Fiscal Federalism in Switzerland: Dos and Don'ts for the EU

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Definition: 'Fiscal federalism' refers to systems with a decentralized fiscal structure, in which the authority to raise, manage, and spend public revenues (fiscal powers and functions) is divided between different levels of government that each has a certain margin of autonomy.

Contents

1 Overview

1.1 Goals of the existing system as per the legal order, design and/or tradition

The twin goals of the Swiss system of fiscal federalism are very much in line with the basic idea of Swiss federalism as such: to guarantee the continued existence of the 26 cantons and ca. 2,000 municipalities as largely autonomous polities, on the one hand, and to ensure that also the federal level has the requisite fiscal means at its disposal, on the other. Each level should be able to fulfil its tasks, while particularly the two lower levels are to be compensated for applying decisions of the higher level(s) ("executive" or "administrative federalism").

At the same time, one would be hard-pressed to a find a policy area in which only *one* level of government is in charge legislatively, administratively, and also financially. For instance, even in the domain of foreign affairs the cantons and their police forces must guarantee the safety of all embassies and delegations located on Swiss territory, while the Confederation also participates programmatically and also financially in typically regional and local areas such as primary schools or public transport. Swiss federalism is thus a system of both vertical power division and intergovernmental cooperation.

To be sure, when the federal government participates in primarily subnational domains, it does so principally through co-funding. Top-down transfers take place via tax revenue sharing, fiscal equalisation, and specific project and programme grants (see below, XY). In turn, when the cantons and/or municipalities become involved in federal policy, they mainly do so through implementation and execution. One of the main results of this division of labour is that residents are only rarely confronted with the federal bureaucracy or even government, which is rather minimal by international standards: only some 35,109 Full-Time Equivalents work in the central apparatus narrowly defined (i.e. without publicly owned or semi-public companies and the armed forces).[1] This is both a reason for and a consequence of the fact that most public money is generated and, even more so, spent sub-nationally.

Accordingly, Art. 43a of the Swiss Constitution of 1999 (as of 1 January 2021; BV 1999) reads as follows:

[1] https://www.epa.admin.ch/epa/de/home/themen/das-bundespersonal-in-zahlen.html

Art. 43a: Principles for the allocation and fulfilment of state tasks

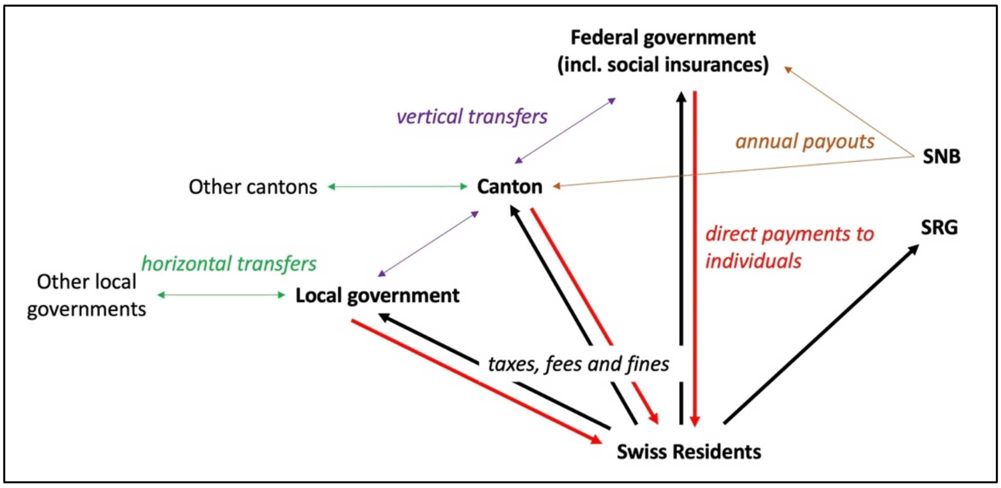
1. The Confederation only undertakes tasks that the Cantons are unable to perform or which require uniform regulation by the Confederation.
2. The collective body that benefits from a public service bears the costs thereof.
3. The collective body that bears the costs of a public service may decide on the nature of that service.
4. Universally provided services must made be available to every person in a comparable manner.
5. State tasks must be fulfilled economically and in accordance with demand.

Thus, while paragraph 1 establishes a basic presumption of competence in favour of the cantons (the Swiss understanding of subsidiarity; see also Art. 5a BV 1999), paragraphs 2 and 3 codify the principle of fiscal equivalence, i.e. the ideal overlap of decision-makers, public service recipients and (usually tax) payers. Articles 44–48 further stipulate vertical and horizontal cooperation, including regular dialogue and mutual assistance, cantonal participation in federal decision-making, and the precedence of federal over cantonal (and thus also municipal) law.

Fiscal flows in Switzerland are rather numerous, complex and intricate. Figure 1 attempts a simplification by pitting residents vis-à-vis all three layers of government: their local government, their canton, and the federal government.[2] Government income comes mainly from (general purpose) taxes, (service-specific) fees and concessions, and (one-off) fines paid by residents and legal entities. To this are added intergovernmental transfers, which circulate money among the different governments of the same level as well as across levels. Hence, governments spend their money either on vertical or horizontal transfers, for instance as part of fiscal equalisation, directly to individuals in the form of health care subsidies or unemployment benefits, for instance, or indirectly through salaries to their staff, investments and project costs.

[2] Every piece of land is always part of all three jurisdictions.

