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Swiss Confederation

Federal Department of Finance FDF
Federal Finance Administration FFA

Cohesion challenges in federal countries: Financial arrangements in Switzerland

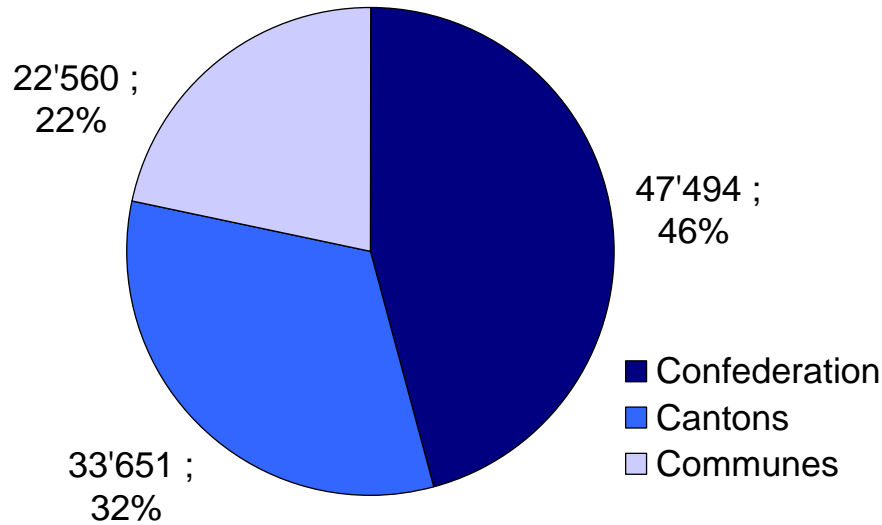
OECD Global Forum on Governance
Rio de Janeiro, 22-23 October 23

Roland Fischer

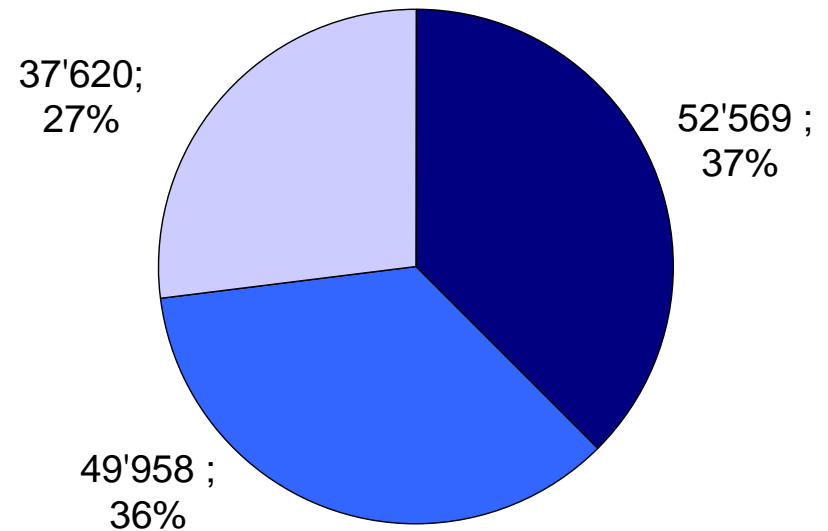


Taxing and spending powers of Confederation, Cantons and Communes

Tax revenues 2005 (in millions of CHF)

