed by both the resource-rich cantons and the Confederation, the fund for cost equalization is financed purely by the Confederation. (See Table 1 for an overview) In the following sections, we will consider resource levelling and cost equalization in turn.

²⁰ All Swiss as well as cantonal constitutions, laws and regulations can be found through www.lexfind.ch

	Resource Levelling		Cost Equalization	
<i>Goal</i>	Reduce the differences between cantons with regard to their financial capacity and tax burden. (Art. 2-a FiLaG)		Compensate cantons for excessive costs arising from geo-topographic and socio-demographic conditions. (Art. 2-e FiLaG)	
<i>Components</i>	Vertical	Horizontal	Geo-topographic	Socio-demographic
<i>Funding</i>	Confederation	Resource-rich cantons	Confederation	
<i>Stock 2008</i>	1.8 billion CHF	1.3 billion CHF	0.3 billion CHF	0.3 billion CHF

Table 1: The new financial equalization scheme

B. Resource Levelling

The main component of the new financial equalization scheme is resource levelling. Cantons are ranked according to their *potential* fiscal resources. The goal is that the resource-rich cantons help the resource-poor cantons to reach a certain minimum level of financial capacity, currently defined as the availability per inhabitant of resources in the amount of at least 85% of the Swiss average. (Art. 6.3 FiLaG) Logically then that these payments are not earmarked, but for general purpose.

Index of Potential Resources

In a first step, a canton's potential fiscal resources are calculated. The cantonal fiscal potential equals the sum of (1) the taxable income and (2) net property of all the persons living in, and of (3) the profit of all the corporations based in a canton. Based on this calculations, an index is formed – a canton's per capita resource potential divided by the Swiss per capita resource potential (sum of all cantonal per capita resource potentials) and multiplied with 100, whereas the Swiss average is set at 100. Cantons with an index above 100 count as resource-rich, cantons below as resource-poor. Table 2 gives the data for the year 2008. (Annex 1 to the FiLaV)

Canton	Resource Potential (in 1'000 CHF)	Population	Per capita resource potential (in CHF)	Resource index
Zug	6'009'194	103'918	57'826	214.9
Genf	17'494'770	430'075	40'678	151.2
Basel-Stadt	7'176'591	190'833	37'607	139.8
Zürich	43'448'036	1'276'015	34'050	126.5
Nidwalden	1'301'268	38'563	33'744	125.4
Schwyz	4'488'004	134'428	33'386	124.1
Waadt	18'514'848	652'466	28'377	105.5
Basel-Landschaft	7'358'428	263'471	27'929	103.8
Tessin	8'312'940	317'958	26'145	97.2
Neuenburg	4'372'882	168'424	25'964	96.5
Schaffhausen	1'918'123	74'170	25'861	96.1
Aargau	13'535'189	561'110	24'122	89.6
Graubünden	4'201'410	191'407	21'950	81.6
St. Gallen	9'985'038	458'628	21'772	80.9
Appenzell I.Rh.	314'463	14'676	21'428	79.6
Appenzell A.Rh.	1'096'473	52'621	20'837	77.4
Bern	19'917'413	960'147	20'744	77.1
Luzern	7'296'496	353'300	20'652	76.7
Solothurn	5'043'202	245'906	20'509	76.2
Freiburg	5'071'912	250'227	20'269	75.3
Thurgau	4'622'836	232'207	19'908	74.0
Glarus	716'568	38'278	18'720	69.6
Wallis	5'296'225	285'070	18'579	69.0
Jura	1'253'731	67'905	18'463	68.6
Obwalden	596'974	33'033	18'072	67.2
Uri	577'491	34'753	16'617	61.8
Total	199'920'504	7'429'582	26'909	100.0

Table 2: The resource potential index for 2008

Determination of Contributions and Disbursements

As with every political endeavour, it is important to strike a balance between a generally accepted formula and adaptability, or controllability, by the political actors. The principle of resource levelling is based on the constitution; the calculations leading to the index as well as the goal (every canton shall have per capita resources of at least 85% the Swiss average) are set out in the FiLaG.

However, in terms of financing the equalizations mechanism, the FiLaG leaves some room for manoeuvring, when it says in article 4.2: „The yearly ratio between the total contributions of the resource-rich cantons and those of the Confederation is at least two thirds, but 80% at maximum.“ As of now, the ratio is 70%.

Every four years, the Swiss Parliament can adapt this ratio, within the margins given; in the years in-between the Swiss Government automatically adjusts:

- The sum of the contributions of all resources-rich cantons to the evolution of *their* resource potential; and
- The sum of the federal contributions to the evolution of the resource potential of *all* the cantons. (Art. 5.1 & 5.2 FiLaG)

For the distribution of funds for the resource levelling purpose, it is again up to the Swiss Government to determine the exact sums each resource-poor canton receives. A last constant parameter guiding the otherwise annually changing disbursement formula is that the ranking of the cantons on the resource-index must not be altered, through disbursements out of the resource levelling fund, as this might create serious disincentives to tax ones potential resources.

