



Answers to OECD Questionnaire: Fiscal rules for cantons and communes

Kurt Stalder, lic. oec., Direktor am IFF

Sigrid Röhrs, M.A., wissenschaftliche Assistentin am IFF

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1. Introduction

The Swiss public debt has increased substantially in the last decades as we can see in Figure 1 and Figure 2. As we see in Figure 1 the greatest part of the public debt in Switzerland is the debt of the confederation. It is also interesting to note that the debt of the communes is constant in the last years whereas the debt of the cantons and of the confederation is still growing.

2. Fiscal Rules in General

In general there are two possibilities to set fiscal rules:

- *formal rules*: concerning the organization of the accounting and budgeting process
- *material rules*: concerning the decision how much to spend and for which project

2.1. Fiscal Rules in Switzerland

- **What *fiscal rules* are considered necessary in Switzerland?**
- **For example, arguments for fiscal rules can rest on *subcentral governments* having an inherent tendency to spend and tax inefficiently, irresponsibly (expecting to be bailed out), and without regard to the future (politically induced myopia), or a mixture of these factors. How would you assess the *relative importance* of these (and any other) types of considerations for Canton and communes in Switzerland?**
- **Does the importance of these considerations *vary* when you consider the communes rather than cantons?**
- **How *different* are the fiscal rules in use across cantons and communes?**

2.1.1. Fiscal Rules of the Confederation:

Because of large deficits in the 1990's the confederation changed the constitution on 22th of June 2001 to implement a debt brake mechanism (changements in Art. 126 BV and Art. 159 BV)¹. This debt brake functions in a simple way: over one business cycle the confederation cannot spend more than it earns (from taxes). This debt brake only applies to the confederation not to the cantons.

¹ BBl 2000 4653

Every new expenditure decision has to be checked regarding its compatibility with the debt brake rule. Furthermore the confederation will revise the federal law about the fiscal budget soon². This revision aims at harmonizing and modernizing the accounting standards of the federal institutions in order to operationalise the debt brake rule everywhere and to achieve a greater transparency of the public finances.

2.1.2. Fiscal Rules of the Cantons

In the cantons many different fiscal rules exist. As the cantons are autonomous in all the spheres of competences where the confederation is not authorized by the constitution (Art. 3 BV) they set their fiscal rules themselves (and are not supervised by the confederation). However the question is complicated by the fact that for a number of areas where the federal government is allowed to set standards a compensation is paid for the higher burden imposed on the sub-national entities³. In such cases a mixing up of competences occurs which makes the system somewhat intransparent (more about the share of competences in chapter 2.2).

The Conference of Cantonal Ministers of Finance has published a Handbook about a Harmonized Accounting Model for the cantons. Although the book is only a recommendation many cantons have already adopted the accounting model called "Harmonisiertes Rechnungsmodell" (HRM)⁴. In addition to those standards some of the cantons have defined debt brake mechanisms⁵.

Appendix A presents an overview of the debt brakes in the cantons. The rules vary substantially across the cantons. The cantons of Fribourg, Nidwalden, St.Gallen, Solothurn and Zürich implemented a very strict budget discipline with the aim of balancing the account of payments and a sanctioning mechanism which prevents a sustained indebtedness. The cantons of Aargau, Bern, Graubünden, Luzern and Wallis know somewhat milder rules where a higher debt in recessions is permitted. The cantons of Appenzell Ausserrhoden, Basel Stadt and Ticino have only weak rules whereas the cantons of Neuchâtel, Schwyz, Appenzell Innerrhoden, Basel Land, Geneva, Glarus, Obwalden, Schaffhausen, Thurgau, Uri, Vaud, Zug and Jura have no budget rules at all.

2.1.3. Fiscal Rules of the Communes

The cantons can also set fiscal rules to control the communes. Mostly the cantons have set formal rules to regulate the municipal finances. The degree of control varies substantially from canton to canton. The Conference of the cantonal centres for the control of communal finances has

² Botschaft, 2004

³ NFA, 2002; Bodmer, 2004

⁴ Hanbuch, 1981

⁵ For a more detailed treatment of fiscal rules for the confederation and the cantons see Stauffer, 2004, p. 45 ff.

published some recommendations regarding minimal standards for the supervision of the communal finances by the cantons⁶. They defined 8 minimal standards:

1. The canton regularises the supervision of the communal finances.
2. The canton sets budgeting and accounting rules for the communal statutory corporations.
3. The canton sets rules for the auditing of accounts and the financial revision.
4. The canton participates in the professional formation and development of accountants and controllers.
5. The canton reports about the work of the cantonal supervision of the communal finances.
6. The canton publishes a statistical report about the communal finances.
7. The canton regularises the cases of when cantonal supervision can interfere in the communal system of accounting and budgeting.
8. The canton evaluates and authorizes the financial regulation of the municipal code and the responsible organizations.

Figure 4 shows the compliance of the cantons to the minimal standards. As we can see Most cantons comply to all 8 standards. Only some small cantons (Obwalden, Nidwalden, Uri, Appenzell Innerrhoden, Basel Stadt) comply to less than 5 of those minimal standards.

Some cantons also define material rules for the communal finances. For example the canton Luzern regulates formally the accounting and budgeting process⁷ of the communes. Materially the canton prescribes in the commune law (Gemeindengesetz) that the current account must be balanced over several years and that the investment account must be shaped so that interest payments, investment consequential costs and depreciation costs are bearable charges for the current account⁸. A cantonal supervisory body controls the compliance of the communes to the rules set in this law⁹. In the worst case, if the commune does not comply the canton can take decisions on its behalf¹⁰.

A special institution at the cantonal level which doesn't exist at the federal level is the fiscal referendum. Expenses which are higher than a certain limit are subject to a referendum, which means that the inhabitants of the canton can decide whether they want to spend as much

⁶ Finances Publiques, 2004

⁷ Gemeindengesetz; VO über Finanzhaushalt

⁸ Gemeindengesetz, Art. 79

⁹ Gemeindengesetz, Art. 99- Art. 105

¹⁰ Gemeindengesetz, Art. 103

money on a certain project or not. If the expense is rejected either the project must be reframed to be less expensive or the project is abandoned. In Appendix B there is an overview over the forms of fiscal referendum in the different cantons.

Furthermore as between the confederation and the cantons there are financial equalisation schemes aimed at compensating communes with higher burdens¹¹.

2.1.4. Arguments for fiscal rules

The arguments named in the political discussion to justify the introduction of fiscal rules are¹²:

- Neutralize *political myopia* which transfers deficits to future generations and charges them with high interest payments
- Implement an *anticyclical fiscal policy*
- Prevent *subcentral governments* to spend inefficiently or irresponsibly
- *Harmonize* the accounting systems of the subcentral entities to achieve greater financial transparency

The *political myopia* argument is the most important argument for the introduction of fiscal rules. Second comes in the wish to implement an *anticyclical fiscal policy*.

The argument of subcentral governments having an inherent tendency to *tax inefficiently* is not an important argument for fiscal rules, because in Switzerland subcentral governments have a strong tax sovereignty and the competition among cantons makes the tax system efficient. The tax sovereignty prevents the cantons from raising taxes too much, because if taxes are too high the households can move to cantons with lower tax rates.

However the tendency to *spend inefficiently* exists if the central government finances tasks of subcentral governments without a careful monitoring. But in the case of the cantons (as subcentral entities) the definition of a clearer share of competences is more important than the monitoring aspect (see chapter 2.2). In the case of the communes a monitoring is desirable as some cantons are liable for deficits of the communes (f.e. the canton of Zürich ???). This is not the case for all cantons and it is desirable to reinforce the principle of autonomy for the communes. However as we have seen in chapter 2.1.3 there are minimal standards for the financial monitoring of the cantons regarding the municipal finances.