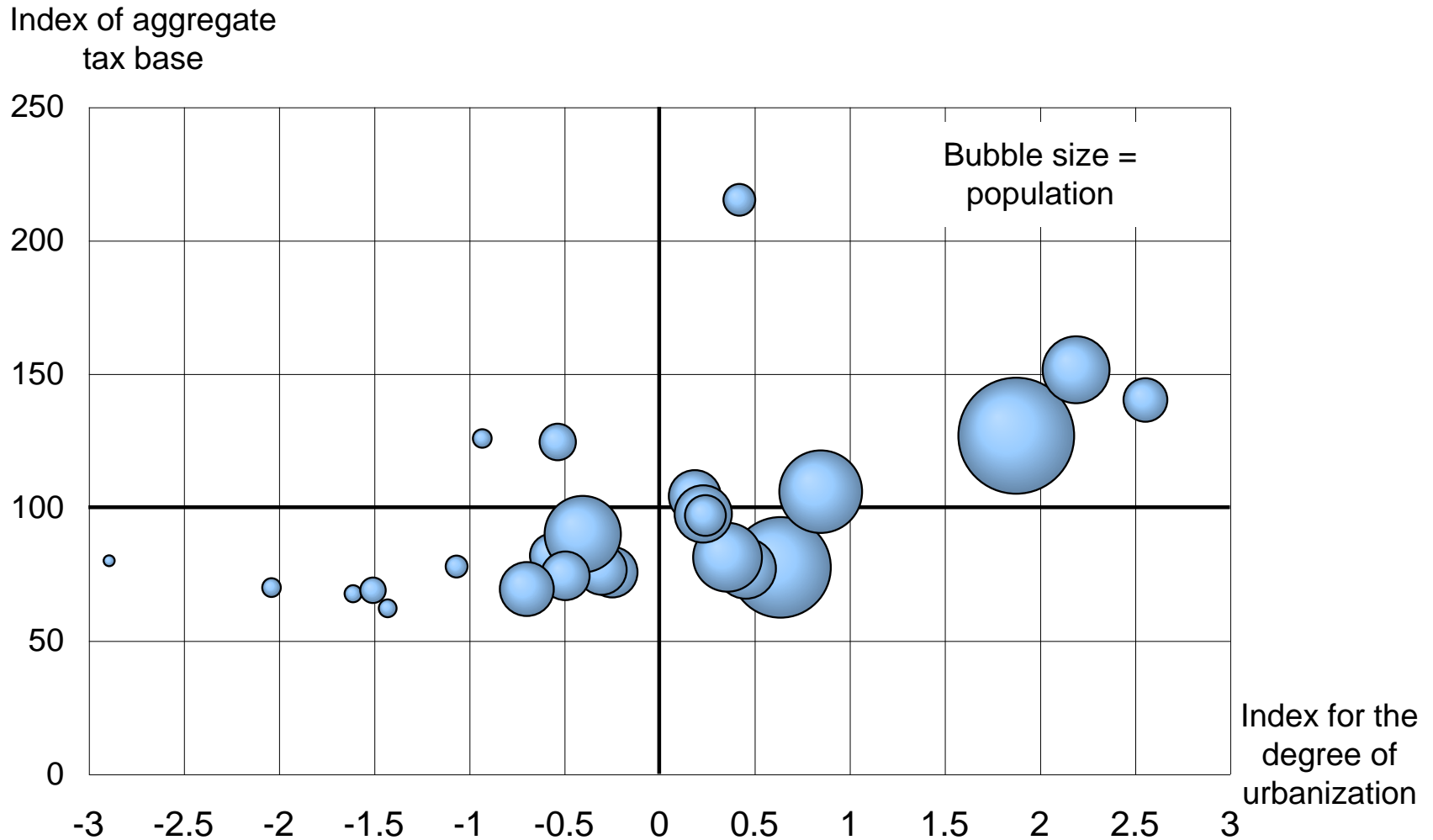


Gov. spending 2005 (in millions of CHF)