Figure 1: Fiscal flows in Switzerland, simplified



Note: SNB = Swiss National Bank; SRG = Swiss national radio and television company. Omitted are payments to and from abroad, by and to legal entities such as enterprises, and salaries and other intra-governmental costs

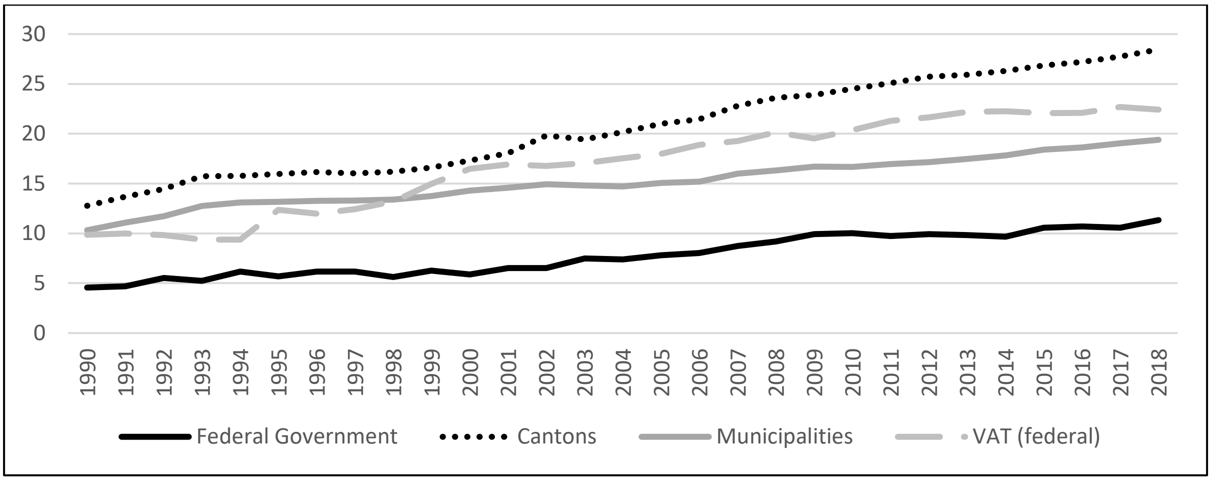
In terms of direct taxes, all three levels of government tax the same base: the income of private individuals and the net profit of legal entities (Art. 128.1 BV 1999 for the Confederation). However, the per capita and total amount of taxes thus paid to the federal level is rather small; most tax yield obtains at the cantonal and – depending on the canton (Mueller 2015) – local level. Most of the time (always?), local governments apply a coefficient to the cantonal "state tax" (*Staatssteuer*), while the federal tax is determined using different rules of, for instance, what and how much can be deducted from one's income before the tax is calculated. Cantons are free to decide not only on the tax rates, but also on the tax schedule (i.e. categories of persons) as well as the degree of progressivity (Schaltegger & Schmid 2020, 4). The cantons also collect the federal tax, at the same time and together with their own.

To provide a first idea of the ensuing distribution of revenue, Figure 2 shows how much each level of government has generated in public revenue from the same source: personal income.[3] Overall, 18% of the total tax yield from that source go to the federal level, 35% to the municipalities and 47% to the cantons. Moreover, this type of revenue only accounts for 16% of all federal tax revenue over the entire period studied here. By contrast, personal income tax revenue is much more important for the cantons (61% of all tax incom) and municipalities (69%). Unlike in other states, then, the most direct link between residents and

[3] Married people are taxed as one household.

“the state” is that between the former and the cantonal level. The implications of this we discuss further below (see xy).

Figure 2: Public revenue from personal income tax and VAT, 1990–2018 [billion CHF]

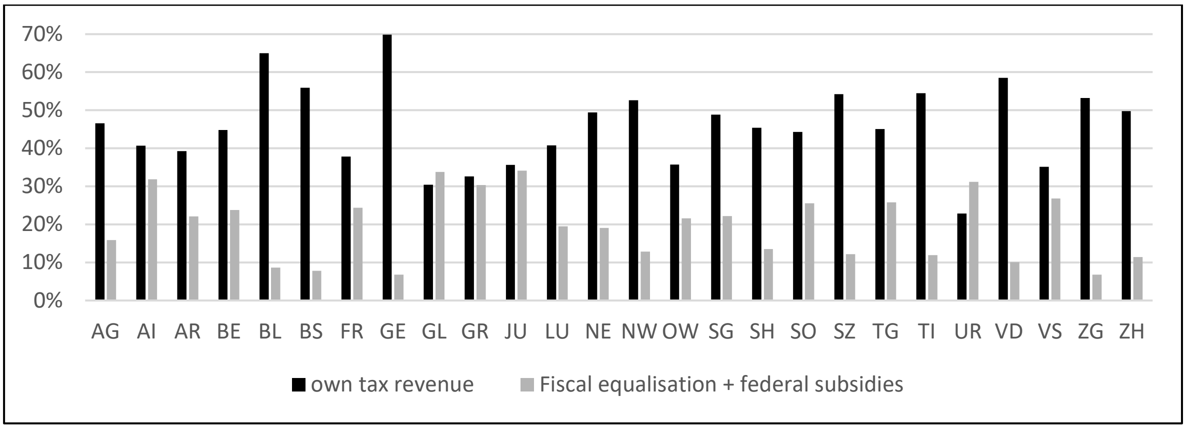


Source: Own graph with data from EFV 2020 (GFS model)

By contrast, the most important single source of income for the federal government is the VAT, i.e. a merely *indirect* tax collected at the point of sales and then transferred to the federal budget almost imperceptibly. The VAT currently accounting for some 35% of all tax revenue at federal level. In other words, federal receipts from the VAT are twice as high as those from the (direct) federal income tax (see again Figure 2). Only the federal government has the right to “levy a value added tax on the supply of goods or services, including goods and services for personal use, and on imports” (Art. 130.1 BV 1999, also Art. 134). In turn, property and fortune are taxed only at subnational level; receipts from this tax account to some 16% of total cantonal tax revenue and 15% for local governments, on aggregate (EFV 2020). That direct taxes are mostly paid to the cantonal and local levels, that even the direct federal tax is collected by cantons on behalf of the Confederation, and that only the indirect tax (VAT) incurs at federal level (via the legal entities supplying the goods or services) reinforces the basic impression of the Swiss state “happening” mainly beneath the national surface.

