



National fiscal equalization

Strengthening federalism



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1 National fiscal equalization – strengthening federalism

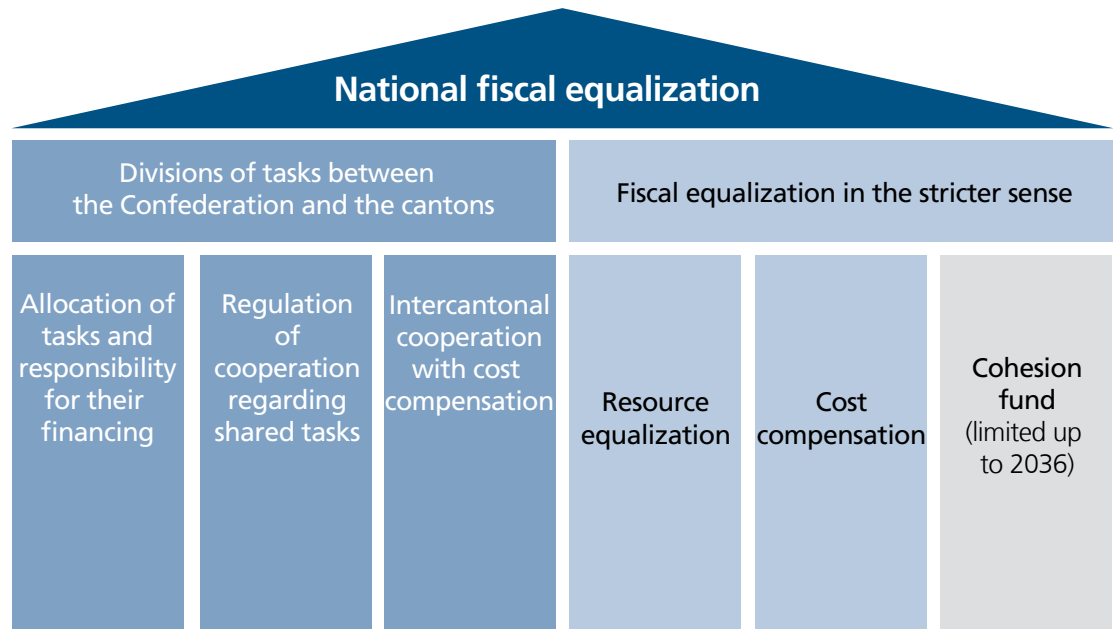
National fiscal equalization governs the financial relationships between the Confederation and the cantons. It encompasses the allocation of public tasks on the one hand, and the redistribution of public funds between the Confederation and the cantons on the other. National fiscal equalization pursues two primary aims: to reduce cantonal differences in financial capacity and to increase the government's efficiency in the performance of its tasks. The current fiscal equalization system has

been in force since 2008. It was developed jointly by the Confederation and the cantons over a period of several years and approved by the people and the cantons on 28 November 2004 by a clear majority of 64.4 percent (see Box 1).

In the brief period since the introduction of national fiscal equalization, the cantons' differences with respect to financial capacity have been reduced, their financial autonomy strengthened and their tax competitiveness maintained.



2 The main pillars of national fiscal equalization



The principles of national fiscal equalization are anchored in the Federal Constitution and further specified in numerous legislative provisions. The Federal Act of 3 October 2003 on Fiscal Equalization

and Cost Compensation (FECCA) and the Ordinance of 7 November 2007 on Fiscal Equalisation and Cost Compensation (FECCO) constitute the specific statutory bases of fiscal equalization.

Box 1

Why was a new system of fiscal equalization necessary?

Federalism is one of the fundamental principles of the Swiss Constitution and can be considered especially pronounced in two respects. Firstly, Switzerland's geographical structure is highly ramified and encompasses 26 cantons and some 2,500 communes. Secondly, these cantons and communes enjoy extensive powers with respect to financial and tax autonomy, for example.