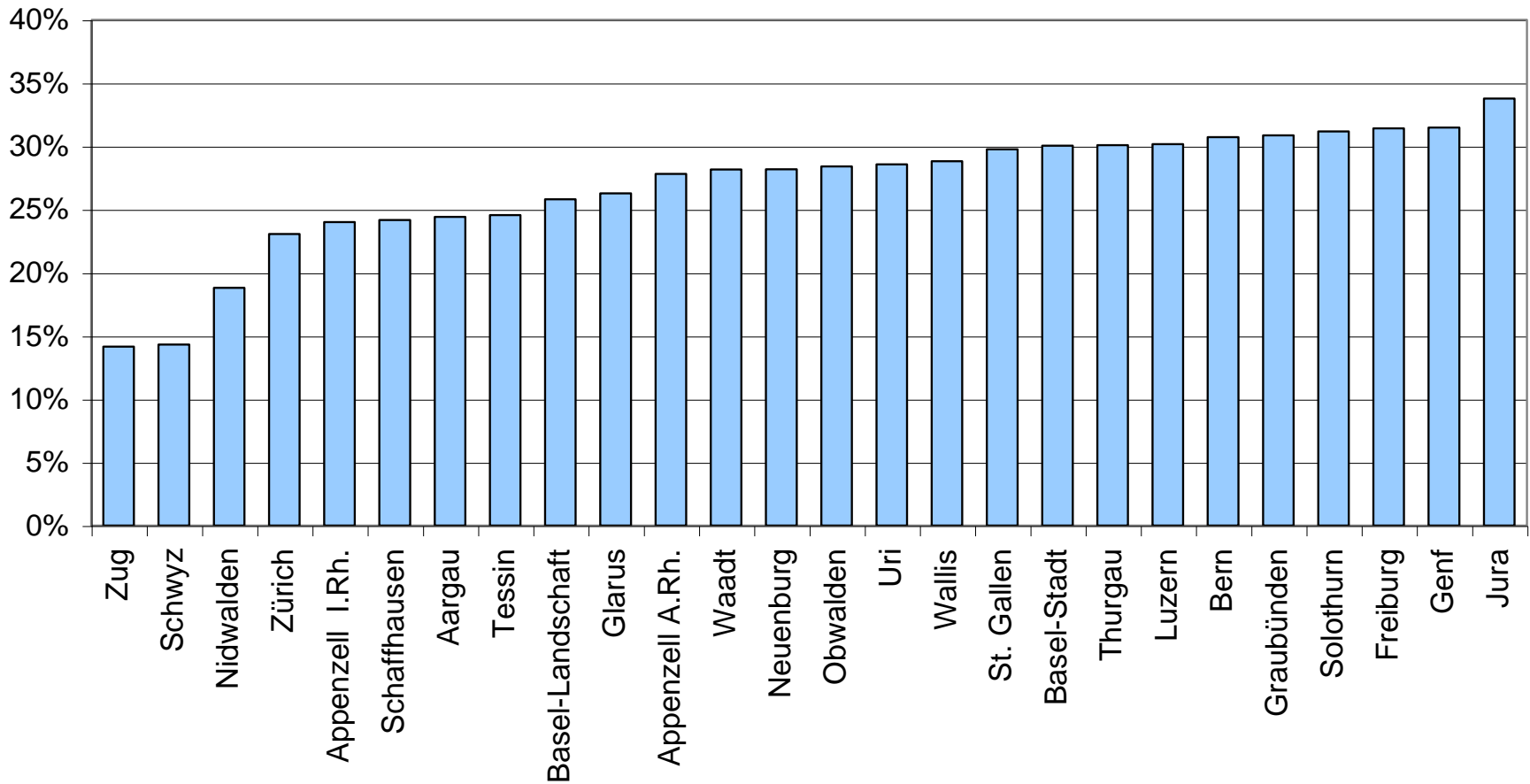
Large economic and structural disparities =>





=> large fiscal disparities

Tax burden of cantons and communes (= tax revenues in percent of aggregate tax base)





The old financial equalization system

- Earmarked grants and tax sharing, based on the index of financial capacity:

