Cantonal tax autonomy in Switzerland: 
Trends, challenges, and experiences

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1 Introduction

Swiss fiscal federalism is characterized by extensive tax autonomy of the subnational government units. On the basis of subnational taxing powers, there is strong fiscal competition between the cantons but also between municipalities within cantons, a characteristic feature of Swiss federalism in general (Braun, 2003).

There are several theoretical arguments regarding tax competition (Gilardi and Wasserfallen, 2009). Tiebout or yardstick models predict that policy-makers take decisions of neighboring units into account, either because citizens look at their neighbors to evaluate the relative tax performance of the incumbent government, which, in turn, is sensitive in years of reelection to its neighbor’s tax decisions (Besley and Case, 1995), or because governments of subnational units compete with each other for the same taxpayers (Tiebout, 1956). In the long run, this leads, given a set of assumptions, to a pressure for optimal allocation of public resources; however, there is also a risk of dysfunctional outcomes.

In a perfect economic setting, a jurisdiction should be large enough that total costs of a collective good are minimized (economies of scales), while beneficiaries and payers of a collective good should overlap, what Olson (1969) termed “fiscal equivalence.” A subnational government providing public services with beneficial spill-overs beyond its borders should be compensated

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accordingly. This principle is theoretically compelling, but difficult to apply in real world, and any time it is violated the outcome is dysfunctional. Dysfunctionality increases according to the importance of a specific spill-overs, which is not compensated.

Moreover, in a tax competition setup, there is, as in other prisoner’s dilemma situations, a mismatch between individual and collective rationality. We can think about tax competition as a social dilemma in which the rationality of individual subnational governments leads to collective irrationality of the public sector, ending at unsustainable income levels. Policy makers might cede to the temptation of setting tax rates slightly lower than their competitors to maximise taxable income. Of course, this should occur especially for rich people, who are considered more mobile and of particular importance to the ability of a canton to raise sufficient revenue. However, empirical evidence does not corroborate fears of such a “race to the bottom” scenario in Switzerland.

This paper pursues two goals. First, we discuss how the power to set tax rates is being used in Switzerland, including the terms of the political debate on this topic in Switzerland and recent reforms. We show that cantonal tax autonomy is deeply rooted in the history and institutions of this country, that harmonization is limited, and that recent reforms have strengthened financial equalization but have not narrowed cantonal autonomy.

Second, we discuss what the Swiss experience teaches us about the likelihood of a “race to the bottom” using the case of personal income taxation. On one hand, cantons are to some extent engaged in competition and try to attract wealthy taxpayers. On the other hand, competition has not led to a nationwide race to the bottom. This is partly explained by the presence of intercantonal cooperative arrangements, like the system of fiscal equalization, by the fact that tax rates are only one parameter among many for the locational choices of individuals and companies, and by the institution of direct democracy. Moreover, competitive behavior, as a strategy for maximizing taxable income, is a feasible option only for some cantons. Small units, especially those near a big unit with a modern and comprehensive infrastructure can profit from a competitive setting.
2 The history of cantonal tax autonomy

2.1 Origins

Historically, Swiss federalism has been a bottom-up construction. The crucial period in Swiss constitutional history was the transition from the Ancien Régime Confederation of independent states (until 1798) to the foundation of the modern federal state in 1848 (Kölz 1992). This transition was characterized by tensions between federalist conservatives and unitarian liberals. The conservatives strived to maintain the old Swiss Confederation of sovereign cantons with aristocratic prerogatives. The liberals defended economic and civil liberties, as well as political centralization, as part of a capitalist project to establish a unified economic space.

The pendulum swung back and forth between these two political models: there was the invasion of Switzerland by Bonaparte and establishment of the centralized Helvetic Republic in 1798, the re-creation of the cantons in 1803, the reestablishment of aristocratic prerogatives and full cantonal sovereignty after the Vienna Congress in 1815, but also a progressive move toward liberal republicanism in some cantons from the 1830s onward. Finally, after a short civil war between liberals and conservatives, the modern federal state was set up in 1848. According to Linder (1994), the main reason for the subsequent stability of the 1848 constitution is a federalist arrangement—directly inspired by the American constitution—that allowed striking a balance in the founding political conflicts between the conservatives and the liberals. Central to Swiss federalism is the subsidiarity principle, which implies that tasks not explicitly assigned to the federation fall within the competence of the cantons. Any transfer of tasks from the cantons to the federations requires a constitutional revision.