¹¹ For a more extensive description of the intra-cantonal equalisation schemes see Angelini, Thöny, 2004

¹² EFD, 2001, p. 3

Another important argument is the desirability of a *harmonization* of the accounting and budgeting procedures to increase the transparency of the public finances and to be able to publish meaningful statistics (see e.g. the documentation of the revision of the federal budgetary law¹³). But this is mostly done by setting formal rules and not material ones.

2.2. Share of competences in fiscal policy

- **How coherent is subcentral government fiscal policy with federal fiscal and monetary policy?**
- **Can the Federal Ministry of Finance influence cantonal fiscal policy?**
- **What is the role of the Conference of Cantonal Ministers of Finance and what is their ability to influence the policy of the federal ministry of Finance?**
- **Are there other institutions that bring together federal and canton representatives to help ensure coherence?**
- **Could this system of relations be made more effective?**

The competences in fiscal policy are mainly shared as follows:

- *Federal fiscal policy*: The federal government is responsible to implement the anticyclical fiscal policy together with the national bank.
- *Cantonal and communal fiscal policy*: The cantons and communes have to ensure a balanced budget and a low indebtedness. Their budgets are mainly neutral to the business cycle.

Principally the cantons are completely autonomous in their areas of competence (Art. 3, Art. 42 and Art. 43 BV). The competences of the confederation are defined in the constitution.

Competences of the confederation are e.g.:

- Foreign policy (Art. 54 BV)
- Army (Art. 58 BV)
- Professional Formation and Secondary Education (Art. 63 BV)
- Research (Art. 64 BV)
- Environment (Art. 74 BV)
- Traffic (Art. 82 BV)
- Post (Art. 92 BV)
- Monetary Policy (Art. 99 BV)

¹³ Botschaft, 2004, p. 15

- Unemployment insurance (Art. 114 BV)
- Agriculture (Art. 104 BV)

In some areas both the confederation and the cantons have a shared competence and work together, e.g.:

- Security of the country (Art. 57 BV)
- Energy (Art. 89 BV)
- Taxes (Art. 127 BV)
- Regional planning (Art. 75 BV)

The *Federal Ministry of Finance* is in this respect not allowed to interfere in cantonal fiscal policy.

The *Conference of Cantonal Ministers of Finance*¹⁴ has the following tasks:

- coordinates and discusses areas of fiscal policy which are of common interest for all cantons.
- attends to the financial interests of the cantons towards the confederation
- encourages the cooperation between the cantons and with the federal government in the area of public finance implementing joint solutions or projects, e.g. public accounting standards
- provides information and documentation about financial- and fiscal issues for the cantons and the public

The Conference of Cantonal Ministers of Finance is the representative of the interests of the cantons towards the confederation. Therefore the recommendations, requests or discussion points of the conference have a higher weight for the ministry of finance than the vote of a single canton. The Conference has no direct veto right for federal decisions. Nevertheless the Conference of Cantonal Ministers of Finance has a certain political importance. She influences on federal policy in discussions with the Federal Minister of Finance or other Ministers or through official communiqués etc. If the cantons don't agree with decisions of the parliament they can use the cantonal referendum (as they do successfully against tax reform packages). Moreover the Federal Finance Minister attends most of the meetings of the Conference of Cantonal Ministers of Finance. The Finance Minister often includes the Conference in the decision process before deciding finally about a project. Lots of projects are common projects of the confederation and the cantons as for example the reform of the equalisation mechanism (NFA).

¹⁴KDK

There are some *other institutions* where federal and cantonal representatives meet:

1. Conferences in other activity spheres (e.g. Education, Health Care), which meet periodically the corresponding federal representatives
2. Conference of the Cantonal governments, which meet periodically the federal council
3. Council of States also interacts with the Minister Conferences.

The system could be made *more effective* by defining more clearly the share of competence between cantons and the federal government on the one side and between the communes and the canton on the other side. This is what is aimed by the new equalisation model (Neugestaltung des Finanzausgleichs (NFA))¹⁵.

2.3. Historical reasons for the creation of fiscal rules

- **Why were the rules adopted by many cantons to balance budgets and reduce debt largely ineffective over the 1990s?**
- **Was this mainly due to sluggish economic growth or a deeper malaise?**
- **Popular democracy has been seen to provide expenditure restraint in the past. Why was this less effective during the 1990s?**
- **What explains the somewhat different deficit and debt dynamics of cantons and communes?**

The reason *why rules to balance budgets were ineffective* in the 1990's is that tax earnings were heavily (and unexpectedly) reduced by the economic slowdown after the boom period in the 1980's. (Colombier, 2003 estimates elasticities between the Swiss GDP and public earnings.) In addition to that the federal financial policy was rather expansive in the 1980's¹⁶. The debt brake mechanisms and fiscal rules in those years did not take into account the business cycle so that expenses were not anticyclical but almost procyclical. Thus the economic recession in the 1990's after the generous expansive fiscal policy in the 1980's gave rise to increased budget deficits.

As one can see in Figure 5 after the rapid growth in the 1980's the growth slowed down a lot in the 1990's. Furthermore the crisis of the cantonal banks in those years affected the opportunities for public institutions to lend money at favorable rates.

¹⁵ NFA, 2002

¹⁶ EFD, 2001, p. 6

The reasons *why direct democracy was ineffective* as a frein to public expenditure in the 1990's are given by Bodmer, 2004. He argues that:

- The areas in which public expenditure increased most in those years, social security and health spending, consist of entitlement programs which could be changed by fiscal referendums.
- The demographical changes (ageing society) also influenced the increase of the public expenditure.
- Social security and health care are financed in an intransparent way hindering clear political and financial responsibilities.
- The positive effects of direct democracy were exaggerated in the previous literature.

As we have seen in the introduction the cantons had larger deficits than the communes. Furthermore the deficits of the communes almost stopped to grow and stabilized in 1996. Reasons for this *different debt dynamics* are:

- The cantons are more subject to the business cycle than the communes, because of the share of competences and the size.
- The cantons include big economic centres which are very dependent on the overall economic situation.

3. Public Expenditure

In the 1990's Public Expenditure in Switzerland increased by 50% and the spending priorities changed. In Figure 6 we can see the evolution of Swiss Public Expenditure from 1990 to 2002. At the beginning of the 1990's expenditure increased rapidly from 86 billion to 110 billion, from 1993 to 1995 it stagnated and then it increased again up to 134 billions in 2002.

The composition of the expenditure also changed slightly although the biggest cost positions stayed the same. Figure 7 shows the composition of Swiss Public Expenditure from 1990 to 2002. The expenditure in Health Care, Social Welfare, Justice/Police and Education increased whereas expenditure in Defence, Culture and Environment (Agriculture) was reduced.

3.1. Principle reasons of growth in spending in cantons and communes

- What have been the *principal reasons* for the growth in spending in cantons and communes over the past decade – not only on health and social security but also other current spending?
- Are *existing trends* likely to maintain pressure on budgets for the foreseeable future?

In Figure 8 we can see which expenses are mainly carried out by the confederation and which ones by the cantons and communes.

Compared to the confederation the cantons accomplish tasks where expenses have grown overproportionally in the last years:

- *Health care*: The ageing of the society and the new medicinal technologies raise costs in the health care sector.
- *Education*: The growth in the educational sector stems from the fact that more and more people use the supply of continuous formation.
- *Social security*: In the social sector costs explode because of the growing unemployment.
- *Public safety*: In the public safety sector the increasing safety problems (terrorism, WEF demonstrations, etc...) produce higher costs.

In contrast to that, the confederation is responsible for areas where expenses were systematically reduced (Agriculture, Army, ...).

Those trends are likely to persist in the future.

3.2. Change in the spending priorities

- During the 1990s when budgets were under considerable stress, was there any discernible *change in the spending priorities* of cantons and communes?
- Can differences in spending patterns across cantons and communes be attributed to the *types of fiscal rules in use*?
- To what extent was there any movement to *shifting some spending off-budget*?