The final element of Swiss federalism that bears mentioning in this opening section is subnational diversity, especially – but not only – in fiscal matters. Thus, while all cantons are equally entitled (by federal law) to levy direct taxes, some choose to exploit this power more than others (tax competition). Also, even if the same rates were applied throughout, a different tax yield would ensue given vastly different socio-economic realities (inter-territorial inequality). Figure 3 provides a snapshot of three key indicators for the year 2018. Black bars show the share of revenue from own taxes as part of total cantonal revenue. The variation ranges from 23% in the canton of Uri to 70% in Geneva. Grey bars capture the extent to which a canton relies on income from fiscal equalisation (see below, section XY) and federal subsidies combined. Here, the variation ranges from 7% in Zug and Geneva to 34% in Glarus and Jura. In other words, while all the 26 cantons possess – in theory – equally strong fiscal autonomy, not all of them can or want to use that autonomy to the same extent.

Figure 3: Cantonal own tax revenue and key federal contributions, 2018 [in % of total cantonal revenue]



Source: Own graph with data from EFV 2020 (FS model)

At the same time, the cantons are of unequal population size and culturally different. The main divide is between French-, German- and Italian-speaking cantons, in terms of culture, and between the large cantons with prosperous cities in the plains and the small, rural ones in the Alps, in terms of territory and wealth. For instance, the ratio between the population sizes of Zurich and Appenzell Inner-Rhoden is 1:92. By comparison, the ratio between the largest and the smallest constituent units in Germany is 1:27, in the US 1:67, and in Canada 1:94. Moreover, several noteworthy fiscal aspects map onto the Swiss language divide: in the French-speaking part, more people finish the public high-school (47% on average vs. 35% in the German-speaking part), less is spent on roads (720 CHF per capita and year vs. 830), almost twice as many inhabitants rely on social aid (4.2% vs. 2.4%) or unemployment benefits (3.2% vs. 1.7%), and taxes are almost 50% higher, on average (BFS 2020).

Italian-speaking Ticino scores sometimes closer to or even higher than the French-speaking (55% high-school degrees), sometimes closer to the German-speaking cantons (810 CHF per capita and year on roads, 2.7% social benefits), sometimes in-between (taxes and unemployment benefits). The share of residents studying at one of the ten cantonal or two federal universities, with only half these institutions located in the German-speaking part, is equally almost double in French-speaking Switzerland (2.8% vs. 1.5%: Italian-speaking region: 1.8%) (BFS 2020). Since universities are largely a cantonal affair, their costs also mainly accrue at that level (although federal co-financing exists?!). Zurich and Fribourg, for instance, both of which host a university alongside other public higher education institutes (teacher's college, art and architectural school etc.), spent 16% of all their expenses on higher education and research, in 2018. By contrast, higher-education free Glarus, Obwalden and Uri only spent 3%. With 9%, Ticino spent only little more than the (unweighted) average of 7% (own calculations based on EFV 2020).

1.2 Evolution over time and major bones of contention

1.2.1 Towards the first direct federal tax…

Modern Swiss federalism has evolved from a very much non-centralised state of affairs, in 1848, into a more balanced (overall) and differentiated (by policy areas and functions) picture, by 2020 (e.g. Dardanelli & Mueller 2019). The same is true for fiscal relations, even if here centralisation was less pronounced than in implementation and especially legislation (ibid.).

When the Swiss federation was created in 1848, the national level was granted the exclusive rights to levy customs duties:

> Until the First World War, the revenue derived from customs duties was sufficient to cover the expenses of the Confederation. Towards the end of the war, stamp taxes were introduced. Later on, as the federal government needed additional financial means, direct taxes, hitherto the domain of the cantons, were levied by the Confederation, as well. This evolution culminated in the introduction of the so-called National Defense Tax in 1940. The Federal Direct Tax, which replaced the National Defense Tax in 1982, is currently the second most important source of revenue after the Value Added Tax (VAT), which replaced the Turnover Tax in 1995 […]. (FTA 2016, 6)

The only other sources of income for the Confederation back in 1848 were the monopolies over postal services (incl. telegraphs and telephones) and gun powder. However, for the loss of their right to levy customs duties and run postal services, the cantons received generous compensation payments. Custom and postal compensations accounted for some 2% (Fribourg) and 4% (Geneva, Bern and Solothurn) of cantonal income, at one end, and 26% (Grisons) and 45% (Uri), at the other end of the scale, by 1870 (11% on average; BR 1894, 835 & BFS 1891, 212).

The first major change to this situation occurred in 1874, when the federal constitution was fully revised for the first time. Because the federal level became more involved in defence, it needed either additional sources of income or to reduce its spending in other areas. The result, as always, was a compromise: compensation payments to the cantons were abolished and the proceeds from the military exemption tax were split (until now the cantons could retain this money in full). Only the Alpine cantons of Uri (70'000 CHF), Grisons, Ticino (200'000 CHF each) and Valais (40'000 CHF) continued to receive annual payments so as to manage major international roads located there. Uri and Ticino received an additional 40'000 CHF per year combined to clear the Gotthard pass from snow until the railway tunnel was fully operational (Art. 30.3+4 BV 1874).

After yet another popularly approved constitutional revision in 1885, cantons were also forbidden to levy alcohol taxes as this was now a federal prerogative (Swissvotes 2020). However, the enacting law of 1887 (which was challenged, but eventually approved by a majority of voting citizens) foresaw that cantons were to receive the full net profits from the new federal tax on distilled spirits (inland production and imports), whereby 10% had be used to combat alcoholism (SSK 2014, 2). By the 1880s, federal income from customs and postal services thus accounted for over 80% of all revenue; only 3% came from the military exemption tax (the federal half) and gun powder (BFS 1891, 208f.). Nevertheless, the balance of fiscal power was rapidly changing: in 1850, all cantons together had raised 20 million, the federal level just 10 million CHF; 40 years later, the ratio was only 79:73 million CHF in favour of the cantons (BFS 1891, 212).