Average cantonal income (net social product) ***factor 1.5***

Tax capacity (= tax revenues / index of average tax rate) ***factor 1.5***

Index of average tax rates ***factor 1***

Share of mountainous regions relative to total area ***factor 1***

⇒ *wrong incentives due to index and dominance of earmarked grants*

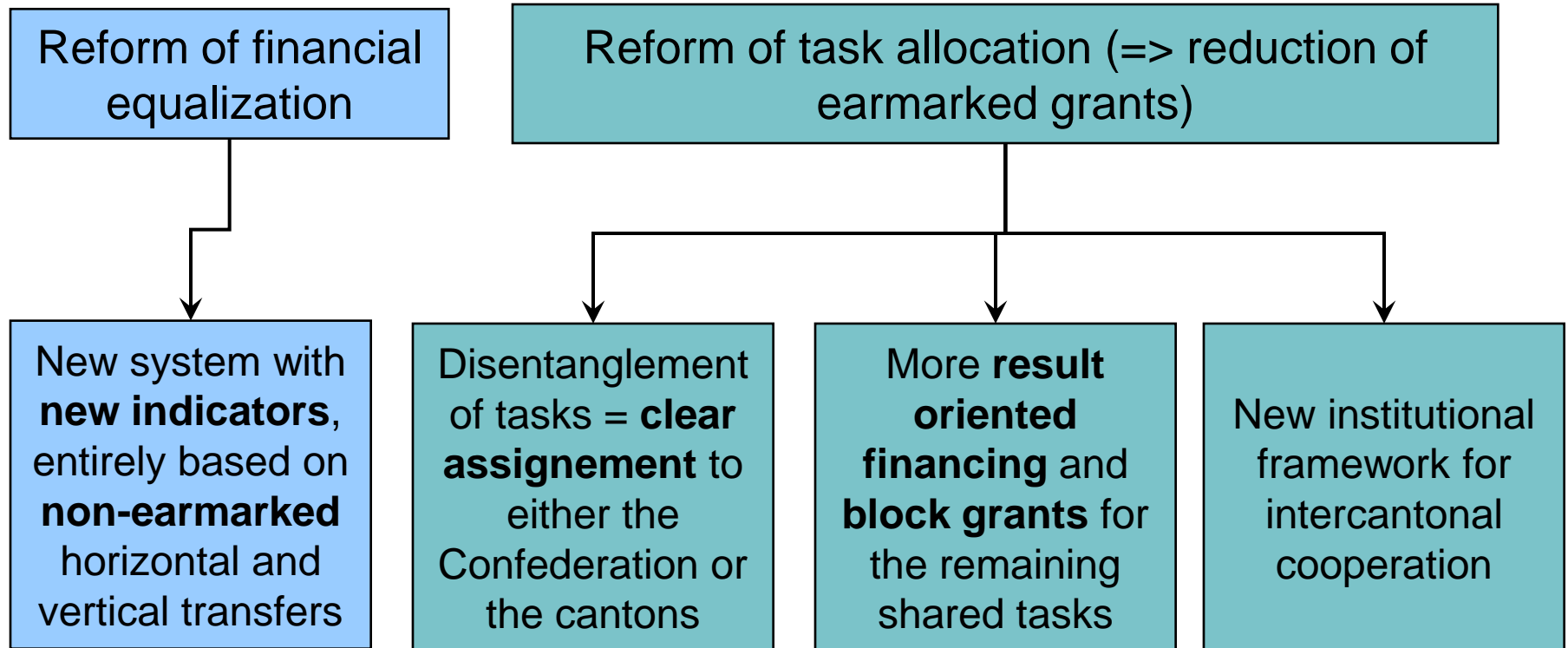
⇒ increase in tax rates → decrease in financial capacity → increase in federal (earmarked) grants → increase in spending

⇒ „poor“ cantons do not have incentives to increase their tax base by lowering the tax burden

⇒ *no reduction of disparities between cantons!*



Reform of financial equalization and task allocation between the confederation and the cantons (NFA)





Difficulties and their solutions (I)

Problem: different interests within the public sector:

- Confederation vs. cantons
- departments of finance vs. other departments
- rich cantons vs. poor cantons
- urban cantons vs. rural cantons
- french speaking cantons vs. german speaking cantons

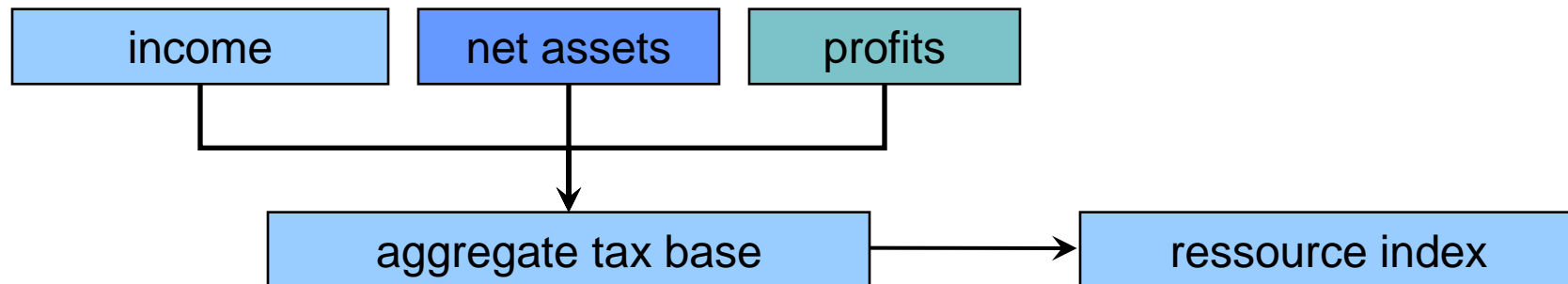
Solutions:

