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# Fiscal Equalization in Switzerland – Implementation Issues in the New System

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# Overview

- New Financial Equalization System came into effect on 1.1.2008. Experience still limited.
- No fundamental criticisms. Not surprising, given the long preparation period and intensive involvement of cantons.
- Strong legitimacy following constitutional referendum (64% of population and 23 cantons were in favor).
- Presentation will focus on four main implementation issues and the evaluation process.



# Implementation Issues

- New equalization system has four instruments:
  1. Disentanglement of tasks
  2. New forms of cooperation between Confederation and cantons
  3. Strengthening the inter-cantonal cooperation
  4. Compensation payments to and between cantons
- Issues:
  - Budget neutrality in the initial year (→ 1)
  - Use of program agreements for joint tasks (→ 2)
  - Data errors in calculation of resource potential (→ 4)
  - Size of geographical social/demographic compensation funds (→ 4)



# Cost Neutrality

- Fundamental parameter for reform: transition from the old into the new system should create no additional costs for confederation or cantons
- Balance sheet of losses and gains stemming from the new system provided basis for initial funding level of the 3 federal funds (resource leveling, geographical costs, socio-demographic costs)
- Recalculation with definitive data for 2008 showed balance in favor of confederation → 100 million CHF (Total amount 2.5 bn)
- Cantons are requesting compensation when determining new funding levels for the next four-period (2012-15)



# Program Agreements

- Program agreement is the new instrument to increase efficiency in those tasks with shared responsibilities. Goals:
  - Clear distinction of responsibilities (strategy vs. implementation)
  - Subsidies based on performance goals instead of costs
  - Multi-year programs with lump-sum payments instead individual project financing
  - Partnership instead of top-down decisions
  
- First review by Federal Audit shows mixed results:
  - Performance based schemes requires change in thinking for both sides. Agencies are moving at different speeds
  - Program agreements have to be tailored to specific tasks
  - Difficulties in defining resource envelopes and output goals



# Data Errors in Calculation of Resource Potential

- Calculation of resource (tax) potential requires extensive data from cantons. Aggregate tax base is based on income, wealth and corporate profits.
- During the 4-year period, funding for resource leveling adjusted annually based on updated figures. Significant error discovered in previous data in one canton.
- Current debate: retroactive correction necessary/sensible?
- Problem was not recognized when formulating the new law.



# Size of Cost Compensation Funds for Special Burdens

- Basic idea of compensation funds → compensate for costs stemming from specific structural burdens
- Two elements: Geographic and socio-demographic cost compensation. Latter element didn't exist in old system.
- Detailed calculations provided basis for assessing costs. According to results resource allocation should be about 2/3 for socio-demographic and 1/3 for geographic burdens.
- 17 cantons benefit from geographic and 8 from socio-demographic cost compensation.
- Result of political agreement was a 50:50 solution



# Evaluation Process

- Resource envelope for equalization funds are determined every four years.
- Evaluation required for new allocation by parliament. Main goals: implementation of the four instruments, assessing achievement of the stated goals, proposal for new resource level
- First evaluation ready in April 2010. Following the consultation process, bill goes to parliament end-2010. Decision by mid-2011.
- Changes in law can be challenged by referendum.





# Cornerstones for Successful Reforms

- Reforms should be developed in an institutional setup that ensures equal treatment of demands by rich and poor states.
- Disentanglement of tasks and reform of financial equalization should be presented as a “package deal”.
- Equalization of resources and of structural burdens should be tackled at the same time.
- Starting point should be a detailed balance sheet of expected changes in financial burdens of central and sub-central levels. Transition to new system should be cost-neutral.