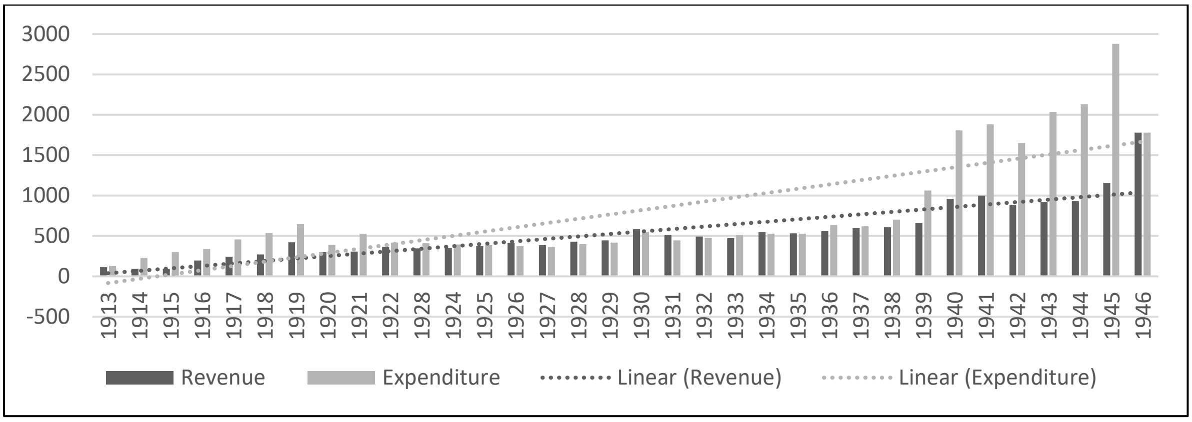
The stage was thus set for the first attempt by "cantonalists" (i.e. those in favour of cantonal autonomy) to strike back. The battleground they chose was public finance, in general, and the ever-increasing federal proceeds from customs duties, in particular. In 1894, the Catholic-Conservative party submitted a popular initiative on partial constitutional change which, if approved, would have guaranteed to each canton 2 CHF per inhabitant, to be paid from federal customs revenue (Swissvotes 2020). The federal government estimated the costs of the proposal to be some 6 million CHF per year (BR 1894, 833). However, only 30% of voting citizens and 8.5 vs. 13.5 cantons approved the proposal, so it failed (Swissvotes 2020).

The fiscal situation thus remained unchanged well into the 20th century. By 1911, customs duties and income from postal services still accounted for over 90% of federal revenue (BFS 1912, 266), and the federal government's total revenue of 172 million almost matched – but still did not surpass – the canton's combined revenue of 185 (ibid. 270). Only in 1915 did the federal level finally acquire the power to tax its citizens directly: the so called "war tax" implied "a direct tax on the property and salary […] levied by the cantons on behalf of the Confederation with a certain share in its proceed" (BR 1915, 155; own translation). It was argued to be necessary because income from customs duties had all but disappeared due to World War I and because the alternative, cantonal contributions to the federal budget (constitutionally possible since 1848 but invoked only once, in 1849), was deemed both insufficient financially and not feasible politically (ibid. 150ff.). The tax, which was more progressive than cantonal taxes, limited to the years 1916 and 1917, and from whose proceeds the cantons received a 20%-share, was approved by a record 95% of Swiss voters and all 25 cantons (Swissvotes 2020; Jura became the 26th canton only in 1979). Until 1927 the first war tax yielded 127 million CHF, of which 25 went to the cantons; the "war profit tax" introduced in 1916 yielded 731 million, of which 62 went to the cantons (BR 1948, 314). Stamp duties were introduced, again via referendum, in 1917 and cantons were again to receive 20% of the net proceeds (Swissvotes 2020).

1.2.2 …but no permanent federal direct tax

If 1915 marked the peak of federal fiscal evolution, it also marked its low point, since it seemed to prove that federal direct taxes only had a chance of being approved at the polls if they were both lower than cantonal taxes and limited in time. Indeed, only a few years later the Socialist Party proposed the introduction of permanent federal tax. However, in June 1918 only 46% of voters and 7.5 vs. 14.5 cantons approved (Swissvotes). In turn, two other extraordinary war taxes were approved in 1916 and 1919, respectively: the "war profit tax" for businesses (for the years 1915–1920) and a second war tax for persons and companies (for the years 1921–32). A second Socialist popular initiative, this time for a one-off, strongly progressive tax on property, was resoundingly rejected in 1922 (13% yes among voters and no canton in favour; Swissvotes 2020). Similar, merely temporary federal "war taxes" were introduced before and during World War Two (SSK 2014). However, in June 1950 a clear majority of voters and cantons rejected the new fiscal order which would have been necessary to constitutionalise the emergency measures of the preceding decade (Swissvotes 2020). This new fiscal order would have been desperately needed to tackle the federal debt, which by the end of WWII had risen to a staggering 8.5 billion CHF – from below zero just before WWI that is (BR 1948). Figure 4 shows that while federal revenue has grown, expenditures especially during the two world wars have grown even more.

Figure 4: Federal revenue and expenditures, 1913–1946 [million CHF]



Source: own graph with data from BR (1948)

Plan B then consisted in a merely temporary federal tax regime, approved by the people and cantons in December 1950 for 1951–54. A second attempt to make federal direct taxes permanent again failed at the polls, in 1953, after which the existing regime was again merely prolonged until 1958 (Swissvotes 2020). In 1958 a six-year plan was approved, extended in 1963 to last until 1974. In 1970 a major modification failed, so in 1971 again an extension until 1982 was approved. The introduction of the VAT failed in 1977, but in 1981 the existing federal fiscal regime was prolonged for 12 years (i.e. until 1994) (Swissvotes 2020). In 1991, the introduction of the VAT failed once more, as did the lifting of the time gap on the income tax. Only in 1993 was the VAT introduced for good, but the direct federal taxes were again only prolonged for yet another 12 years (i.e. until 2006). A further 14-year prolongation occurred in 2004 (i.e. until 2020). In 2018, finally, a 15-year prolongation was overwhelmingly – but with very low turnout – approved by the Swiss people and cantons (Swissvotes 2020).

So the current fiscal regime at federal level, covering both direct taxes and the VAT, is valid until 2035. In other words: half the income of the Swiss Confederaion is temporary only.