- Joint project organisation of Confederation and cantons, composed of politicians (steering committee) and specialists (technical working groups) from different regions and levels of government
- New fiscal equalization system composed of both revenue equalization and cost compensation

The new fiscal equalization system

⇒ *entirely based on non-earmarked grants*

1. *Vertical and horizontal resource equalization*



2. *Geographic-topographic cost compensation (only vertical)*

Structural indicators based on density, elevation and topographic location of settlements

3. *Sozio-demographic cost compensation (only vertical)*

Structural indicators based on the share of the poor, the old and immigrants of total population as well as on the degree of urbanization



Difficulties and their solutions (II)

Problem: the financial winner – loser matrix (initial values 2001/02)

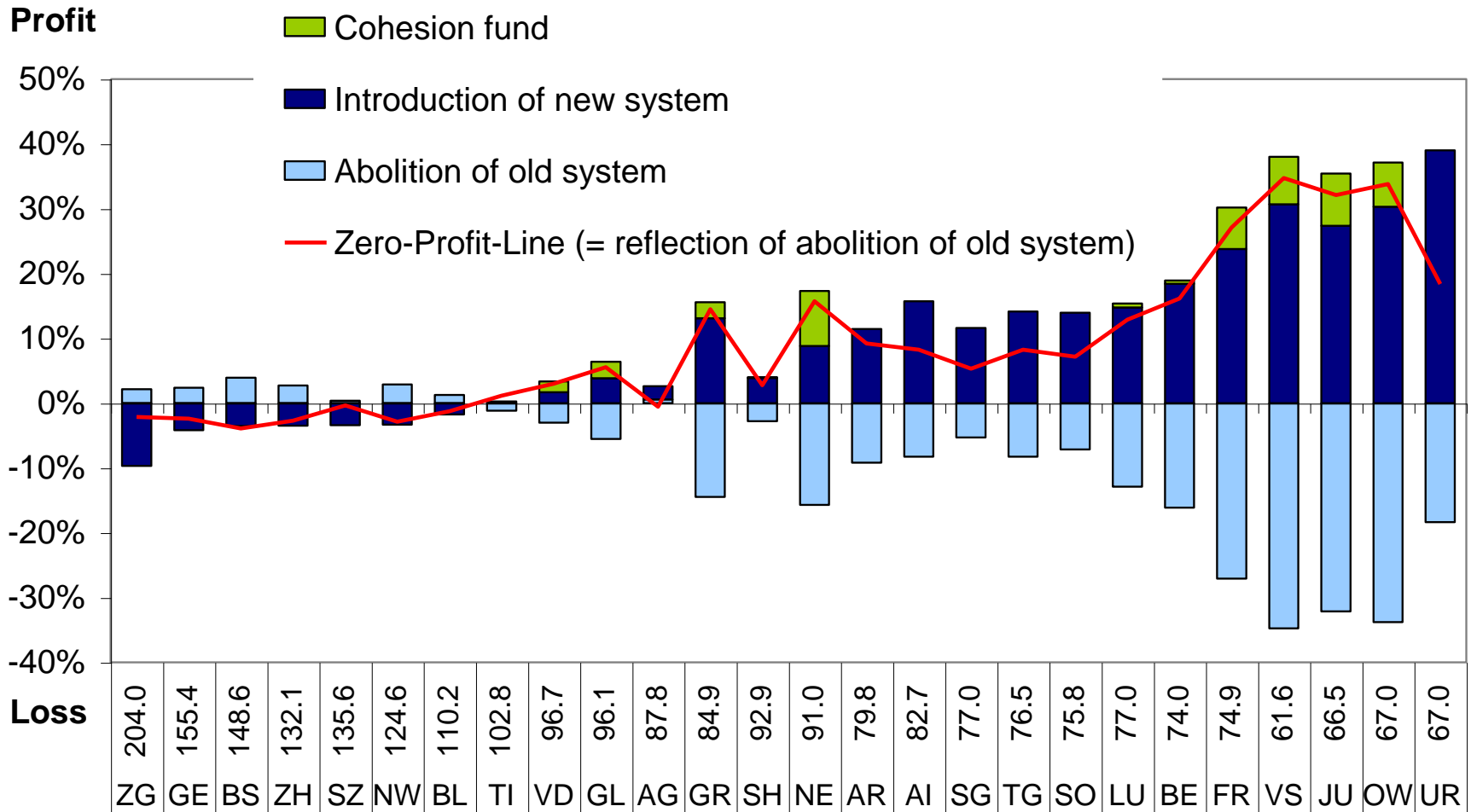
	net profit from reform	net loss from reform
rich cantons	BS	ZH, SZ, NW, ZG, BL, GE
poor cantons	BE, LU, UR, SO, SH, AI, SG, GR, AG, TI, TG, VS	OW, FR, NE, JU, VD, GL, AR