- **Are there estimates for contingent liabilities available for cantons and communes and how did they evolve over the 1990s?**

As we can see in Figure 9 the priorities of the cantons and communes were shifted to Social welfare, Education and Justice whereas their expenses were reduced in the other sectors.

Figure 10 shows us the composition of expenses by functional groups:

As we can see the wage policy was restrictive from 1995-1998. Material costs, interest costs and subventions were also proportionally reduced in that period whereas investment and compensations grew.

Fiscal rules had no influence on the spending patterns of the cantons and communes.

Some cantons have outsourced tasks like hospitals, education, waste management or traffic.

In February 2005, Credit Suisse Research has published a brochure "Swiss Cantons Credit Handbook". In this brochure they present details on the cantonal contingent liabilities from guarantees to cantonal banks and pensions¹⁷.

3.3. Effectiveness of debt brakes

- **Is there an observable difference in the evolution of spending in the cantons that adopted debt brakes during the 1990s, compared with other cantons?**

Figure 11 shows the evolution of expenses for 5 cantons with a rather strict debt brake (St.Gallen, Solothurn, Luzern, Fribourg, Aargau) and 5 cantons without any or only with a weak debt brake (Geneva, Basel Stadt, Ticino, Neuchâtel, Waadt)¹⁸. As we can see from the figure the spending evolution in cantons which adopted a strict debt brake is smoother than the one of the other cantons.

3.4. Problem of insufficient investment

- **A problem associated with strict expenditure limitations in some countries has been insufficient investment in infrastructure over a sustained period, eventually**

¹⁷ Cantons Credit Handbook,

¹⁸ The numbers were found in the "Finanzstatistik der öffentlichen Hand" from the Federal Finance Administration ("Eidgenössische Finanzverwaltung") 1988-2003

requiring significant corrective investment. Is this a potential danger for cantons, and if so, is it a greater problem in areas where referenda are more restrictive, fiscal rules are more binding, or both?

No, this is not a problem, because debt brake mechanisms differentiate between current expenses and investment expenses.

For example the canton St.Gallen has strict expenditure limitations since 1929. The strict fiscal rules have led to a low level of public debt. The tax burden is not excessive. Despite of that St.Gallen has a very good infrastructure.

4. Public Revenue

4.1. Budget balance requirements at the canton level

- Budget balance requirements are reasonably widespread at the canton level. How widespread are rules that will require corrective action if a canton or commune runs a deficit?**
- Do these corrective actions more typically take the form of increases in tax rates rather than cuts in expenditures?**

In Appendix A we present the different debt brake mechanisms at the canton level. All of those rules require corrective action if the golden rule is broken. Tax increases are required in some cantons (e.g. in Fribourg, Neuchâtel, St.Gallen, Solothurn, Zürich and Aargau) but also expenditure reductions are necessary. A mixture of both is most common. However there is sometimes the possibility for the canton to evade those corrective actions with some quorum of the parliament.

In practice tax increases are very unpopular, so that the cantons will lower them again once the budgets meet their targets again.

4.2. Non tax revenue

- To what extent has the importance of non-tax revenue risen over the past decade for cantons and communes?**
- What are the main factors behind the trends with respect to non-tax revenue?**

Jaeger et al., 2002 describe the evolution of public revenue¹⁹. They emphasize that non-tax revenue has gained some importance during the last decade. In 1999 23.8% of the revenue in the current account is non-tax revenue (compared to 20.8% in 1990). In the communes the share of non-tax revenue increased from 31% to 35.7%. Compensatory transfers from the confederation (to the cantons) and from the cantons (to the communes) have also gained importance.

Non-tax revenue in Switzerland can be subdivided as follows:

- Public dues to finance specific services
 - Contributions
 - Compensatory Contributions
 - Fees
- Public dues without financing aim, e.g. fines
- Privately earned capital gains
- Central bank gains
- Credit

Figure 12 shows public revenue from 1994 to 1999. As we can see Compensations have risen a lot. Capital revenue has also risen but was very volatile (large gains in 1998, because the gold of the national bank was sold). Fees, Seignurage and Concessions as well as shares and contributions have risen rather modestly like the tax revenue.

The reason why fees and contributions have increased is that the cantons and communes are increasingly implementing the principle of causality (which means that they are trying to allocate the costs to the corresponding services).

Possible explanations for the increase of the compensatory transfers is that transfers are paid for urbanity which increases steadily or that the equalisation scheme is not incentive-compatible.

4.3. Debt brakes in the cantons

- **The debt brakes in several cantons require taxes to be raised when projected deficits exceed certain thresholds. Are there upper limits in how far taxes can be raised?**

¹⁹ Jäger, 2002

- **Have debt brakes that are based on budget projections led to systematic biases in projected revenues or expenditures?**
- **Do these debt brakes have similar corrective mechanisms to the federal debt brake?**

No, there are no upper limits for tax increases. There are no biases because of the tax competition between the cantons. Furthermore the projections are activated yearly, so that potential biases vanish. The debt brakes in the cantons are very different to the federal debt brake, e.g. they mostly do not take into account the business cycle.

4.4. Tax competition and harmonisation across cantons

- **The cantons have substantial revenue autonomy. How does this impact on compliance costs of enterprises and individuals?**
- **For example, have tax bases that have been harmonised across cantons reduced compliance costs?**
- **Is there a case for greater tax base harmonisation?**
- **If there were to be greater harmonisation would this undermine effective tax competition across cantons?**

The cantons can decide themselves which taxes and fees to charge. Therefore the tax systems and tax rates are very different across cantons. The compliance costs could probably be reduced by harmonizing the tax system. However in Switzerland there exists only a formal tax harmonization. The tax system (especially the main taxes) is ruled by a federal law. The cantons are free to fix the tariff and the deductions; a further going tax harmonisation endangers the federalism in Switzerland and is therefore not planned. The concurrence between the cantons in tax matters is one of the reasons for the relatively low tax burden in Switzerland. The tax federalism is viewed as an important asset for the international competitiveness of the country.

4.5. Borrowing for capital expenditures

- **In cantons and communes where borrowing is allowed for capital expenditures only is there any evidence that definitions are stretched such that current expenditures are financed from this source?**

There is no evidence that definitions are stretched in such a way. The Harmonized Accounting Model of the cantons previews that borrowing is not part of the budgeting process.

4.6. Danger of excessive tax burdens

- **Is there a danger at the cantonal and commune level that the mechanisms for restraining deficits and debt may lead to excessive tax burdens?**

The danger of excessive tax burdens is very small especially on the cantonal and communal level, because the cantons and communes are competitors with respect to their tax rates. If a canton would e.g. decide to raise taxes much over the average persons living in this canton would start to move in other cantons. The competitive pressure is so high, that the mechanisms restraining deficits mostly work on the expenditure side (see chapter 3).

4.7. Cantons' fiscal equalisation schemes

- **How do the cantons' fiscal equalisation schemes prevent commune governments exploiting them through building up debt servicing requirements?**

The aim of the fiscal equalisation schemes is to reduce financial differences between communes which stem from external factors (e.g. difficult topography) or special financial burdens (e.g. theatres, hospitals, schools) from which the other communes around also profit²⁰.

There are mainly two types of equalisation instruments used by the cantons:

1. Bound payments
2. Unbound payments

The bound payments are prescribed by the law. The unbound payments are granted by the cantonal government and their magnitude is not fixed.

The payments are attributed to certain communes based on:

- the resources available to the commune compared to other communes

²⁰ See e.g. Angelini, Thöny, 2004

- key financial ratios
- special financial burdens compared to other communes (like schools, hospitals, theaters)
- differences in the base tax rate
- specific projects or competences

Financially strong communes must pay for the financially weak communes and the canton also provides some funds.