1.2.3 Concluding assessment

To summarise this section, Table 1 lists all the main taxes at federal level. The evolution of revenue sources at federal level can be summarised as follows. First of all, there were no grand moments that ensued in major shifts. Instead, we find gradual introductions of some revenue sources and their temporal extensions, especially regarding direct taxes and the VAT.

Table 1: Main taxes at the federal level, 1848–

Year/period in which introduced/in force	**Type/name of tax**
1849–	Customs duties
1878–	Military service exemption tax
1887–	Taxation of distilled spirits
1915–1920	War gains tax
1916–1917	War tax
1918–	Federal stamp duties
1921–1932	New extraordinary war tax
1933–	Tobacco tax
1934–	Beverage tax (beer tax)
1934–1940	Federal crisis contribution
1939–1946	War gains tax
1940–1942	One-off contribution for national defence
1941–	**Direct federal tax (until 1983: “national defence tax”)**
1941–	**Value added tax/VAT (until 1995: “turnover tax”)**
1941–1945	Emigrants national defence contribution
1941–1954	Equalization tax
1942–1959	Luxury tax
1944–	Withholding tax
1945–1947	New contribution for national defence

1997–	Mineral oil tax and automobile tax (previously “customs duties of a fiscal nature”)
2000–	Casino tax

Source: FTA (2019, 7), with some own adjustments. Main taxes in bold.

Second, the cantons were always somehow included too – first by receiving annual compensations for the loss over their tariffs and post and gun powder monopolies, then be receiving a fixed percentage of federal revenue (military exemption tax, stamp duties, alcohol charge, direct taxes etc.). Until 2008, many of these compensations and revenue sharing mechanisms also included an (often differently determined) equalisation component (Dafflon 1995, 53 and 91ff.).

Third, even the small, merely gradual steps each had to be approved by the people and, when concerning constitutional revisions, also a majority of cantons. Needless to say, cantonal payoffs in the form of compensations of revenue sharing had the convenient benefit of helping to work towards exactly such a cantonal majority. The ensuing system is also for this political reason heavily tilted towards the sub-national level (especially as regards direct taxation, less so in terms of indirect taxes and consumer charges; see above) and highly legitimate from a democratic point of view since repeatedly approved at the polls. The Swiss way of dividing sources of public revenue is thus intimately connected to its character as a semi-direct democracy (Linder & Mueller 2020), where elected officials and the electorate find themselves in a constant dialogue. However, as this dialogue is increasingly taking place among members of the executive and their administrative staff, cantonal parliaments and electorates do tend to get sidelined

Finally, the major bones of contention where never categorical – e.g. should the federal level have its own sources of income, or should the cantons levy taxes also on behalf of the Confederation – but rather numerical: *how much* should go to the federal, *how much* should stay at cantonal level? Nobody today questions that both levels should have their own, independently determined income; and no territory wants to secede because it feels exploited financially. The reform debates that continue to this day instead circle around specific compensation degrees and mechanisms to determine territorial fiscal needs.

1.3 *Distribution mechanisms regarding revenue and expenditure*

Both the federal and the cantonal level, as well all Swiss communes, have their own-source revenue (see below, section 1.3.1). With regards to direct taxation all three levels tax the same base in terms of income and corporate profits; only the two sub-national levels, however, also tax personal wealth and the capital of legal entities. Progressive scales are applied in all cantons except Obwalden and Uri, which practice a flat tax (FTA 2019). Not only the tax rates vary widely across cantons but also the amount – total and per inhabitant – thus gained. The total tax yield gained by a canton in each year is a function of two main variables: the tax rate and the affluence of its residents (income and property) and companies (profit and capital).

To account for differences in the latter dimension, which can only be influenced to some extent by political decisions, an system of fiscal equalisation was put in place as early as 1938 (provisionally, until 1941), institutionalised in 1958 (Dafflon 1995, 51) and fully revised in 2008 (Ruiz-Palmero 2017, 173ff. – see below, section 1.3.2). Fiscal equalisation also happens more or less indirectly though social security systems (section 1.3.3) and public broadcasting (section 1.3.4).

1.3.1 Revenue autonomy and tax competition

The concept of revenue autonomy is key to Swiss federalism as it directly ties into larger notions of fiscal responsibility and democratic accountability. Indeed, democracy presupposes autonomy of decision-making (e.g. Benz 2020) and, if those decisions are to have actual meaning, also of revenue generation and administration. In line with the development of modern states elsewhere, Swiss revenue autonomy is intimately linked to taxes. However, unlike elsewhere, the main direct taxes accrue sub-nationally, at cantonal and even local level, not at the federal level. Yet the federal level still disposes of its own revenue in that general (i.e. the VAT) and specific consumption-taxes (on tobacco, beer, mineral oil, and spirits) accrue to it (see above, section 1.2).

Among the cantons, the idea of tax competition is very important. The basic idea is to attract wealthy taxpayers through changes in the taxation structure – lower the tax on the rich this year and the arrival or rich tax payers next year will more than compensate your losses. Tax competition can play out with regards to subjects (who is liable to pay tax and who is exempt, and for how long); objects (what is taxed, what not and how much of it); and actual tax rates and coefficients (e.g. Matteotti 2020, 2237; see also Box 1). Through the Tax Harmonisation Law of 1990 (version of January 2020), cantonal competition in the area of direct taxes is however restricted to the rate, coefficient and the amount of different deductions.

