



Conference for Federal Studies

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TABLE OF CONTENTS

New Journal: The Quarterly Journal of New York State Politics... 1
1982 APSA Conference for Federal Studies Panel... 2
Recent Conferences... 2
Liberty Fund Conference on "The Meaning of American Pluralism"... 2
Workshop on Covenant and Politics: "Federal Liberty as a Covenantal Theme in American Civil Society"... 3
Call for Information from Notebook Editor: Annual Inventory of Research Activities... 4
"Further Evidence on Fiscal Centralization and Decentralization" by D. G. Davies... 8
"Economic Aspects of Swiss Federalism" by René L. Frey... 12

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NEW JOURNAL: THE QUARTERLY JOURNAL OF NEW YORK STATE POLITICS

The New York State Political Science Association and Empire State Report are pleased to announce the establishment of a new journal, The Quarterly Journal of New York State Politics. The Journal is interested in publishing research dealing with the government and politics of New York State and with the policy concerns of the state. It is also interested in publishing summaries of existing research trends, book reviews, and materials on the teaching of New York state politics, government and policy. The Journal invites contributions from scholars working on subjects of interest to the New York political and academic community. For further information, please contact: Professor Henry J. Steck, Quarterly Journal of New York State Politics, Department of Political Science, SUNY College, Box 2000, Cortland, New York 13045.

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1982 APSA CONFERENCE FOR FEDERAL STUDIES PANEL

The Conference for Federal Studies will sponsor the following panel at the APSA Meeting in Denver. The meeting is scheduled for 8:45 a. m. on Sunday, September 5.

Topic: Federalism in Court: The Social Scientist as Expert Witness

Chair: William H. Stewart, Political Science Department, 302 Ten Hoor, P. O. Drawer I, The University of Alabama, University, Alabama 35486

Papers: "Experiences of an Expert Witness"  
Charles Cottrell, Political Science Department, St. Mary's University, San Antonio, Texas 78284

"Contributions of Social Scientists in Federal District Courts"  
William H. Stewart, The University of Alabama

Disc. : Katherine Rudder, Associate Director, American Political Science Association;  
Gary Orfield, The Brookings Institution, 1775 Massachusetts Avenue, N. W., Washington, D. C.

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RECENT CONFERENCES

Liberty Fund Conference on "The Meaning of American Pluralism"

This conference was conducted by the Center for the Study of Federalism from May 16-18, 1982. It was funded by the Liberty Fund. The following papers were presented:

"William Penn's Conception of a Pluralist Polity"  
(Keynote address)  
E. Digby Baltzell, Department of Sociology,  
University of Pennsylvania

"A Pluralism of Political Cultures"  
Aaron Wildavsky, Survey Research Center,  
University of California, Berkeley

Liberty Fund Conference on "The Meaning of American Pluralism" (Con't)

"The Idea of a Pluralistic Polity and Its Implications"  
William Allen, Department of Humanities and Social  
Sciences, Harvey Mudd College

"Political Expressions of Pluralism"  
Robert Pranger, American Enterprise Institute

"Pluralism and Federalism"  
Daniel J. Elazar, Center for the Study of  
Federalism, Temple University

Other participants at the conference included:

Earl M. Baker  
Temple University

Samuel Krislov  
University of Minnesota

Gary Browne  
University of Maryland

Donald S. Lutz  
University of Houston

Gordon Freeman  
Walnut Creek, California

David W. Noble  
University of Minnesota

Morton J. Frisch  
Northern Illinois University

Howard Penniman  
American Enterprise Institute

Joseph E. Goldberg  
Hampden-Sydney College

James Reichley  
The Brookings Institution

Robert B. Hawkins, Jr.  
The Sequoia Institute

Stephen L. Schechter  
Russell Sage College

Ellis Katz  
Center for the Study of Federalism

Mulford Q. Sibley  
University of Minnesota

John Kincaid  
North Texas State University

Kenneth S. Templeton, Jr.  
The Liberty Fund, Inc.