Switzerland passed its first law on fiscal equalization in 1959, forming the foundation for transfers to the cantons on the basis of their financial strength. As a consequence, nearly all federal subsidy rates were linked in some way to the financial strength of the cantons. This created disincentives and led to an opaque system of transfers between the Confedera-

tion, the cantons, and social security funds over the years. The equalization effect of the system was unclear and difficult to manage from a political standpoint.

The new system of fiscal equalization was one of Switzerland's most important reform projects in terms of content and timing. It encompassed both the division of tasks between the Confederation and the cantons as well as among the cantons themselves, and fiscal equalization in the stricter sense. The broad-based work on the project regarding the new system of fiscal equalization and the division of tasks between the Confederation and the cantons (NFE) began in 1995 and ended in 2008, when the reform package entered into force.

2.1 What is the “division of tasks between the Confederation and the cantons”?

The Confederation’s responsibilities are governed by the Federal Constitution. Tasks are divided between the Confederation and the cantons according to the principles of **subsidiarity and equivalence**, both of which are anchored in the Constitution. Under the principle of subsidiarity, a higher regional authority in a federal state should assume a task only if it is demonstrably able to do so more effectively than a lower government level, i.e. at lower cost and/or higher quality level. In the context of government tasks, the principle of fiscal equivalence specifies that those reaping the benefits must be consistent with those making the decisions and paying the costs. These two principles were binding for the new division of tasks between the Confederation and the cantons as part of the reform package (see Box 2).

The number of tasks performed jointly by the Confederation and the cantons, so-called **shared tasks**, saw a substantial decline: seven formerly shared tasks were transferred in full to the Confederation and ten to the cantons. Of the remaining 17 shared tasks, new instruments of cooperation were introduced. The Confederation sets strategic targets under programme agreements to enforce uniform standards for task performance, for example, and allows the cantons scope for implementing these targets in a way that ensures proximity to citizens. For some tasks, ultimately, intercantonal cooperation may make sense even when federal involvement may not. Under the legal framework for intercantonal cooperation with cost compensation, the particular aim with respect to task performance is to make better use of economies of scale and reduce unwanted geographical spillover effects. The Confederation’s role in this regard is solely that of an arbitrator.

Box 2

The new system of division of tasks

Allocation of tasks and responsibility for their financing	Regulation of cooperation regarding shared tasks	Intercantonal cooperation with cost compensation
<ul style="list-style-type: none"> • Tasks assigned solely to the Confederation: e.g. motorways or national defence. • Tasks assigned solely to cantons: e.g. homes for the handicapped, primary and special schools, and scholarships up to secondary school level. • Shared tasks: e.g. health insurance premium reductions, regional transportation, main roads, flood protection, nature conservation and landscape protection. • Intercantonal tasks: e.g. cantonal universities, metropolitan transportation, waste management and waste water treatment. 	<p>Programme agreements: multi-annual programmes with target agreements and lump-sum and flat-rate contributions. The Confederation is responsible for strategic management, whereas the cantons assume operative responsibility. Increased monitoring ensures that tasks are performed in line with objectives.</p> <p>Programme agreements were concluded with the cantons in the environment sector, in regional policy and concerning cadastral surveys, for example.</p>	<p>Increased institutionalization on the basis of the intercantonal framework agreement. Cantons conclude contracts on mutual procurement or joint production of public services. The Confederation assumes the role of an arbitrator: at the request of concerned cantons, it can, under certain circumstances, oblige the cantons to cooperate with cost compensation in nine task areas. This is unique in OECD countries.</p> <p>Examples of intercantonal contracts can be found in the university sector and that of metropolitan transportation.</p>