Box 1: Tax rate and tax coefficients

In Switzerland, "the applicable tax rate consists of two components in most cantons, i.e. the simple tax rate set by law and the tax coefficient set periodically. These cantons' tax laws contain only the basic tax scale, i.e. the simple rates. The tax resulting from the basic scale is called simple tax [*einfache Steuer* or *Staatssteuer*]. The cantonal or communal tax actually due results from multiplying this simple tax by the tax coefficient. The latter is a ratio and is generally reset annually by the legislative body. In the case of income and wealth taxes for individuals, the communes generally apply the same assessment basis and the same scales as the canton. The communes levy these taxes as a multiple (expressed in absolute figures or percent) of the cantonal basic tax scale, i.e. the simple cantonal tax, or as a multiple of the cantonal tax actually due." (FTA 2019, 52)

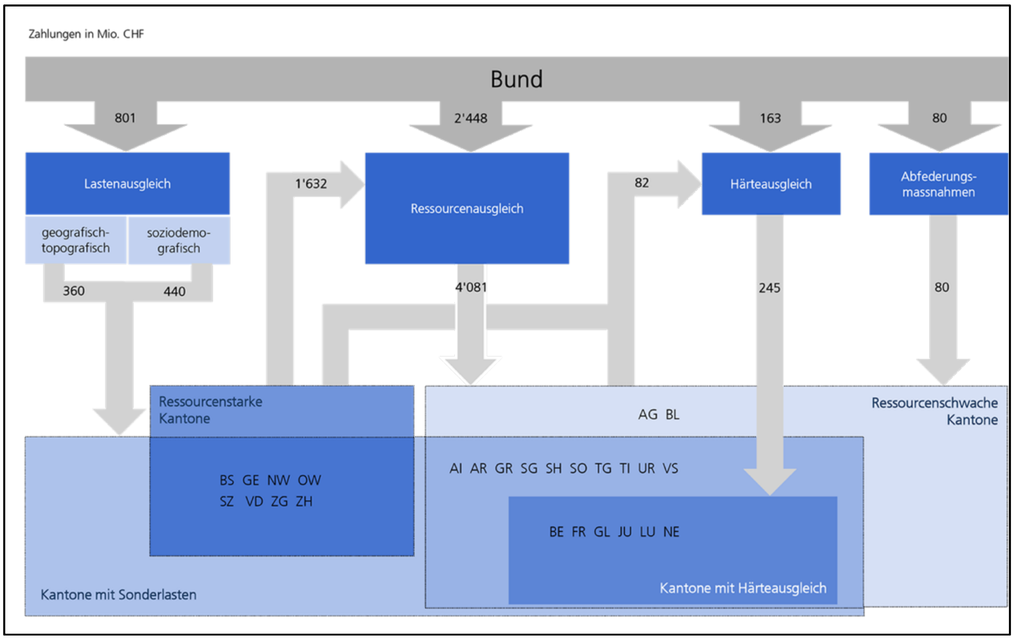
To give an example: In Canton X a single person's taxable income for the year Y is 50'000 CHF. The cantonal tax rate is 9%, resulting in a simple state tax of 4'500 CHF (50'000 * 9%). The cantonal multiplier or tax coefficient is 54%, the communal 63%. Hence: 4'500 CHF * 54% = 2'430 CHF cantonal tax and 4'500 CHF * 63% = 2'835 CHF local tax, or 5'265 CHF combined. To this is added the federal income tax, which is much lower and simpler to calculate: 50'000 CHF (if identical) * 0.9% = 450 CHF. Citizens generally declare by spring how much they have earned in the previous year; cantonal tax administrations send out, collect, control and process this annual tax declaration.

1.3.2 Fiscal equalisation (in the narrow sense)

Under the Swiss fiscal equalisation system in the narrow sense, the more affluent cantons as well as the Confederation pay the less affluent cantons each year a certain sum without any strings attached (*resource equalization*). In parallel, special *cost compensation* payments, again to be used as seen fit by recipients, exist for mainly urban and mountain cantons, while a transitory *cohesion fund* compensates those cantons which would have lost excessively by leaving the old system behind. The total volume of all three equalization mechanisms is 5.2 billion CHF, with 4 billion going to resource equalization, 801 million to cost compensation and 245 million to the cohesion fund in 2021 (Figure 5). Only cost compensations are funded entirely by the federal government. For the other two funds, there are cantonal contributions alongside top-down transfers: the Confederation covers 2.4 billion CHF of resource equalization, with the financially strong cantons contributing the other CHF 1.6 billion. In the case of the cohesion fund, the Confederation pays 163 million CHF and the cantons CHF 82 million.

How to evaluate the importance of this system? On the one hand, in 2018 the 5 billion fiscal equalisation payments received by the cantons overall amounted to just 5% of their total income. However, this figure obscures significant cross-sectional variation: dependency on fiscal equalisation transfers alone was as high as 18% (Jura), 19% (Valais) or even 20% (Uri and Glarus) of cantonal revenue, in 2018 (EFV 2020 – to which can be added other federal transfers, see above Figure 3). At the other end of the scale we find the two Basels, Geneva, Ticino, Vaud and Zurich, with 1% dependency, or even Nidwalden, Schwyz and Zug with 0% each. That last canton was in fact the only one not to receive anything at all in 2018 – on top of having to pay…

Figure 5: Swiss fiscal equalisation, 2021



Source: https://www.efd.admin.ch/efd/en/home/themen/finanzpolitik/national-fiscal-equalization/fb-nationaler-finanzausgleich/grafik-nfa.html

This brings us to consider the other side of the equation: expenditures. Overall, the fiscal equalization system is a rather negligible position in cantonal budgets: cantonal contributions into the system worth 1.7 billion (in 2018) amounted to a mere 2% of total cantonal expenditures. However, there is an even greater cross-sectional variation here, with fiscal contributions amounting to a record 24% of total expenditures in Zug but 0% in no less than 19 cantons (EFV 2020).

Over the years, this spread has created significant disquiet among the donor cantons, which have pushed for a reform of the system. A first attempt in 2015 having resulted in only minor changes (Schnabel & Mueller 2017), more significant changes occurred between 2018 and 2019 (cf. Stöckli 2019 for details).