The actual problem of lots of the cantonal equalisation schemes is that they are not incentive compatible in the sense that they pay equally for exogenous financial differences (which cannot be reduced by the commune itself) and endogenous financial differences (which can and should be reduced by the commune itself). The cantons try to reduce payments which are given without conditions other than financial power for matters where the debt is the communes own fault. But up to today the equalisation schemes are far from being optimally framed to prevent shirking behaviour.

5. Monitoring

5.1. Provision of financial information of the subcentral entities

- **Subcentral fiscal accounts are only prepared with a substantial delay. Does the lack of information complicate fiscal and monetary policy of the confederation?**
- **Is it possible to speed up the provision of this information?**

The delay of the provision of financial information of the subcentral entities is not a predominant problem, because there is no common policy of the confederation and the cantons. As we said before the cantons are almost completely autonomous. Federal policy is thus unaffected by this delay. A harmonisation of the accounting and financial reporting could speed up the provision of information. This is the aim of the harmonized accounting model which has been published by the conference of cantonal finance ministers and will soon be revided.

5.2. Standards for budgetary reporting

- **The provision of budgetary information has not been standardised. Is there any intention to require budgetary reporting to observe certain standards and improve comparability?**

Today the provision of budgetary information is done through a questionnaire.

5.3. Finance Commissions

- **How widespread are the *Finance Commissions* and have there been any developments recently aimed at giving these bodies greater powers as a means to exercise greater expenditure restraint?**
- **What *other organisations* or bodies monitor budgetary formation and implementation at the canton or commune level?**

The *Finance Commissions* have a great importance but only as counsellors for the respective parliaments. They act in favor of a more restrictive budget policy. However they can only partly be heard. The confederation e.g. includes the Finance Commission only for supplementary expenses during the year not for the budgeting process per se.

Other organisations which monitor budgetary information are:

- Conference of Cantonal Ministers of Finance (Finanzdirektorenkonferenz)
- The Federal Finance Administration (Eidgenössische Finanzverwaltung)
- The Swiss National Bank: The SNB publishes an annual report about the cantonal budgetary policy.

5.4. Repercussions of the Leukerbad case

- **What have been the *repercussions* of the Federal Court's dismissal in the Leukerbad case of claims against the canton?**
- **For example, has *financial sector lending behaviour* changed to reflect different risk perceptions in lending to communes?**

- **Is it more *difficult for communes to access credit?***
- **Have *other cantons* sought to clarify their potential liability for commune debt?**
- **To what extent do *cantons guarantee the debt of communes?***

The *Leukerbad case* was an important turning point for the relation between cantons and communes. The risk awareness with respect to the financial situation of the communes has increased. Since then it is now clear that cantons are not liable for a commune's deficit. The principle of autonomy was reinforced by the Federal Court's decision. Now the communes are forced to take responsibility for their own deficits and to balance their budgets.

The behaviour of the *financial sector* has changed in some ways in the sense that the communes are now rated separately to the cantons. This tendency is intensified by the Basel II minimal reserve regulation for banks which forces them to take out stricter assessments of creditworthiness before granting a loan. Two main aspects play a role for the rating of communes:

1. Financial situation: The financial situation of the commune itself is assessed by looking at the annual financial statements.
2. Cantonal laws and fiscal equalisation: The banks assess the probability that a Canton is liable for the commune, the degree of control that the Canton exerts over the communal finances and the possibilities of the canton to interfere or to sanction when deficits occur.”

Accessing credit is more difficult for communes since the Leukerbad case, especially for small communes. Small rural communes have only the possibility to access credits from banks inside Switzerland mostly from cantonal and regional banks. Big urban communes (e.g. cities like Lausanne) can also borrow from international banks from outside Switzerland. Their international prestige and reputation makes it possible for them to borrow much more money regardless of their rating.

To our knowledge *other cantons* have not sought to clarify their potential liability for commune debt after the Leukerbad case. However since this case the Conference of the cantonal centres for the control of communal finances has published the 8 minimal standards for the revision of communal finances and evaluated the compliance of the cantons to those standards (see chapter 2.1.3 for more details). This was the main repercussion of the Leukerbad case for the cantons.

Generally the Leukerbad case has shown that the principle of autonomy is valid. This means that in principal the *cantons do not guarantee debts of communes*. However different cantons have different rules for obligatory supervision (see chapter 2.1.3). If the canton does not control the

communes adequately it could be hold responsible for a commune that is in financial difficulties. But a bailout of the commune by the canton is very improbable.

5.5. Importance of financial markets

- **How important are financial markets in disciplining the fiscal policy of cantons and communes?**
- **Are rating agencies active in monitoring cantons and communes' fiscal policy?**
- **How important are cantonal and commune owned and controlled banks for borrowing?**

The financial markets are increasingly important in disciplining the fiscal policy of cantons and communes. The cantons and communes are rated periodically by banks and rating agencies (see for example fedafin for the communes or the cantons credit handbook of credit suisse research for the cantons). The monitoring of the financial markets increases the efficiency of the cantonal and communal finances. Appendix C shows the rating of the cantons from the cantons credit handbook.

The cantonal and commune owned and controlled banks are nowadays less important for borrowing, because many of the banks have been privatised and lend to the same conditions as international banks. Appendix D shows a list of the cantonal banks which still have a state guarantee.

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I. Figures

Figure 1 Swiss public debt²¹

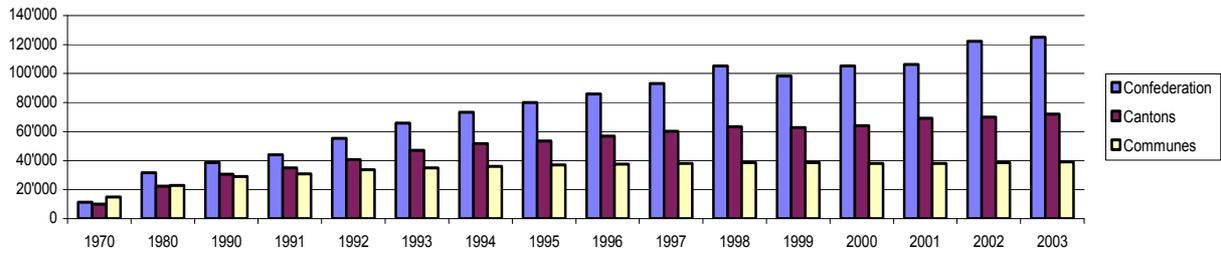
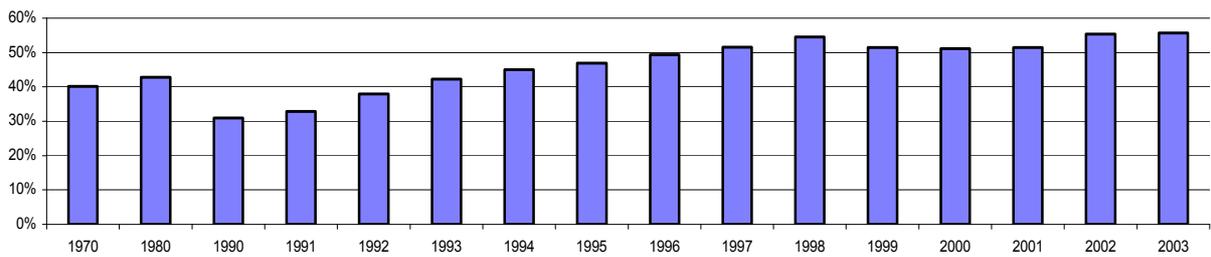