2.2 How does fiscal equalization in the stricter sense work?

The fiscal equalization system has been completely redesigned with the NFE project. The equalization effect has been improved and wrong incentives have been eliminated. The focus in doing so was to replace the earmarked financial strength supplements with non-earmarked resource equalization and cost compensation contributions. The cantons can decide themselves as to whether they use their financial resources for debt reduction, tax reduction or for the financing of their tasks. The independence and self-reliance of the cantons is thereby strengthened and their deployment of resources is better adjusted to the needs of the regional population. Under the old system, the financially weak cantons that have a relatively high tax burden received somewhat higher equalization payments than comparable cantons with a low tax burden. In order

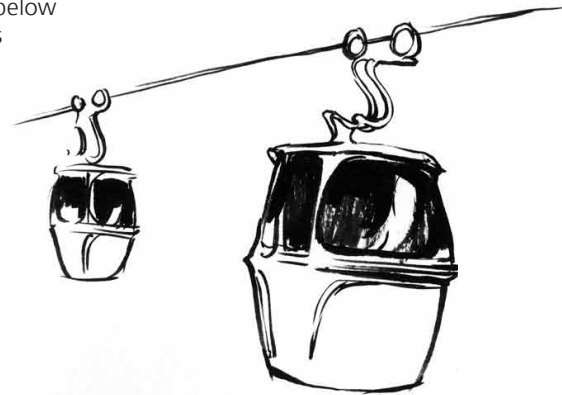
to counter these wrong incentives, the tax burden index has been eliminated as a criterion. The resource potential thus covers only the utilisable fiscal capacity of a canton without taking account of the effective tax burdens.

Fiscal equalization in the stricter sense covers three equalization mechanisms. The total volume of all three equalization mechanisms amounts to CHF 4,676 million for the 2012 reference year. Approximately two-thirds of the financing is provided by the Confederation (2012: CHF 3,102 mn) and one third by the cantons (CHF 1,575 mn); fiscal equalization in the stricter sense is thus not just a vertical equalization (i.e. redistribution from the Confederation to the cantons) but a horizontal equalization as well (i.e. redistribution among the cantons).

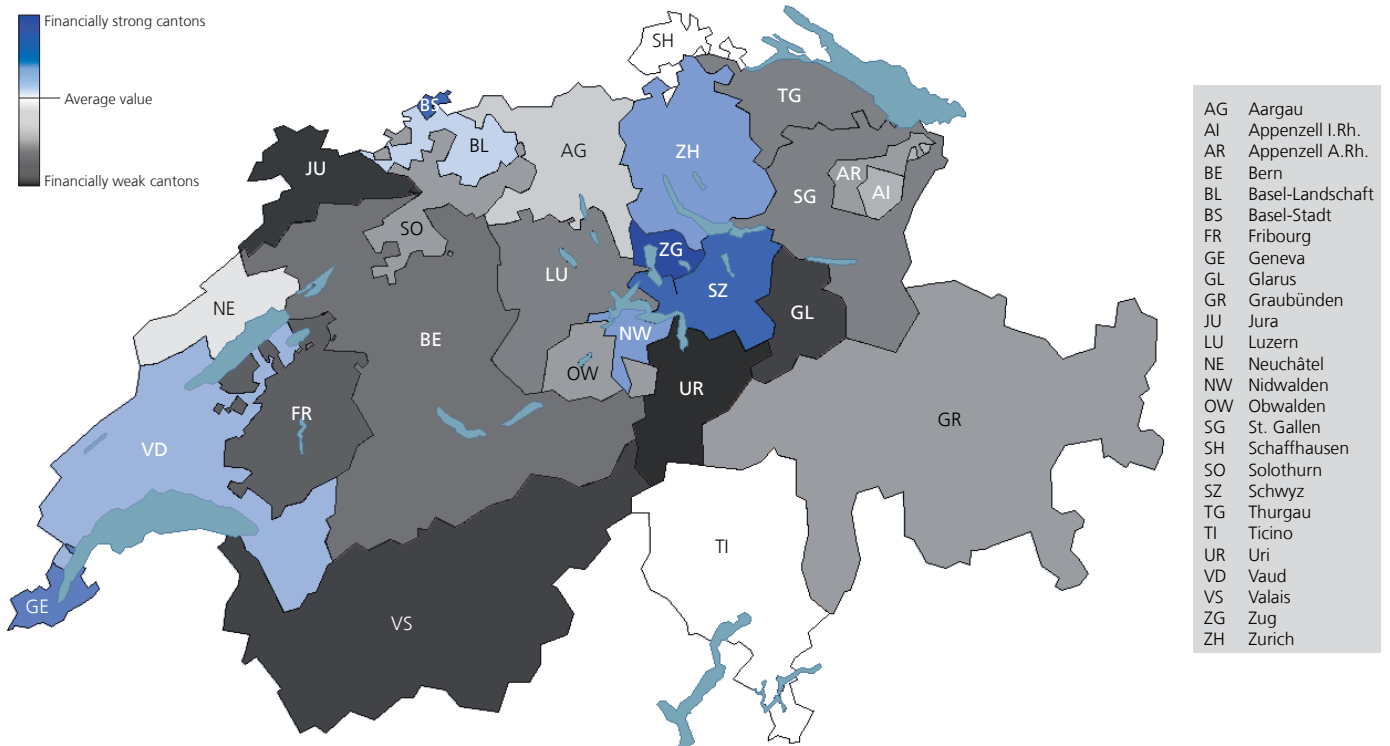
2.2.1 Resource equalization: redistribution of financial resources