Noncentralisation is an organizing principle of Swiss federalism (Braun 2003, 62), which is rooted in the historical conflict preceding the establishment of the modern Swiss state in 1848. Together with extensive cantonal regulatory powers and cantonal competencies to determine expenditures, the extensive tax autonomy of Swiss cantons is a logical consequence of the noncentralization principle. It is interesting to note that the tax regime has followed closely, during the founding transitional period, the institutional back and forth between centralization and cantonal sovereignty. Before 1798, taxing power was entirely in the hands of the cantons. The centralist Helvetic Republic was armed with considerable taxing powers; however, the centralised tax legislation of the Helvetic Republic remained a singular historical exception. After
1803, when the Helvetic Republic came to an end, cantonal tax autonomy was reestablished and has endured until the present day. Cantonal tax autonomy is a principle of Swiss federalism with deep historical roots and protected by the Constitution. Cantonal tax autonomy is extensive and involves the power of the cantons to define the type of tax that is levied, as well as the rates. The only limitation to cantonal tax autonomy is a provision in the federal constitution—derived from 19th-century liberal principles—stipulating that the tax burden on the taxpayer should be commensurate with his or her economic capacity.\footnote{This is an important basic principle of the Swiss tax system, found in Art 127 Abs. 2 of the Federal Constitution: “Provided the nature of the tax permits it, the principles of universality and uniformity of taxation as well as the principle of taxation according to ability to pay shall be applied” (SR 101). On June 1, 2007, the federal court declared that a regressive tax system with flat-decreasing tax rates, which the canton of Obwalden attempted to implement, violated this basic redistributive principle (\emph{iustitia distributiva}).}

In addition to extensive cantonal tax autonomy, the lowest institutional level in the Swiss federation, the municipality, also enjoys significant tax autonomy. While municipalities generally can not determine the type of taxes they levy, they can set their own tax rate.

\section*{2.2 Historical change and current debates}

As we have seen, the Swiss tax system is strongly rooted in the principles of Swiss federalism and therefore closely follows the federalist architecture. The same is true of the political debate about the tax system that is framed according to the principles of the more general discussion on the functioning of Swiss federalism. The main line of this debate concerns the weight of the federation with respect to the cantons. During the 19th century, custom duties (thus indirect taxes) were the main source of income of the federal state. In the early 20th century, the left started to claim stronger centralization of the system to realize income redistribution. These early attempts to transfer taxing powers from the cantons to the federation were unsuccessful, and the substantial federal taxing powers introduced in the early 20th century were a result of exceptional historical circumstances. The first direct federal tax, a tax on war profits, was approved in 1915 as a consequence of financial needs of the federal state in World War I, and a new indirect federal tax on general sales was introduced in 1941 to cover military expenditures of the federal state in World War II.

However, conceding to the principle of noncentralization, these federal taxing powers are granted only provisionally. This means that, ever after, the federal power to levy direct taxes and sales taxes must be periodically confirmed by the parliament and in a referendum.
result of the new federal taxing powers, the federation’s share in the overall tax income was significantly increased. In 1900, each institutional level—the federation, the cantons, and the municipalities—raised roughly one-third of the overall tax income. By 2000 the federation’s share had increased to 45%, while the cantons had risen to 30% and the municipalities to 25% of the overall tax income.

Since the early days of the modern Swiss federal state, the tax systems of the cantons have obviously evolved. During the 19th century, most of the cantons introduced direct taxes on natural persons and businesses, mainly in the form of property tax. Toward the end of the 19th century, cantons started introducing progressive taxes on income, as well as a broad range of other taxes, including death duties, gift taxes, dog taxes, taxes on financial transactions (taxes on change of property, stamp duties), and consumption taxes (on tobacco and luxury goods). As a result of the specific historical trajectories, and despite the increased weight of the federation over the 20th century, the cantonal tax systems are characterized today by an impressive variety, as shown in Table 1.