Figure 2 Swiss public debt in % of GDP²²



²¹ Source: economiesuisse

²² Source: economiesuisse

Figure 3 The debt brake mechanism of the Swiss confederation

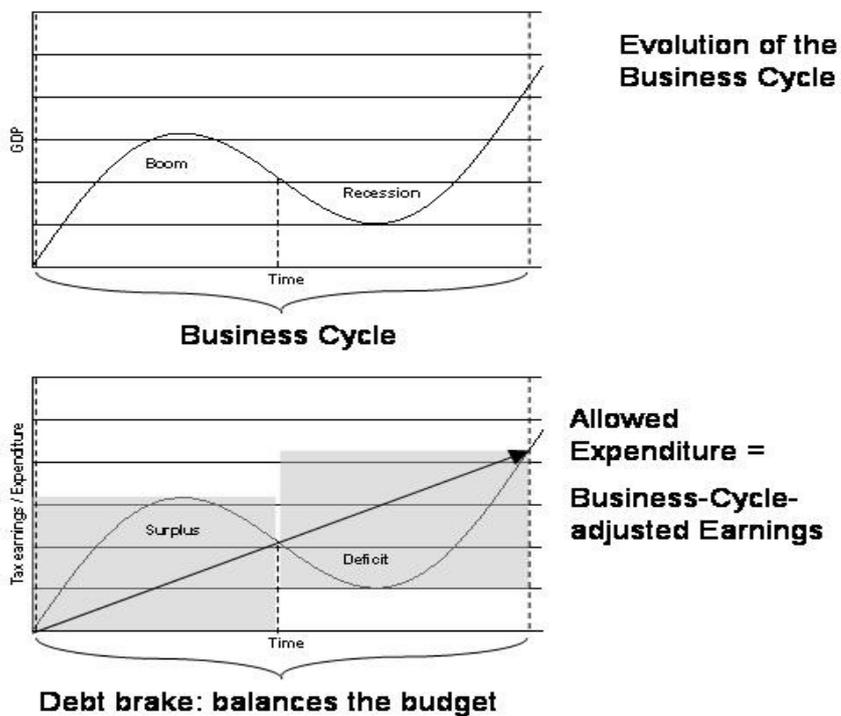


Figure 4 Compliance to minimal standards for the cantonal financial supervision of the communes

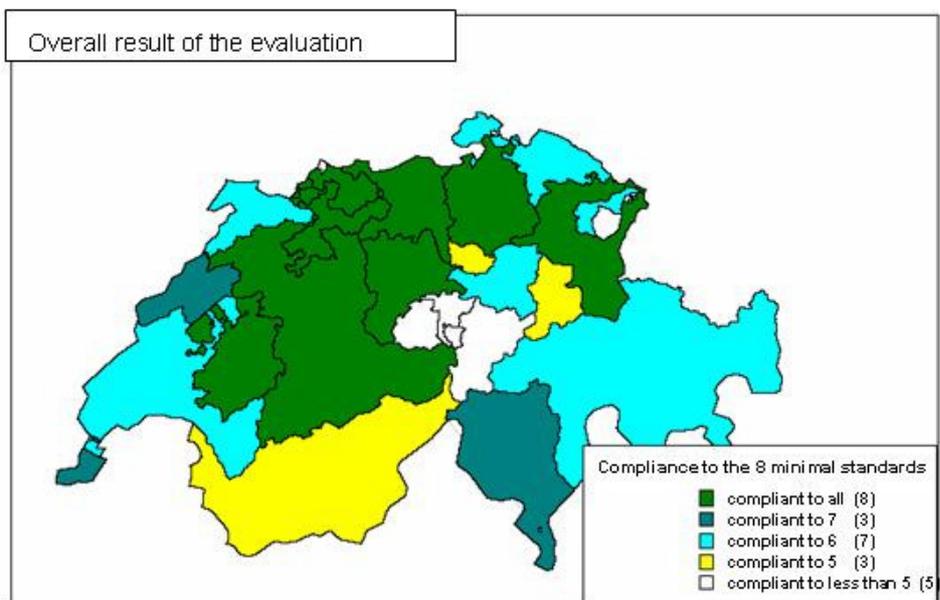


Figure 5 Swiss Nominal GDP (in 1000 CHF)²³

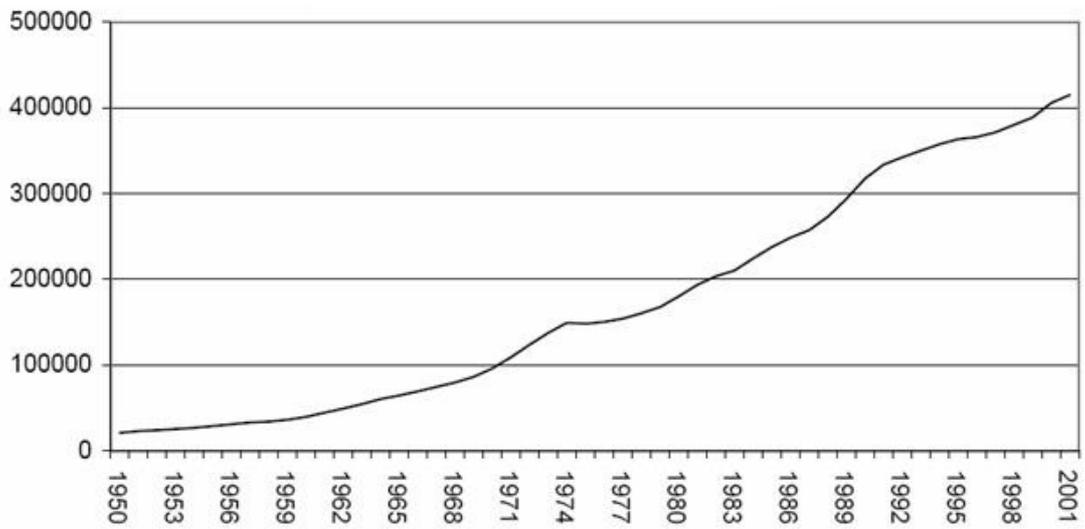
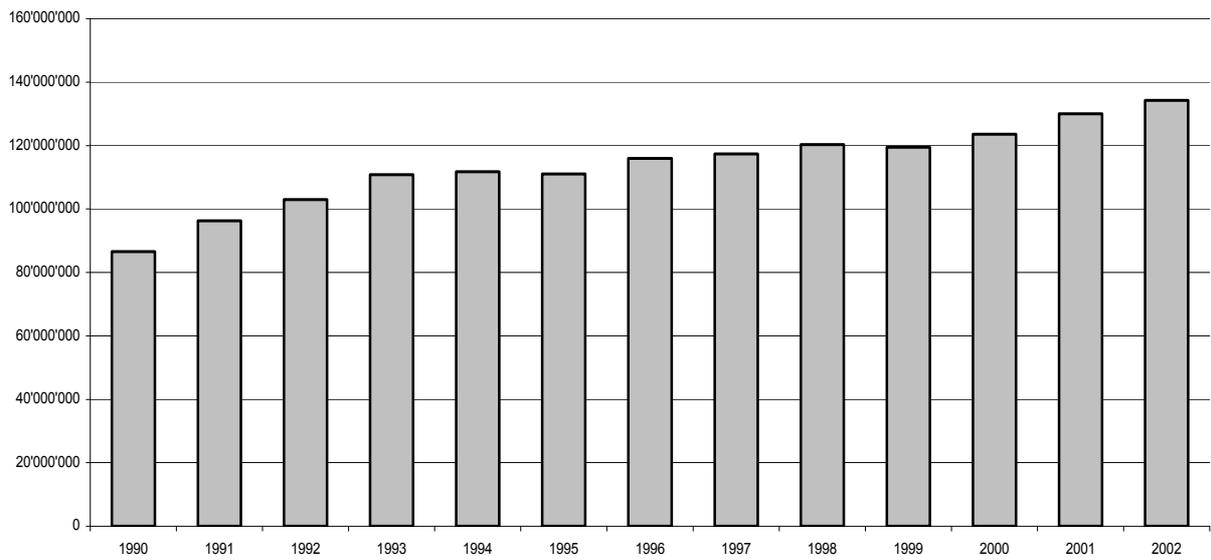