1.3.3 Social security

Anyone working or, for some social security systems, also simply living in Switzerland is subject to its social security system. Everything is organised using the insurance principle. Its five areas are the following:[4]

1. *Old-age, survivors' and invalidity insurance:* this domain is further divided into three "pillars", of which the first refers to the public insurance (AHV/AVS) mandatory for everybody older than 18 years (or 20 if they have no work yet); the second to mandatory contributions and benefits for anybody employed in gainful employment (2nd pillar: occupational benefit plan); and the third to private savings and voluntary insurance arrangements (3rd pillar). The aim of the first pillar is to cover basic costs during retirement; of the second to allow persons to maintain their standard of living, and of the third to cover anything beyond. In the case of salaried individuals, the employee and the employer each pay half of the total contribution, i.e. 4,35 % each of the income on which AHV/AVS contributions must be paid. The employer must transfer the total contribution directly to the OASI compensation office. The disability insurance (IV/AI), which forms part of the first pillar, is compulsory in the same way as the AHV/AVS insurance. It is aimed at preventing, reducing or eliminating invalidity. It also ensures that the basic needs of those suffering from a disability are covered by the provision of rehabilitation measures and cash benefits. Employers and employees each pay 0,7% of the gross income gained. Supplementary benefits are paid when pensions and income do not cover the minimum living costs; they are determined by the cantons and divided into two categories: annual benefits paid monthly and

[4] Adjusted from "Social security in Switzerland", https://www.ahv-iv.ch/p/890.e [10.9.20].

payment of illness and disability cost. Supplementary benefits are financed through the general state budget.

2. *Income compensation allowances in the event of compulsory service or maternity:* Applying the same rationale as for the old age and invalidity, for individuals in salaried employment both the employee and the employer each pay a contribution which corresponds to 0,225 % of the relevant income. From this are funded 80% of the previous income of persons in military or civil service as well as – during 14 weeks/98 days – employed or unemployed women after giving birth.
3. *Sickness and accident insurance:* Health insurance is compulsory for everyone living in Switzerland. Anyone who is in Switzerland for longer than 3 months must buy a health insurance. Parents and children are insured separately. The amount of health insurance premiums depends on the insurance company, the place of residence and the insurance model chosen – but *not* the income. By law, the same basic services must be provided to everybody. People who cannot afford to pay their health care premiums are entitled to subsidies; these are financed jointly by the federal government and their canton of residence. However, the cantons decide on the thresholds to entitlement, the amount paid and how to claim the subsidies (notably whether the tax authorities automatically assess a person's status or whether a demand has to be submitted by certain deadline). In 2017, health care subsidies amounted to 4.5 billion CHF, of which the cantons financed 42%, on average; some 26% of residents were on the receiving end (BAG 2018, 9). The compulsory accident and occupational diseases insurance, in turn, is arranged through the employer and provided by the Swiss Accident Insurance Fund (SUVA) or other approved accident insurers. The employer usually pays the premiums for the insurance against occupational accidents and diseases, while the employee pays the premiums for the insurance against non-occupational accidents. The employer deducts the employee's contribution from his or her salary and pays the total amount to the chosen insurance company.
4. The public *unemployment insurance* provides benefits in the event of loss of employment, reduced working hours, lack of employment due to weather conditions and insolvency of the employer. It also covers reintegration measures. Again, the employee and the employer contribute equally, namely 1,1% each of insured income

up to 148'200 CHF. Income above that sum is subject to a solidarity contribution of 1%.

5. *Family allowances:* Along with tax relief, family allowances are the main provision to compensate for the costs incurred from raising a family. Family allowances form part of the social security system. However, unlike the benefits available from other types of social insurance, family allowances are not a substitution for income, but rather an addition to it. Family allowances for employees are almost exclusively financed by the employers, as a rule in the form of contributions based on a percentage of their salary. Family allowances take the form of child benefits of at least 200 CHF per child and month for children up to the age of 16, and education allowances of at least 250 CHF per child and month for children aged 16 to 25 who are in education. Many cantons grant benefits that are higher than this legal minimum.

Of all the publicly run social insurances, the AHV/AVS spent by far the most: 46 billion CHF in 2017 (including supplementary benefits; BSV 2020). The IV/AI (again including supplementary benefits) accounted for "only" 11, the unemployment insurance for 7 and family allowances for 6 billion CHF. Service and maternity payments came last with less than 2 billion spent in 2017. Interestingly, as fewer and fewer Swiss men end up in the military service, less and less has to be paid out in compensation payments (-11% between 2010 and 2018). In turn, as more and more women are in gainful employment before giving birth, more and more is spent on maternity leave (+25% in the same period).

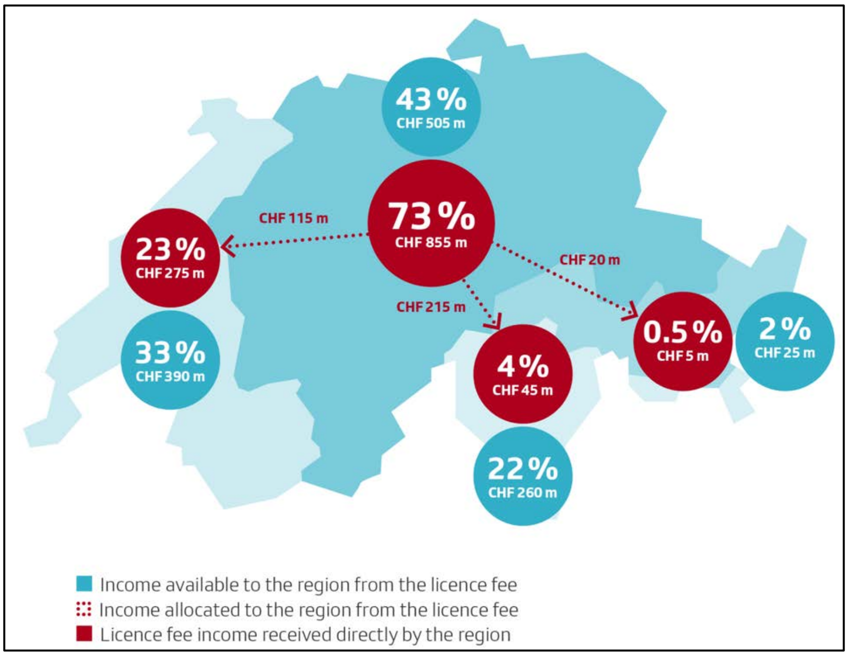
In principle, the social security insurances also contain a fiscal equalization payment. A region with high salaries and few unemployed or retired people will end up contributing to the overall fund, whereas one with the opposite structure will receive. However, none of the social insurance funds provide territorial details on their receipts and payments. Calculating the net equalization effect of social security payments would also have to take individual mobility into account (e.g. a person retiring from a high-income canton into one with lower salaries). Moreover, the actual administration of some of the social security systems is entrusted to private (health insurance) or private and public entities (e.g. regional unemployment offices run by the cantons and but unemployment payments administered by private bodies). Still today, there are some 80 *Ausgleichskassen* which administer AHV/AVS and IV/AI matters on the ground.