<table>
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<th>Taxes</th>
<th># cantons</th>
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<tr>
<td>Direct</td>
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<tr>
<td>Income tax of natural persons</td>
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<tr>
<td>Property tax of natural persons</td>
<td>26/26</td>
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<tr>
<td>Personal or household tax</td>
<td>10/26</td>
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<tr>
<td>Tax on profit of businesses</td>
<td>26/26</td>
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<td>Tax on capital of businesses (flat rate)</td>
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<td>Tax on inheritance</td>
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<td>Gift tax</td>
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<td>Tax on lottery gains</td>
<td>26/26</td>
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<tr>
<td>Tax on real estate gains (natural persons and businesses)</td>
<td>12/26</td>
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<tr>
<td>Real estate tax (natural persons and businesses)</td>
<td>19/26</td>
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<tr>
<td>Tax on owner change</td>
<td>20/26</td>
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<tr>
<td>Casino tax</td>
<td>10/26</td>
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<td>Tax on motor vehicles</td>
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<td>Dog tax</td>
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<td>Leisure tax</td>
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<td>Stamp duties</td>
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<td>Lottery duties</td>
<td>6/26</td>
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<td>Visitors tax</td>
<td>23/26</td>
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<td>Tourism duties</td>
<td>2/26</td>
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<td>Waterwork tax</td>
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Table 1: Cantonal taxes. \(^a\)progressive rate in 24 cantons, flat rate in 2 cantons; \(^b\)progressive rate in 19 cantons, flat rate in 7 cantons; \(^c\)progressive rate in 1 canton, flat rate in 18 cantons, mixed in 7 cantons. Source: Eidgenössische Steuerverwaltung (2009).

For an overview, see the article “Steuern” in the Historisches Lexikon der Schweiz (www.hls-dhs.dss.ch, accessed on 10 February 2010).
Owing to increased spatial mobility of taxpayers, this variety of the cantonal tax systems has reinforced tax competition between cantons and, within cantons, between municipalities. From the 1980s onward, some cantons started pursuing a low-tax strategy, based mostly on the abolishment of death duties and gift tax, as well as on a substantial reduction of tax rates. This not only led to a further increase in the variety of cantonal tax systems, but also widened the gap between high tax and low tax cantons. Table 2 shows cantonal personal income tax rates in four income categories for an an unmarried person without children in 2007. Tax levels vary indeed substantially in all income categories.

In the annual income category of CHF 25,000, which is even for a single person an insufficient annual income to make a living, Glarus has with 2.1% an exceptionally high tax rate. In general tax rates lay somewhere between 0% and 1%. For the annual income category of CHF 50,000 cantonal tax rates vary between 1.2% in Zug and 5.34% in Glarus, the mean being 2.57%. The top tax rate in the canton of Glarus is again an outlier, the second highest rate in this income category, taxed in Berne, is at 3.78%. For people earning CHF 100,000 Zug is with a tax rate of 2.64% again the canton with the lowest tax level, while it is 3.5x higher in Neuchâtel, namely at 9.37%. And a person with an annual income of CHF 200,000 was taxed slightly more than 4% in Schwyz, Zug, and Obwalden, and more than 12% in Glarus, Geneva, and Neuchâtel.

Furthermore Table 2 shows that cantons also differ greatly in the progressivity levels of their tax rates, that is, in the differences between tax rates for different income categories. The last column displays the ratio of the tax rate for an annual income of CHF 200,000 and CHF 50,000. In average the tax rate for a high income of CHF 200,000 is 3.43x higher than the tax rate for an annual income of 50,000. Basle-Country, Ticino and Geneva have the most progressive tax systems with a ratio above 6, while Geneva is the front runner in this category with a value of 8.17, meaning that this canton has very low taxes for poorer people and high taxes for high income earners. Obwalden is the outlier on the other side with a ratio of just 1.68, which is that low because this canton taxes the high income of CHF 200,000 at a very low level and the CHF 50,000 annual income with an average rate.

Besides resulting in unequal treatment of taxpayers across cantons, the intercantonal tax competition is also believed to have led to fiscal disparities. On one hand, high tax cantons

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3Note that Table 2 displays only cantonal tax rates. Swiss residents are taxed on all three government levels. The federal income tax is quite progressive, and municipal income taxes differ in rates within cantons, whereas the system is fixed to the respective cantonal scheme.
Table 2: Cantonal personal income tax rates in four income categories and 200k/50k tax rate ratio for an unmarried person without children in 2007. Source: Gilardi and Wasserfallen (2009).

are also those with fewer wealthy taxpayers or businesses and therefore struggling with budget deficits. On the other hand, low tax cantons have proportionally more wealthy taxpayers and profitable businesses, and their public finances are generally in very good shape. The causal link between these disparities and tax competition is subject to debate. While some accuse low tax cantons of simply externalizing costs onto their neighbors (e.g., central infrastructures that are in cantonal financial competence such as universities, airports, cultural institutions), others argue that deficit-ridden high tax cantons tend to live above their means and should cut costs (e.g., generous welfare programs or subsidies). Be that as it may, the deepening fiscal disparities between cantons have stirred a long-running political debate that ultimately led to the introduction of a system of financial equalization in the mid-20th century that has recently been substantially reformed.
In addition to the debate over cross-cantonal fiscal disparities and equalization, there is a second line of intense political debate over the Swiss taxing system, fueled by the increasingly unequal treatment of taxpayers across cantons. This debate is about the ways in which the variety of cantonal tax systems should be reduced and to what extent this should be done. This debate has led to attempts at tax harmonization and implementation of subsequent reforms in 2000.