Figure 6 Total Swiss Public Expenditure from 1990 to 2002



²³ Source: Colombier, 2003, p. 11

Figure 7 Composition of Swiss Public Expenditure from 1999 to 2002

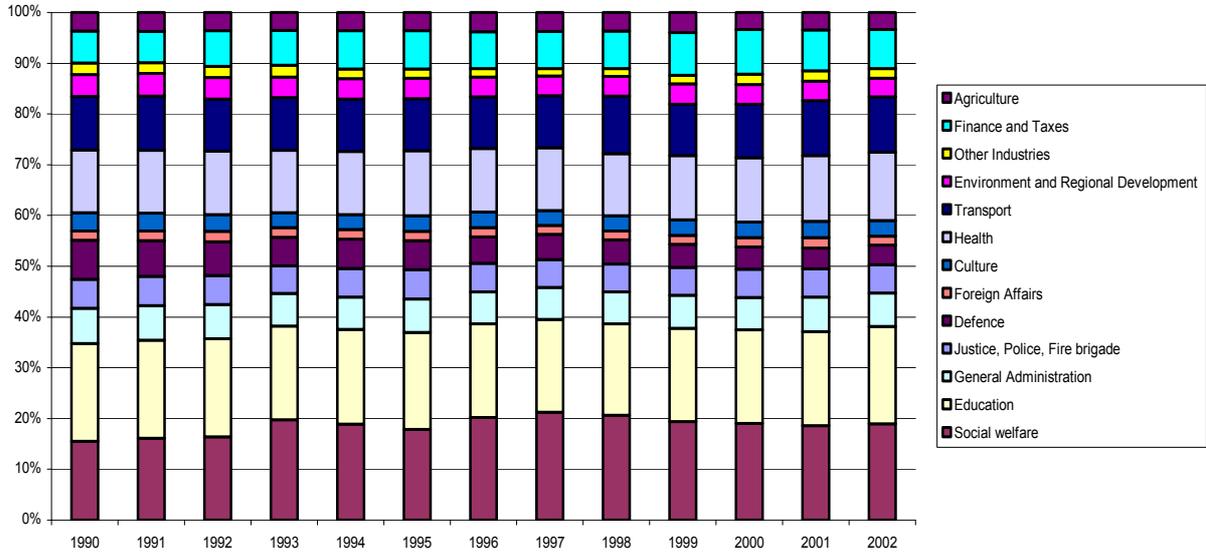


Figure 8 Expenditure share of cantons/communes vs. confederation

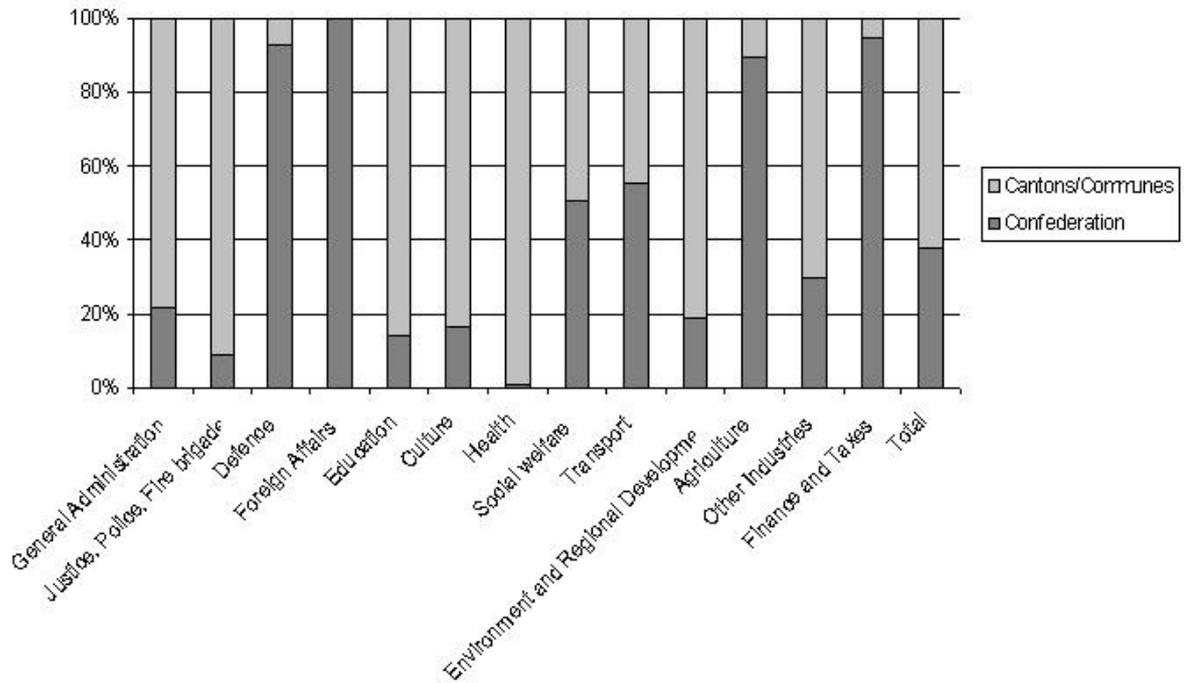


Figure 9 Composition of the expenses of the cantons/communes from 1991 to 1999 (by spheres of activity)

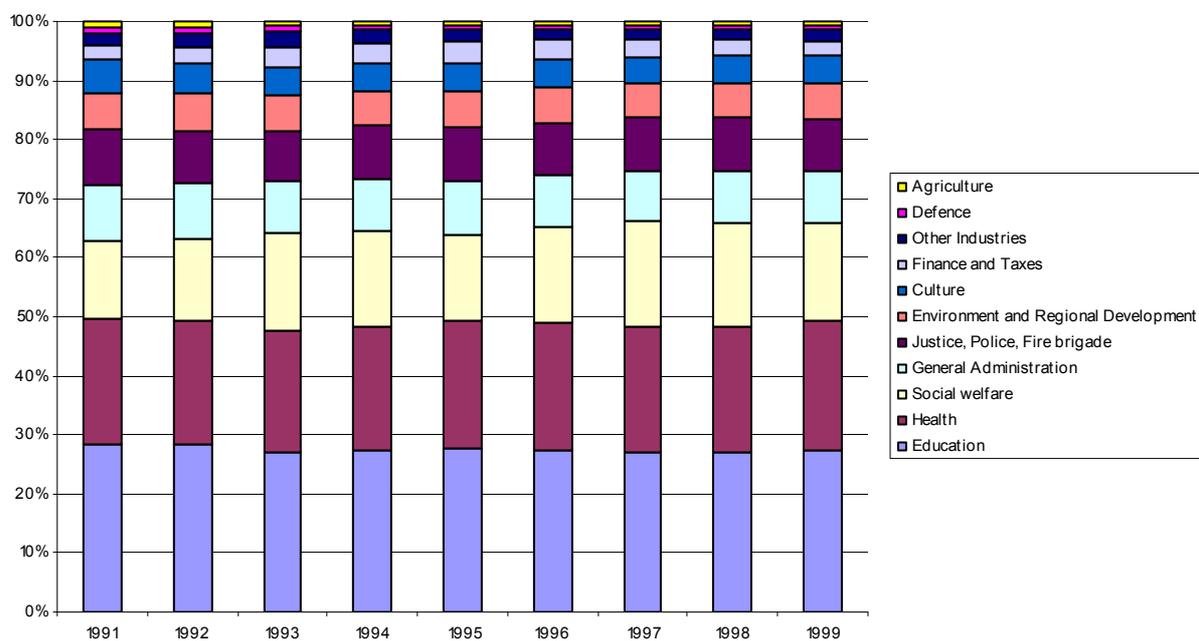


Figure 10 Composition of the expenses of the cantons/communes from 1995 to 2002 (functional groups)