On top of – or rather beneath – the mentioned social security insurances, there is social aid. In 2018 some 270’000 persons (ca. 3.2% of the population) received this kind of aid which is paid when no other social insurance is available or when the income does not suffice to cover basic needs. Its total costs of ca. 3 billion CHF are finance entirely by the cantons and communes, who have agreed on standardised tariffs via the SKOS (Schweizerische Konferenz für Sozialhilfe).

1.3.4 Public broadcasting

The final element of fiscal equalization across the entire country is contained within the public broadcasting company SRG-SSR. Figure 6 shows how the company running all of Switzerland’s nationwide public TV and radio channels re-distributes some of its income generated from mandatory licenses. In short, the largest, German-speaking area sends around 40% of “its” income to the French-, Italian- and Romansh-speaking areas or sub-companies. Since 1 January 2019, every household (incl. companies) has to pay for the license, even if they own neither a TV nor radio set.

Figure 6: Fiscal equalisation within the SRG-SSR



Source: https://www.srgssr.ch/en/what-we-do/solidarity/financial-equalisation/

1.4 Other revenue sharing arrangements

Next to a cantonal share in the proceeds from the federal direct tax (which, since 1 January 2020, amounts to 21.2%), fiscal equalization payments (where cantons either contribute or receive), social security payments (which go to individuals) and public broadcasting money (tied to the four language regions and the sub-companies servicing them), the cantons also profit from a number of other revenue sharing arrangements. More specifically, they get

- "A minimum of two thirds of the net profits made by the Swiss National Bank" (Art. 99.4 BV 1999), to be used as they see fit (1.3 billion CHF in 2018);
- 10% of withholding tax on income from moveable capital assets, on lottery winnings and on insurance benefits, again without strings attached (821 million CHF in 2018);
- One third of the net proceeds from the road charges for lorries, to be used for public works in connection to roads (522 million CHF in 2018);
- 10 % of proceeds of the mineral oil tax to be spent on roads (365 million CHF in 2018);
- 20% of the military service exemption tax, unconditioned (34 million CHF in 2018); and
- 10% of the net proceeds of the tax on domestically produced as well as imported spirits, which have to be used combat the causes and effects of addiction problems ("alcohol tenth"; 25 million CHF in 2018).[5]

By comparison, cantons received a total of 3.8 billion CHF from the federal direct tax in 2018, fiscal equalization payments amounted to some 5 billion and all public broadcasting fees to 1.2 billion CHF. Subsidies of all kind amounted to another 10 billion CHF (EFV 2020). All in all, that is taking into account revenue sharing, fiscal equalisation and subsidies, cantonal reliance on federal money ranges from 12% of all cantonal income (Basel-City) to 48% (Uri) (weighted mean: 25%; EFV 2019, 41; see also above, Figure 3).

1.5 Fiscal mechanisms and the distribution of 'substantive' competences

[5] Not included here are the.

1.6 How is control of financial stability exercised on the various levels?

Each level is fully autonomous and responsible for its own fiscal health. There no limits on borrowing that are imposed by another level. However, all cantons and also the federal government have introduced their own “debt breaks”.

1.7 What is the role of the concept of solidarity?

Solidarity is as important as, and possibly even more so than, competition.

1.8 ‘One size fits all’ monetary policy

- Does it exist?
- If so, is it a burden?
- And how does it meet challenges in federations with substantive diversity?

2 Merits and deficiencies of Swiss Fiscal Federalism

Measured against its ‘goals’, what are the merits and deficiencies of Swiss fiscal federalism?

2.1 Impact on equalisation in the federation

2.2 Macro-economic effects on the federation and its entities

2.3 The system’s democratic legitimacy

2.4 Control

2.5 Legitimacy and efficiency of conflict resolution

3 Covid-19 Crisis – testing the resilience of fiscal federalism:

- Did the impact of the pandemic and/or the ensuing/ongoing counter measures reveal any new deficiencies of the <Name of the Federation> Fiscal Federalism or exacerbate already known ones?
- Which characteristics of the fiscal federal system proved valuable/advantageous?
- Did the distribution of competences for health care and economic policy (support and stimulation of the economy) cause difficulties? If so, how were they addressed?
- Were there adjustments to the institutional set-up or to the institutional practice and if so, what are they aimed at?
- Did financial solidarity within the system increase or is (if existent) the gap between constituent units widening due to the crisis?
- Emergency situations, rule of law, and the role of Courts – which problems are, if any, emerging?

4 Dos and Don'ts: What Can the EU Possibly Learn from Swiss Fiscal Federalism?

4.1 *Deficiencies – negative examples*

- No Justiciability of core federal issues
- Large majority (though not necessarily a consensus) needed to advance, which means it takes time and trial and error
- State aid (e.g. cantonal banks) largely hidden beneath, in an insparnet manner?
- No full *Kostenwahrheit*, unfair distribution of costs (e.g. highway tolls, mandatory TV & radio license)

4.2 *Achievements – positive examples*

- A negotiated, popularly legitimated system
- Different pots for different, specific things: fiscal equalisation just one of many elements in the system, others are fiscal autonomy, social security based on individual/insurance principle, separate broadcasting authority,?

- Both vertical & horizontal fiscal equalisation
    - …where a large majority are net recipients…
    - …and almost everybody gross recipients
- Pareto efficiency: everybody needs to believe they win at least something (comment by Frank Schimmelfennig)
- Balance between technical rigidity/complexity (formula!) and political flexibility/simplicity (transparency and politicisation)

5 Conclusions

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