2.3 Compensating drawbacks of cantonal tax autonomy: fiscal equalization and tax harmonization

2.3.1 The Swiss system of fiscal equalization

The financial autonomy of cantons is one of the founding principles of Swiss federalism. The independence of cantons’ financial trajectories is thus inherent to this system. From the beginning, there have been differences between rich and poor cantons; however, it was only around World War II that the federation began to get involved in compensating cantonal differences in wealth. In 1938, the first equalization policy program was introduced in the form of conditional grants, with rates graded according to the tax capacity of the cantons. But only in 1958 was a constitutional article introduced providing the federation with the competence to equalize fiscal disparities between cantons; however, no quantitative objective was fixed regarding the level up to which the cantonal revenue raising capacities or the costs of public service provision should be compensated for.

Following adoption of the constitutional article, a system of intercantonal fiscal equalization was set up. The original objective of this system was to correct fiscal imbalance, meaning that all cantons should be able to provide some minimum levels of service without excessive differences in tax burdens across cantons. This system rested on three main equalization mechanisms (Dafflon, 2004, 15). The first two consisted of transfer flows from the center to the cantons in the form of conditional federal grants-in-aid and revenue sharing, while the third was a transfer flow from the cantons to the federation in the form of cantonal contributions to social security policies. In all three mechanisms, transfer payments are weighted according to the financial capacity of cantons, calculated with a formula that takes into account per capita economic

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4For an overview, see Dafflon (2004).
capacity, tax burden, tax revenue as well as the cost of public services provided. The transfer payments within this system steadily increased and, by the year 2000, accounted for roughly 25% of federal expenditures. Nevertheless, the system was ineffective, as it was unable to reduce the fiscal disparities between cantons, and differences in tax burdens across cantons continued to increase.

In 1994, an expert group commissioned by the federal government identified several flaws in this system of financial equalization and urged major reforms (Frey et al., 1994). Subsequently, a reform process was initiated, and a totally new system of financial equalization was implemented in 2008 (Eidgenössisches Finanzdepartement, 2001). Seeking to eliminate the flaws of the old system, the new system is based on two pillars: resource equalization (redistribution of financial resources between cantons) and compensation of charges (the federation pays contributions to cantons facing excessive costs related to public infrastructure requirements in large urban areas or mountain regions). In addition, reform of fiscal equalization was paralleled by a process of disentangling federal and cantonal responsibilities in a whole range of policy fields. Indeed, cooperative arrangements had, in the past, led to blurring of responsibilities between the cantons and the federation (Politikverflechtung, see Scharpf, 1978), a situation that had also been diagnosed as a major cause of ineffectiveness of the past equalization scheme.

The new system of financial equalization (Neuer Finanz- und Lastenausgleich) therefore has a comprehensive scope and can, no doubt, be qualified as one of the major innovations in Swiss (fiscal) federalism. As yet, however, it is too early to assess the effects of this reform. We will have to await the results of future evaluations (the first to be completed by 2012) to see whether the new system effectively contributes to reducing financial disparities between cantons.

2.3.2 Tax harmonization

The variety of cantonal tax systems not only results in unequal treatment of taxpayers across cantons but also leads to highly complex legal dispositions on the basis of which cantons collect their taxes. For instance, not only would types of taxes, tax rates, and tax allowances vary between cantons, but also the legal procedures for determining tax liability and calculating taxes due, and even the definitions of tax fraud and the extent of penal sanctions. The legal complexity of the Swiss tax system was increasingly criticized and, in the late 1970s, a new
constitutional provision was adopted, giving the federation the competence to work toward harmonization of direct taxes levied by cantons and municipalities.

However, it is important to note that this harmonization objective is limited to formal legal dispositions. The harmonization of tax types, tax rates, or tax allowances—so-called material tax harmonization—is explicitly excluded by Art. 129 of the Federal Constitution of the 18th of April 1999, which reads as follows (our emphasis):

1) The Confederation shall set out principles on the harmonization of the direct taxes imposed by the Confederation, the Cantons and the municipalities; it shall take account of the efforts toward harmonization made by the Cantons.