Resource equalization is based on the so-called resource potential of the cantons. This takes into account the taxable value creation in a canton and thereby reflects the economic influence of a canton. It is made up of the taxable income and assets of natural persons and the taxable profits of legal entities. If the resource potential per capita is compared to the corresponding Swiss average, the result is the **resource index**. Cantons with a resource index of over 100 are considered to be financially strong and contribute to resource equalization in line with their resources and population. Cantons with a resource index below 100 points are financially weak and are thus recipient cantons.

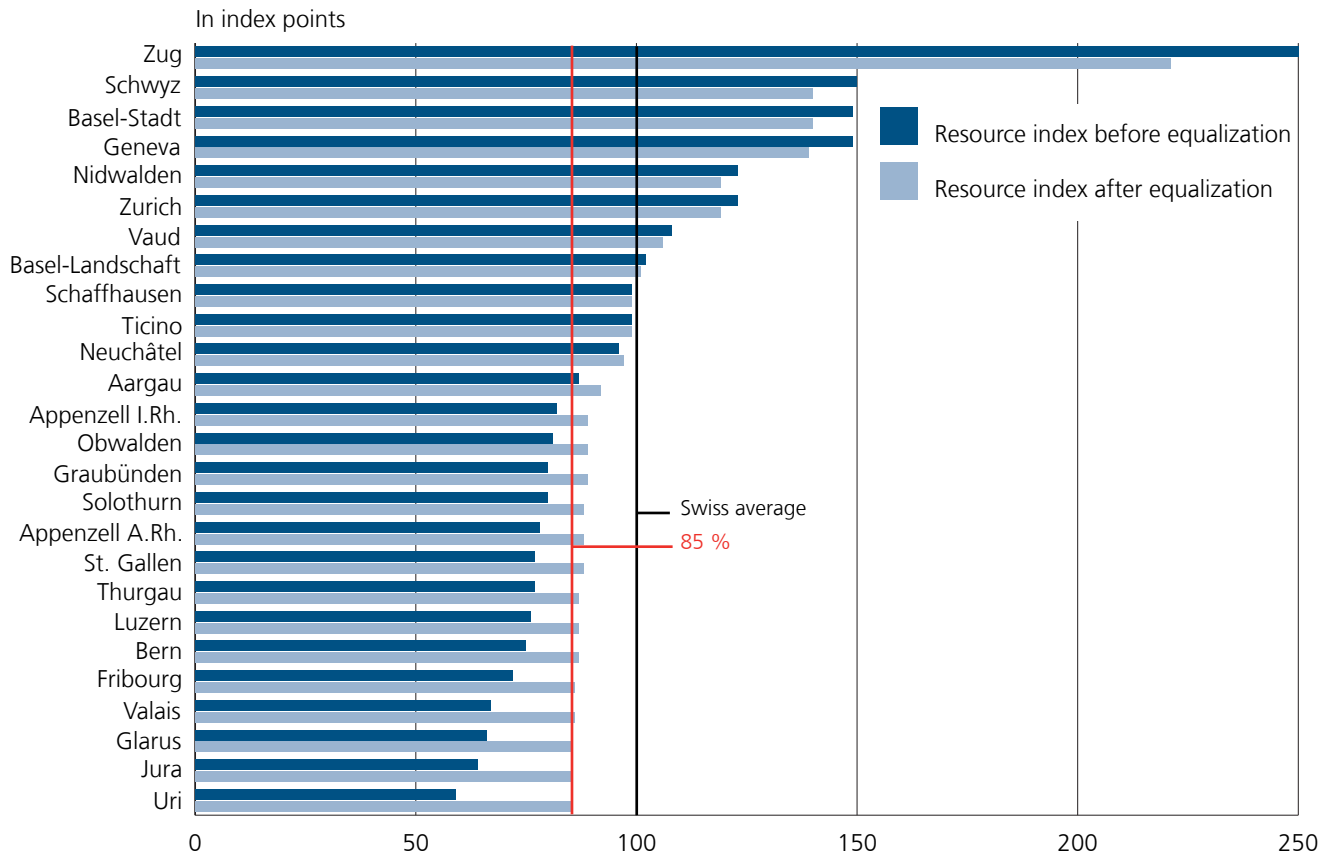
Resource equalization is financed jointly by the Confederation (vertical resource equalization) and by the financially strong cantons (horizontal resource equalization). It is anchored in the Federal Constitution that horizontal resource