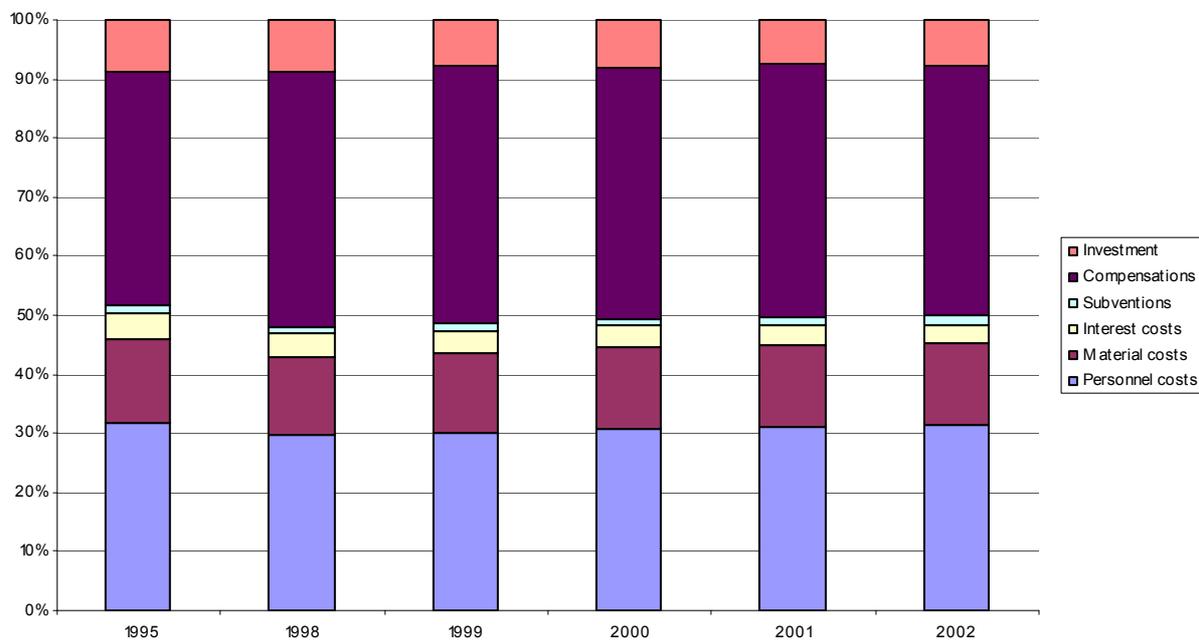


Figure 11 Comparison of cantons with strict debt brakes and cantons without any or weak debt breaks

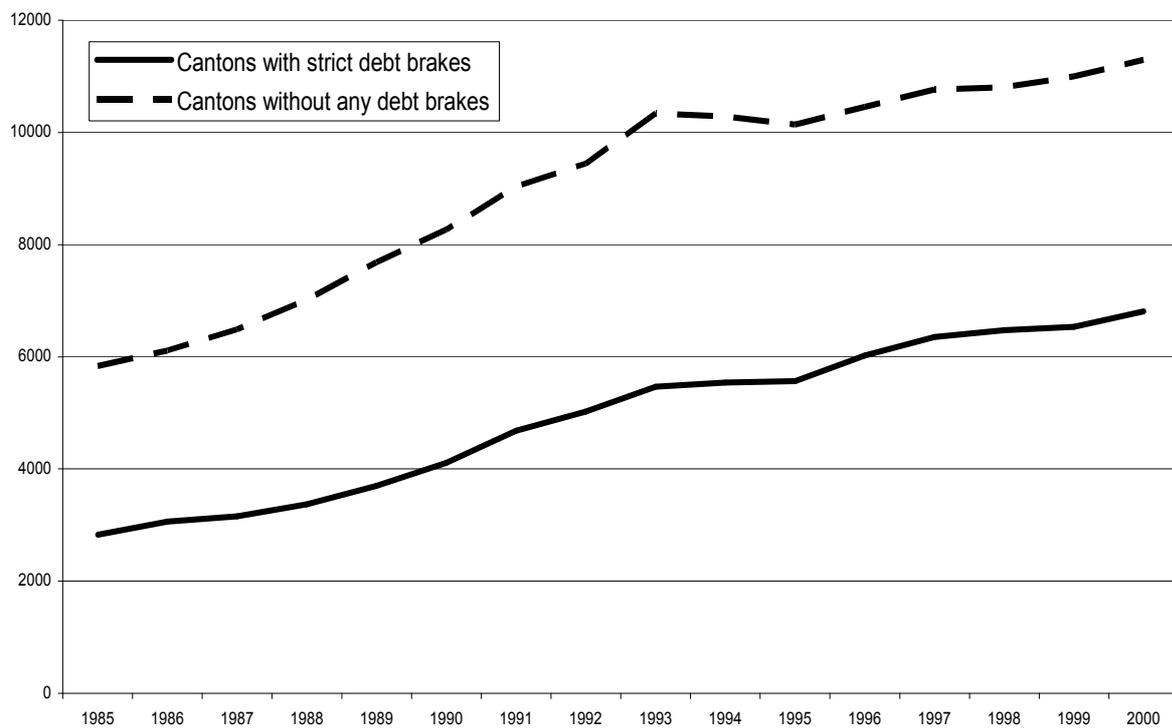
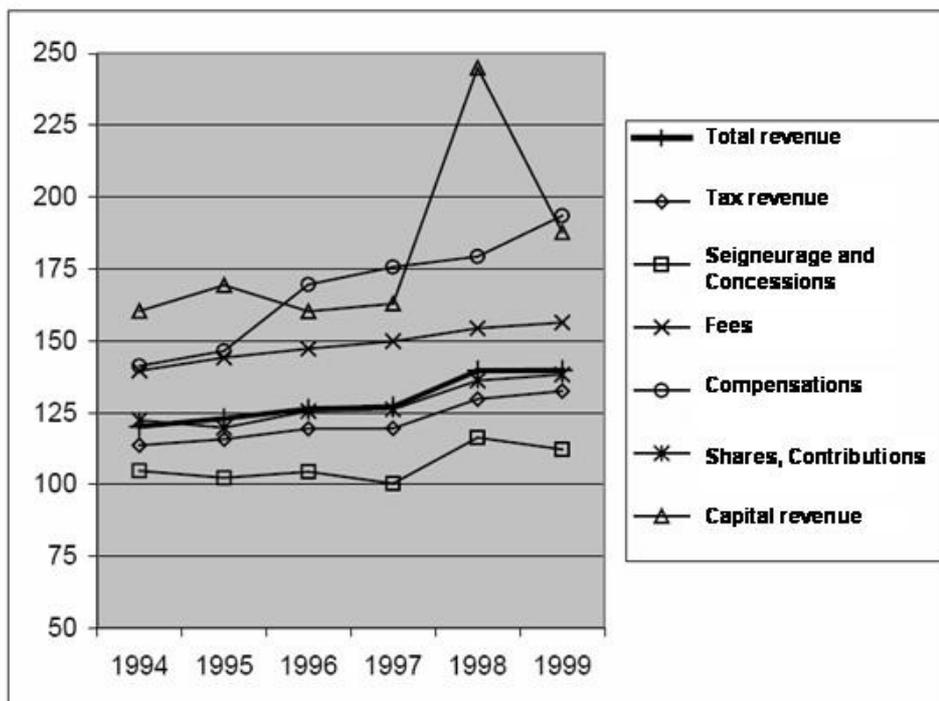