2) Harmonization shall extend to tax liability, the object of the tax and the tax period, procedural law and the law relating to tax offences. Matters excluded from harmonization shall include in particular tax scales, tax rates and tax allowances.

3) The Confederation may issue regulations to prevent unjustified tax benefits.

The formulation of this article makes clear that the idea of a material tax harmonization has not yet been able to find a political majority, notwithstanding the claims of the left, which has been criticising cantonal tax autonomy for a very long time. Subsequent to the adoption of this new constitutional provision, the general goal of formal tax harmonization was detailed in new federal legislation (Steuerharmonisierungsgesetz) that took effect in 1993. Cantons were given a transitory period of eight years to adapt their tax laws to the new standard set out in the federal law. Formal tax harmonization was achieved at the end of 2000.

3 A race to the bottom?

Given the extensive autonomy of cantons in tax policy, the danger of ruinous tax competition is real and has indeed been at the forefront of political debate for a long time, most recently in a referendum on harmonization of tax rates for high incomes on which Swiss citizens will vote in 2011. The Social Democrats launched this initiative, which aims to restrict tax competition with a harmonized minimal tax rate for incomes higher than CHF 250,000. They argue that tax differences for high incomes, as shown in Table 2, are too large and unfair. Center and

right parties defeat the proposal. For them tax competition is a major locational advantage of Switzerland and should not be restricted at all. Cantonal authorities also oppose the initiative because it would restrict cantonal tax autonomy.

A critical point in this debate is that tax competition would trigger a race to the bottom in taxation. But how much empirical evidence is there in support of this argument? If competition occurs, we would expect the tax rates of neighboring cantons to be similar, as these influence one another in the attempt to attract more taxpayers. Furthermore, this regional clustering of tax rates should be stronger for higher income categories, because wealthier taxpayers are obviously a better asset for cantonal finances. Figure 1 displays the geographic distribution of tax rates for two income categories, namely CHF 25,000 and CHF 200,000. The darker the grey shades, the higher taxation, while the respective tax rates of the shades are displayed on the right side of the maps. Figure 1 shows that tax rates for the CHF 200,000 income category are significantly clustered geographically, with lower tax rates concentrated in the cantons in the middle of the map (roughly in the region of Zurich), while tax rates for the CHF 25,000 income category are more scattered, with fewer regional similarities.

These spatial effects, as well as the differences between income categories, are confirmed by more systematic analyses (e.g., Gilardi and Wasserfallen 2009; Feld and Reulier 2008) and are also consistent with abundant anecdotal evidence. Figure 1 shows that especially small cantons close to Zurich, the economic center of Switzerland and providing extensive public infrastructure, tax high income people at very low rates.

Most critics of tax competition do not criticize competition so much per se, but rather its consequences, in particular a possible race to the bottom in tax rates that would put cantons under strong pressure to reduce expenditures and cut services. Gilardi and Wasserfallen (2009) analyzed in detail how cantonal tax rates changed in Switzerland from 1990 to 2007. Results can be summarized as follows:

1) Tax rates for low incomes decreased in almost all cantons. There has been a large degree of convergence towards a lower taxation level, or, in other words, a race to the bottom.\[6\]

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6 Revenue raised by taxing low incomes is fiscally negligible. In 1990 a large part of cantons taxed incomes, which are by far insufficient to make a living. Given the taxation levels in 1990 for low incomes, general cuts in these categories might not be that surprising.
2) For middle incomes the general trend has also been a lowering of income taxation between 1990 and 2007, although the general downward dynamic was much less consistent then in the case of the low income categories.

3) Cantonal tax changes for high incomes have been much more heterogenous. The majority of cantons have decreased tax rates for high incomes, but a significant number of cantons have increased tax rates since 1990. Hence, convergence towards a lower level does not characterizes the overall dynamic in the high income categories.

In sum, tax rates between 1990 and 2007 generally decreased for low and middle incomes, but not for high incomes. This is surprising because if competition leads to a race to the bottom, then tax rates for high incomes should converge towards a lower level. But such a dynamic can
be observed for the lower and middle income categories, although competition cannot be the factor driving it. Hence, empirical evidence contradicts the wasteful tax competition hypothesis, which argues that tax competition would trigger a race to the bottom in taxation for rich people because they are most mobile, and all governments would seek to attract them by lowering taxes. Looking back at Figure [1] we can note again that low tax rates are concentrated in a relatively narrow region, which means that, to the extent that competition exerts a downward pressure on tax rates for high incomes, its effects do not reverberate nationwide.