equalization should amount to at least two-thirds but at the most four-fifths of vertical resource equalization. The equalization payments to the financially weak cantons are calculated in such a way that the weakest cantons receive disproportionately more assistance. The aim is for all cantons to have a resource index of **at least 85 index points**.



2012 resource index



Equalization effect in resource equalization, 2012 resource index before and after equalization

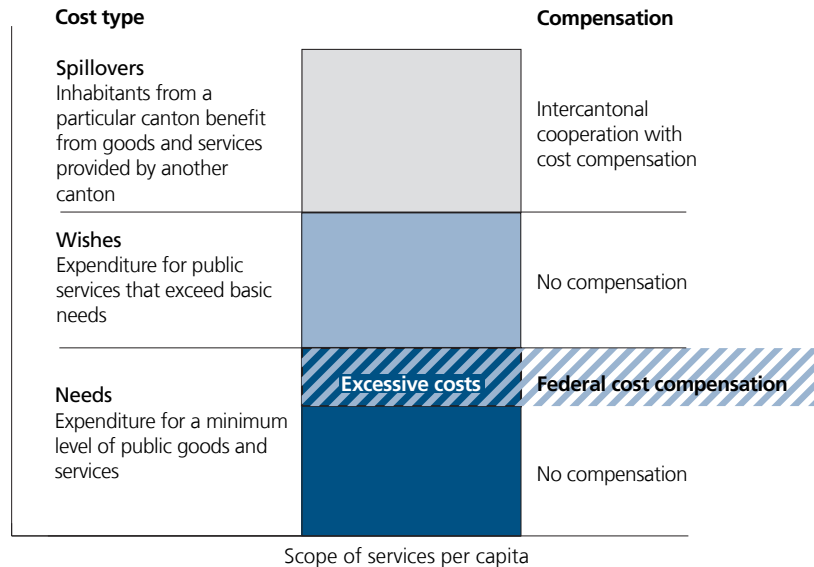


2.2.2 Cost compensation: contribution for excessive costs

Cost compensation eases the burden for **Alpine and centrally situated cantons**, which, for structural reasons, face higher costs for the provision of public goods and services. The Alpine cantons have higher costs for infrastructure, winter road maintenance and schools (e.g. school buses), for instance. The centrally situated cantons frequently have an above-average proportion of elderly, poor