Cantonal contributions to the fund are proportionate, i.e. for every index-point above 100 the resource-rich cantons pay a fixed amount, multiplied by the number of persons residing on its territory: “The contribution per inhabitant of a resource-rich canton is proportionate to the difference between his resource index and the Swiss resource index“. (Art. 25.1 FiLaV)²¹

In turn, disbursement happens progressively, i.e. the further away from 100 a resource-poor canton is situated, on the index, the higher the amount it receives per cantonal inhabitant. (Art. 26.1 FiLaV)²²

C. Cost Equalization

If through resource levelling resource-poor cantons are supported to reach a certain level of fiscal capacity, the cost equalization mechanism targets cantons that suffer excessive costs for certain public services. The reasons for higher costs must be structurally grounded for a canton to benefit from payments out of this fund, which is exclusively financed by the Confederation. As with resource levelling, payments are not earmarked, so that they allow the benefiting cantons to keep with their own preferences.

In Switzerland, it is thought that two main factors lead to excessive costs for *minimum* services – *additional* services (and costs arising there from) correspond to the choice of a canton and are not taken into consideration. These two factors are geographic-topographic and socio-demographic.

²¹ For 2008, Zurich for example has to pay 500 million CHF, Geneva 330 million CHF, Zug 180 million CHF, Basel-City 115 Million CHF, Vaud 53 million CHF, Schwyz 50 million CHF, and Nidwalden and Basel-Country some 15 million CHF each. (Annex 8 to the FiLaV)

²² For 2008, Berne will receive a total of 800 million CHF, Valais 380 million CHF, but the small canton of Jura (last on the index) only some 90 million CHF. (Annex 9 to the FiLaV)

Geographic-Topographic Cost Equalization

Payments from this fund go to cantons whose minimum services cost more than the Swiss average because of their special geographic-topographic situation. Reasons for higher costs are a disproportionately high share of settlements and productive area that is located high above sea level; and/or dispersed settlement structures and a low population density. (Art. 7.1 FiLaG) Four indicators capture these structural reasons for higher costs of public services:

1. Settlement height: People living at 800 or more meters above sea level;
2. Area slope: Elevator median of productive area;
3. Settlement structure: People living outside the main settlement structures; and
4. Population density: Inhabitants per square kilometre. (Art. 29.1 FiLaV)

For the calculation of the index of excessive costs due to geographic-topographic reasons, the first two factors are weighed by one third each, and the last two by one sixth each.

Socio-Demographic Cost Equalization

Payments from this fund go to cantons whose minimum services cost more than the Swiss average because of their special socio-demographic situation. Reasons for higher costs are a disproportionately high share of people living in poverty, elderly and young people, unemployed, drug addicts and foreigners in need of support to be integrated. (Art. 8.1 FiLaG)

Three indicators capture these structural reasons for higher costs of public services:

1. Poverty: People benefiting from social services;
2. Age: People above 80 years; and
3. Foreigners: Foreign inhabitant who do not come from neighbouring countries and who live here for a maximum of 12 years. (Art. 34.1 FiLaV)

For the calculation of the index of excessive costs due to socio-demographic reasons, the first factor is weighed by 40%, the second by 25%, and the last one by 35%.

On the other hand, important cities may suffer additional excessive costs due to their special function. (Art. 8.2 FiLaG) Indicators for these excessive costs are:

1. Size of the municipality: People permanently residing on its territory;
2. Population density: Inhabitants per productive area;
3. Employment ratio: Employed in relation to permanently residing persons. (Art. 36 FiLaV)

For the calculation of the index of excessive costs due to the function as major city, the first factor is weighed by 35%, the second by 37%, and the last one by 28%.

Disbursement of Funds

The disbursements to cantons that qualify under these conditions are regulated again through an index. Payments to one canton for one specific excessive cost are proportionate to its share of the sum of all the specific excessive costs.

For 2008, for example, Berne receives 17 million CHF for its highly dispersed settlement structure, but only 1.3 million CHF for the area slope. In turn, Appenzell A.Rh. gets only 200'000 CHF for area slope, but 15 million CHF for settlement height. The total sum disbursed in 2008 for the compensation of excessive costs due to geographic-topographic reasons is 340 million CHF. (Annex 12 to the FiLaV)

The same sum is at disposal for the compensation of excessive costs due to socio-demographic reasons. Of this, 230 million CHF for excessive costs due to the population structure and 110 million for excessive costs due to the function of a central city. (Annex 15 to the FiLaV)

D. Conclusion

Overall, the new financial equalization mechanism appears to equilibrate several principles. It strikes a balance between resource-rich and resource-poor cantons, to the extent that every canton shall have at least 85% of the Swiss average fiscal resources at its disposal. The ranking of the cantons on the resource index shall not be altered through resource levelling, so it is still better for a canton to make its own efforts in achieving a higher efficiency in using his resources than to rely on transfers only.

Formula-based calculations are clearly set out in positive law (constitution, formal law and regulation). Still, the political bodies – Parliament every four years, Government in the years in-between – may adjust the formula. Furthermore, the decision of Parliament is subject to an optional referendum.²³

In taking into account not the real revenue of cantons, but the potential fiscal capacities, the cantons are treated equally. Another mechanism exists alongside, specially targeted towards mountainous and densely populated regions, i.e. major cities.

Lastly, while the general equalization (resource levelling) is funded by the Confederation and resource-rich cantons together, at a ratio of currently 70%, the specific excessive cost equalization is purely vertical. However, both equalization funds provide unconditional transfers – a consequence of the always present principle of cantonal autonomy. After all, to “strengthen cantonal financial autonomy” is the first goal mentioned in article 2 FiLaG.

²³ Meaning that if 50'000 citizens challenge the decision within 100 days after its publication, a binding popular vote is held.

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