Part of the explanation for this contradictory pattern lies in institutionalized forms of cooperation among cantons. Although, as explained earlier, there are few limits to cantonal autonomy in tax policy, cantons strive to coordinate their policies in forums such as the national and regional conferences of cantonal finance ministers. Although these institutions do not make binding decisions, and its members are often more interested in preserving their autonomy instead of achieving meaningful cooperation, regular interaction may be a way out of the prisoner’s dilemma that characterizes tax competition (Gilardi and Wasserfallen, 2009).

In addition to these cooperative arrangements, other factors limit the extent of competition. First, in their locational choice, residents and businesses obviously do not look only at tax rates. They also consider the level of public services such as traffic infrastructures. Hence, it is not the tax level as such, but rather the ratio between tax and services that is important for locational choice. Second, differences in tax levels are capitalized. In cantons and municipalities with low tax levels, prices for soil and housing are higher. Hence, by moving to a low-tax location, residents and businesses might save tax expenses, but this may be compensated by higher costs for housing and living. Third, thanks to extensive direct democracy at the subnational level, citizens can decide about tax levels and government expenditures. Tax cuts might be supported in the short term, but, again, the ratio between taxation and public services is critical for the support of a tax reform. If service levels are considered too low, tax cuts are unlikely to be supported. Also, tax reforms considered unfair because they serve exclusively the rich might have a hard time standing to direct democratic votes.

Finally, specific characteristics define whether trying to attract taxable income with a low tax strategy makes sense for a canton or not. A tax cut implies reduction of revenue from the people already residing in a canton, and it is likely associated with some influx of supplementary
taxable income. For small cantons, the additional revenue might compensate for the losses, but for a big canton, this mechanism is fiscally risky because the initial losses are simply too big to be compensated by extra money. A similar pattern can be observed on the country level in Europe: small countries have lower corporate tax rates than big countries (Ganghof and Genschel 2008).

In the case of Swiss cantons, proximity to Zurich is obviously another important factor. Zurich is economically the most vibrant place in Switzerland, and the provision of public services such as cultural affairs, an international airport, and a large university, are extensive compared to other cantons. Therefore, it comes as no surprise that small cantons around Zurich successfully attract high incomes with low taxes. Because of the short travel distance they can still work in Zurich and profit from the benefits of a large city. Whether the fiscal equalization system is sufficient to compensate for such distortions is an open question.

4 Conclusion: tamed competitive federalism

The sovereignty of subnational units is deeply rooted in Switzerland. Noncentralization and subsidiarity are ruling principles also in the case of taxation. Direct taxes, especially, are largely decentralized, meaning that cantons differ substantially not only in tax rates but also in tax systems, while tax harmonization is limited to formal legal dispositions. A system of financial equalization, which has recently been substantially reformed, should reduce fiscal disparities to some extent. It is still too early to evaluate the effect of this new system. What is clear, however, is that the old system, which was criticized extensively, was neither transparent nor targeted and was unable to reduce fiscal disparities.

Yet, despite significant cantonal competence in income taxation and the poor functioning of the old equalization system, a general downward dynamic in tax rates, often labeled a race to the bottom, is only evident for low and middle income groups. Reductions in tax rates for these income groups cannot be explained by competitive dynamics. The picture for high incomes is more nuanced: while systematic analyses corroborate competition effects (e.g., Gilardi and Wasserfallen 2009, Feld and Reulier 2008), tax rates for high incomes generally did not decrease between 1990 and 2007. Hence, even though Swiss fiscal federalism is characterized by strong competitive elements, this has not led to the dysfunctions commonly associated with tax
competition. We argue that cooperative arrangements, the institution of direct democracy, and the capitalization of tax differences, for example in housing prices and rents, tame competitive pressures. Moreover, a low tax strategy is fiscally too risky for big cantons, and, in fact, only a handful of small cantons around Zurich have taxed high incomes at very low levels for an extended period of time.

Whether the differences in taxation between cantons are acceptable or not is eventually a political question. What this paper shows is that differences are indeed extensive. However, over the last 20 years a wasteful downward dynamic among high incomes could not be observed. The effects and the functioning of the new fiscal equalization systems, which unfortunately can not yet be assessed, will be critical for the further development of the complex decentralized tax system in Switzerland, with its competitive, cooperative, and compensatory elements.

References