Solution:

- For poor cantons: temporary cohesion fund: no poor canton shall be a net loser in the first years of transformation to the new system
- For rich cantons: substantial reduction of earmarked grants => increase in spending power



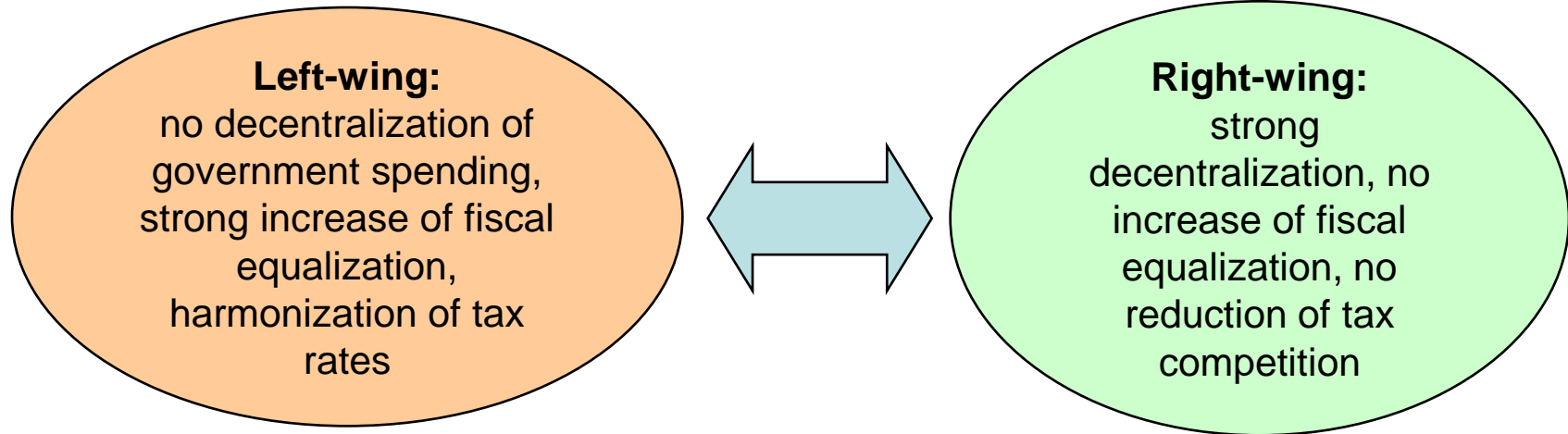
Net financial effect on cantons with cohesion fund (in percent of standardized tax revenues)





Difficulties and their solutions (III)

Problem: political camps had different expectations of the reform:



Solutions:

- Budget neutrality of the reform => no reduction of total government spending => decentralization is compensated by an increase in fiscal equalization
- High legitimacy of the reform because of a strong majority in the mandatory plebiscite on the necessary constitutional changes => in 23 of 26 cantons, a majority of voters approved the reform!



Results of the popular vote on constitutional changes in the cantons