and foreign residents. This leads to greater demand for public services. These groups give rise to higher social expenditure and generate less in terms of tax receipts. The excessive costs mentioned are generally not to be equated with above-average costs. For example, higher healthcare expenditure could reflect both excessive costs as well as different cantonal preferences (needs vs. wishes).

Classification of excessive costs



Contributions for excessive costs are made via geographical/topographic cost compensation (GCC) on the one hand, and socio-demographic

cost compensation (SCC) on the other. The calculation of excessive costs is based on clearly defined and measurable indicators.

Cost compensation indicators

GCC	SCC
<ul style="list-style-type: none">• Average altitude• Terrain steepness• Settlement structure• Low population density	<ul style="list-style-type: none">• Poverty• Age• Immigrant integration• Core city indicator

Cost compensation is entirely financed by the Confederation. Half of the endowment is allocated to SCC and the other half to GCC.

2.2.3 Cohesion fund: temporary contribution for transition period

The cohesion fund cushions the repercussions of the introduction of the new system during a transition period, and prevents financially weak cantons from being worse off because of the switchover. The cohesion fund amounts to a total of CHF 366 million. The Confederation finances two-thirds of this, with the rest coming from the cantons based on the number of inhabitants. It will remain constant until 2015, subsequently decline by 5% of the starting amount every year, and end in 2036.