Figure 12 Public revenue from 1994 to 1999



II. Appendix

A. Debt brake mechanisms in the cantons

Cantons	Types of mechanisms	Are the mechanisms active or in preparation? (A/P)	Principal goals	Basis for action	Golden rules	Corrective actions	Possibilities to evade the corrective actions	Allowing for a correction with respect to the business cycle	Date when coming into force
FR	Strong	A	A balanced account of payments	Equilibrium	Earnings = Expenses	Increase of taxes if the deficit is greater than 3% of the earnings	No	No	1996
NW	Strong	A	Stabilized rate of debt; A balanced account of payments	Equilibrium following to a financial plan	Maximal limit for the budget deficit (mean over 3 years)	Reduction of the expenditure, tax increases, deferral on the next year	No	In exceptional situations	2001
SG	Strong	A	Stabilized rate of debt; A balanced account of payments	Equilibrium	Maximal limit for the budget deficit: 3% of the earnings. It is legally possible to create more rigid budget positions.	Deferral of deficit to the next period, tax increases, no reduction of taxes before the necessary capital has not been reconstituted (exceeds by 20% the earnings)	No	No	1929, revision in 1997
SO	Strong	P	A balanced account of payments		Maximal limit for the budget deficit (5% of expenditure)	Tax increases (if by more than 10% a referendum is necessary), no reduction of taxes before the necessary capital is disposable	Majority of 2/3	No	

ZH	Strong	A	Stabilized rate of debt; expenditure brake	Not specific	Account balance = 0	Reduction of the expenses. Tax increases for a period of up to 3 years.	No	Yes, 8 years.	2001
AG	Medium	P	Stabilized level of debt, Reduction of public debt and of government expenditure relative to GDP.	Equilibrium	Stabilized rate of debt and reduction of expenditure	The deficit must be amortized over 5 years. Extraordinary expenses are not amortized. Tax increase possible with a qualified majority.	Yes, a qualified majority is needed.	Yes, if there is a stagnation the amortization rate is 10% or 0% if there is a recession.	
BE	Medium	A	Stabilized rate of debt, indirectly a balanced account of payments	Equilibrium	Account balance = 0	Deferral to the following year if the financial capital is not sufficient	Majority of 2/3	No	2002
GR	Medium	A	Stabilized rate of debt, balanced account of payments	Equilibrium and stabilized government expenditure relative to GDP	Growth of expenditure proportional to economic growth, except when strong variation in confederation transfers or a strong influence of unemployment exists	Deferral to the following year	No	Yes	1998
LU	Medium	A	Stabilized rate of debt, balanced account of payments	Equilibrium	Maximal limit for the budgetized deficit (4% of fiscal earnings).	Deferral to the following year	No	Yes	2001
VS	Medium	P	Stabilized rate of debt, balanced account of payments and investment account	Equilibrium	Earnings = expenses	Deferral to the following year's budget	Majority of 2/3	Yes	
AR	Weak	A	Balanced account of payments	Equilibrium	Maximal limit for the budgetized deficit (5% of fiscal earnings).	Amortization over 7 years.	No		

BS	Weak	A	The proportion of the debt to GDP must not exceed appr. 20%	Expenditures	Growth of expenses following a defined rate.	Amortization in the following year. Compensation accounts.	Absolute majority	Yes
TI	Weak	P	Proportion of government expenditures to GDP	Current expenses	Growth of expenses following a defined rate (trend of GDP). 4 indicators to satisfy.	Automatic expense cut, then selection of expenses.	No quorum, but a control commission.	Yes
NE	In preparation	P						
SZ	In preparation	P						
AI	No	-						
BL	No	-						
GE	No	-						
GL	No	-						
OW	No	-						
SH	No							
TG	No							
UR	No	-						
VD	No	-						
ZG	No	-						
JU	No	-						

B. The fiscal referendum in the cantons

Canton	Nonrecurring expenses		Recurring expenses		Necessary quorum of signatures
	Facultative	Mandatory	Facultative	Mandatory	
ZH	2-20	20	0.2-2	2	5000
BE	2	-	0.4	-	10'000
LU	3-25	25	3-25		3000
UR	0.5	1	0.05	0.1	300
SZ	-	0.25	-	0.05	2000
OW	0.5	1	0.1	0.2	100
NW	0.25	5	0.05	0.5	250
GL	-	0.5	-	0.1	1500
ZG	-	0.5	-	0.05	-
FR	0.25%	1%	0.25%	1%	6000
SO	1-2	2	0.1-0.2	0.2	1500
BS	1	-	0.2	-	2000
BL	0.5	-	0.05	-	1500
SH	0.3-1	0.3	0.05-0.1	0.05	600
AI	0.25	0.5	0.05	0.1	200
AR	-	5%		1%	-
SG	3.15	15	0.3-1.5	1.5	4000
GR	1-5	5	0.3-0.5	0.5	3000
AG	3	-	0.3	-	3000
TG	1	3	0.2	0.6	2000
TI	0.2	-	0.05	-	7000
VD	-	-	-	-	-
VS	0.75%	-	0.25%	-	3000
NE	-	1.5%	-	1.5%	6000
GE	0.125	-	0.06	-	7000
JU	0.5%	5%	0.05%	0.5%	2000

C. Rating of the Swiss Cantons

Canton	Rating	Outlook
Aargau	High AA	Stable
Appenzell-Ausserrhoden	AAA	Stable
Appenzell-Innerrhoden	AAA	Stable
Basel-Land	High AA	Stable
Basel-Stadt	Mid AA	Stable
Bern	Low AA	Stable
Fribourg	Mid AA	Stable
Geneva	High A	Negative
Glarus	High AA	Negative
Graubünden	High AA	Stable
Jura	Low AA	Stable
Lucerne	Mid AA	Stable
Neuchâtel	Low AA	Stable
Nidwalden	AAA	Stable
Obwalden	Mid AA	Stable
Schaffhausen	High AA	Stable
Schwyz	AAA	Stable
Solothurn	Mid AA	Stable
St.Gallen	High AA	Negative
Ticino	High AA	Negative
Thurgau	Mid AA	Stable
Uri	Mid AA	Stable
Vaud	High A	Stable

Valais	Low AA	Stable
Zug	AAA	Stable
Zurich	AAA	Negative

D. Cantonal banks with state guarantee

Cantonal bank	Legal form	State guarantee
Banque Cantonale de Fribourg	Public institute	Unlimited state guarantee
Banque Cantonale de Genève	Corporation	Limited State guarantee
Banque Cantonale du Jura	Corporation	Unlimited state guarantee
Banque Cantonale Neuchâteloise	Public institute	Unlimited state guarantee
Banca dello Stato del Cantone Ticino	Public institute	Unlimited state guarantee
Banque Cantonale Vaudoise	Corporation	Limited State guarantee
Banque Cantonale du Valais	Corporation	Unlimited state guarantee
Aargauische Kantonalbank	Public institute	Unlimited state guarantee
Appenzeller Kantonalbank	Public institute	Unlimited state guarantee
Basellandschaftliche Kantonalbank	Public institute	Unlimited state guarantee
Basler Kantonalbank	Public institute	Unlimited state guarantee
BEKB / BCBE	Corporation	Unlimited state guarantee
Glarner Kantonalbank	Public institute	Unlimited state guarantee
Graubündner Kantonalbank	Public institute	Unlimited state guarantee
Luzerner Kantonalbank	Corporation	Unlimited state guarantee
Nidwaldner Kantonalbank	Public institute	Unlimited state guarantee
Obwaldner Kantonalbank	Public institute	Unlimited state guarantee

Schaffhauser Kantonalbank	Public institute	Unlimited state guarantee
Schwyzter Kantonalbank	Public institute	Unlimited state guarantee
St.Galler Kantonalbank	Corporation	Unlimited state guarantee
Thurgauer Kantonalbank	Public institute	Unlimited state guarantee
Urner Kantonalbank	Public institute	Unlimited state guarantee
Zuger Kantonalbank	Corporation	Unlimited state guarantee
Zürcher Kantonalbank	Public institute	Unlimited state guarantee