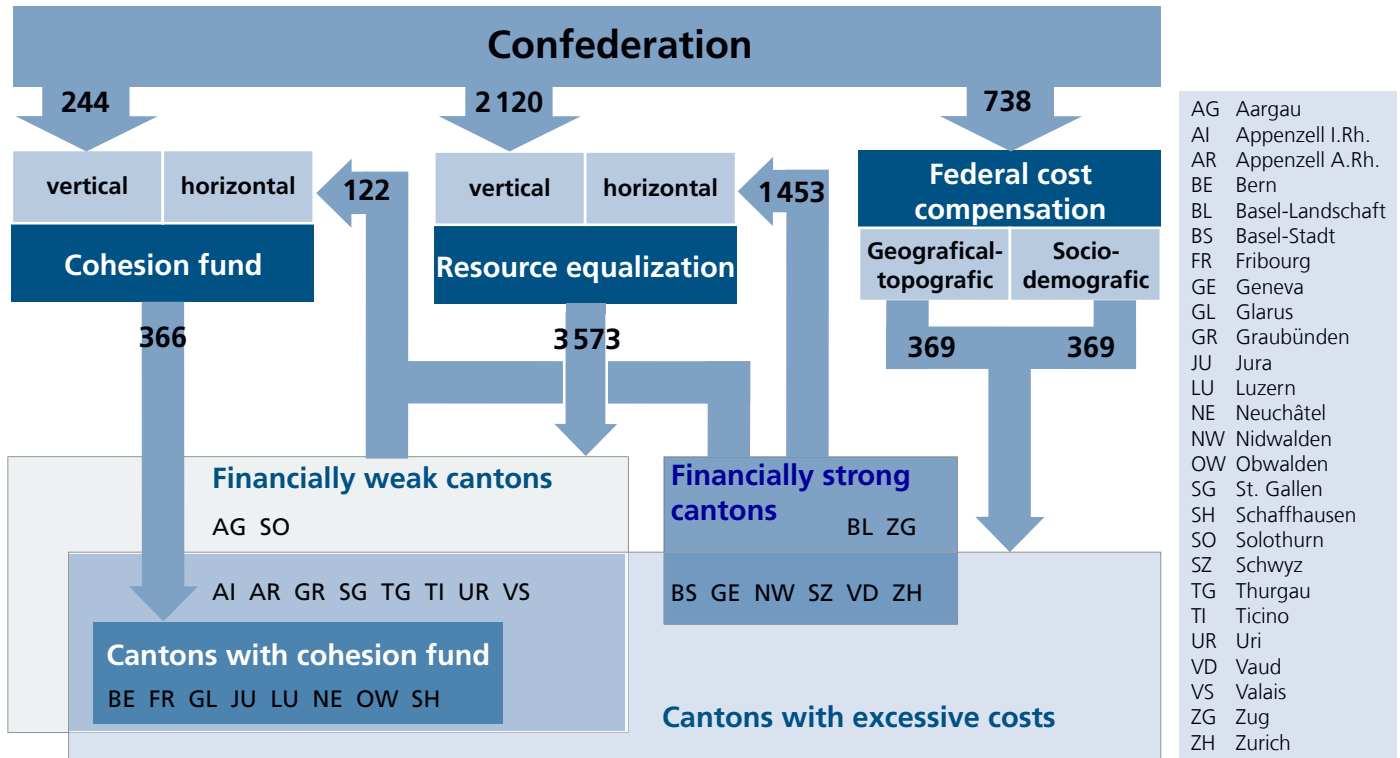


2.3 Financial flows with the three equalization mechanisms

Every four years, taking into account the results of the efficacy report, parliament defines the amount of the federal and cantonal contributions in the first year of a four-year period. This arrangement ensures the political control of the fiscal equalization system. The Federal Council adjusts the payment amounts in each of the three subsequent years. In this regard, the extrapolation for resource equalization is based on the resource potential trend, while that for cost compensation is based on inflation.

Financial flows using the 2012 reference year as an example

in CHF mn



3 Effect in the first few years

The Federal Council submits a report on the implementation and effectiveness of the new system to the Federal Assembly every four years. The report analyses the achievement of objectives during the period just ended, and outlines possible measures for the period ahead. The first **efficacy report** covered the period from 2008 to 2011. The observation period was thus very short, which meant that a comprehensive analysis of the achievement of the objectives of fiscal equalization was only partly possible. The most important findings of the first efficacy report were as follows:

- *Strengthening of cantonal financial autonomy:* the share of ear-marked transfers between the Confederation and the cantons was reduced significantly with the changeover to the new fiscal equalization system, while the share of non-earmarked transfers was increased. Consequently, the cantons currently have considerably more freely disposable funds than prior to 2008.
- *Reduction in differences regarding financial resources:* resource equalization reduces the disparities between financially strong and financially weak cantons.
- *Maintenance of tax competitiveness:* the tax competitiveness of Switzerland and the cantons remains high not just in terms of corporate taxes but also in terms of income taxes. The financially strong cantons were able to further reduce or at least maintain their tax burden in spite of the financial burden resulting by the new fiscal equalization system. The objective of maintaining tax rates that are competitive both within Switzerland and internationally was achieved.
- *Assurance of a minimum level of financial resources:* since the introduction in 2008, the objective of a minimum capital level per capita of 85 % of the Swiss average, taking the cohesion fund into account, was largely achieved.
- *Equalization of excessive geographical/topographic and socio-demographic costs:* with the Confederation's cost compensation, on average 12 % of the excessive costs are compensated, whereby the coverage ratio for geographical/topographic cost compensation (GCC) is higher than for socio-demographic cost compensation (SCC). As the relationships have not changed fundamentally compared with the introduction of the new system, the 50-50 distribution has been maintained for the new four-year period from 2012 to 2015.

- *Guarantee of appropriate intercantonal cost compensation:* as statistical data is still lacking, it is not possible to make quantitative statements on intercantonal cost compensation at the moment. However, qualitative evaluations show that the strengthening of intercantonal cooperation sought with cost compensation is taking place.

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