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Workshop on Covenant and Politics:

"Federal Liberty as a Covenantal Theme in American Civil Society"

This most recent Workshop on Covenant and Politics was conducted on May 19-21, 1982. The following papers were presented:

"Federal Liberty as a Covenantal Theme in American Civil Society" (Con't)

"The Almost-Covenanted Polity"

Daniel J. Elazar, Temple University and Bar-Ilan University

"Dimensions of Liberty in the U.S. Constitution"

Donald S. Lutz, University of Houston

"Lincoln's Political Humanitarianism"

J. David Greenstone, University of Chicago

"Covenant Foundations in the American Economic Community"

John F.A. Taylor, Michigan State University

"Covenantal Perspectives on Freedom of Speech"

John Kincaid, North Texas State University

Other participants at the Workshop included:

James Luther Adams  
Harvard Divinity School

John Peacock  
American University

William B. Allen  
Harvey Mudd College

Filippo Sabetti  
McGill University

Anthony Careless  
Ministry of Intergovernmental  
Relations, Canada

M. Estellie Smith  
State University of New York,  
Oswego

Morton J. Frisch  
Northern Illinois University

William H. Stewart  
University of Alabama

B.J.S. Hoetjes  
Queen's University

Douglas Sturm  
Bucknell University

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CALL FOR INFORMATION FROM NOTEBOOK EDITOR:  
ANNUAL INVENTORY OF RESEARCH ACTIVITIES

It is time, once again, to compile our annual inventory of current research activities by members of the Conference for Federal Studies. This is done as a service to its members, the results being published in the CFS Notebook. The following form is provided for the convenience of members in transmitting information on their current research activities and publications. We hope that all members will fill out the form and return it to the editor, Donald S. Lutz, Department of Political Science, University of Houston, Houston, Texas 77004.

Annual Inventory of Research Activities (Con't)

The responses to this inventory will be published in the issue of CFS Notebook following the next one (that is, two issues from now). If you have any information on grants, travel, meetings, etc., please include them for publication in future issues. Thank you.

1. Name \_\_\_\_\_

2. Institutional Affiliation (university and department, governmental agency, etc.) and Address

\_\_\_\_\_  
\_\_\_\_\_

3. Title and position \_\_\_\_\_

4. Current Research Activities

Project Number 1

(a) Title \_\_\_\_\_  
\_\_\_\_\_

(b) Description \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

(c) Information Contact \_\_\_\_\_  
\_\_\_\_\_

(d) Starting Date/Completion Date \_\_\_\_\_

(e) Availability of Final Report (Address) \_\_\_\_\_  
\_\_\_\_\_

(Please use back of this page for additional projects)

Annual Inventory of Research Activities (Con't)

6. Conference for Federal Studies Activities

(a) What services would you like the Conference to provide for its members?

(b) What topics would you like to see presented at the Annual Symposium organized by the Conference at the yearly American Political Science Association Meetings?

(c) Would you be willing to serve as a reader for PUBLIUS manuscripts?

\_\_\_\_\_ Yes                      \_\_\_\_\_ No

Please indicate your areas of specialization and interest.

(d) Would you be willing to review books for PUBLIUS?

\_\_\_\_\_ Yes                      \_\_\_\_\_ No

(e) On what topics would you like to review books?

THANK YOU.

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# FURTHER EVIDENCE ON FISCAL CENTRALIZATION AND DECENTRALIZATION

D. G. Davies

## Introduction

Powerful economic and social forces have been at work in developed countries over the past 35 years. The purpose of this note is to show the impact of these forces on fiscal centralization and decentralization in those economically advanced countries that have federally structured governments.

There are many complex reasons for believing that there has been an increasing centralization of government finances in federal countries. These factors range all the way from the effect of Keynesian policy prescriptions to continued international tensions.<sup>1</sup> Somewhat surprisingly, however, the evidence of the post-World War II era does not support the idea of increased fiscal centralization.

## The Evidence

The figures in Table I show for the respective countries the proportion of total taxes collected that is levied by the central government. The long run trend of the figures is falling for all countries with Canada exhibiting the steepest decline.<sup>2</sup> Additional analysis of each country indicates that the elasticity of central taxes with respect to GNP is less than the elasticity of total taxes to GNP. This result lends further weight to the thesis that federal tax collections have grown less rapidly than total tax revenue despite the fact that central government revenues have increased appreciably and manifested sensitivity to changes in GNP during the post-war period.

As in the case of centralization there are many reasons for the financial growth of provincial-state-local governments. They range from the fact that the traditional governmental functions performed by non-federal governments are more income elastic than those undertaken by the federal government to the belief that minority groups receive more effective representation in smaller units of government.

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\*The author wishes to express his appreciation to Professor R. L. Mathews, Director of the Centre for Research on Federal Financial Relations at the Australian National University for his kind permission to use part of the research completed at the Centre.

<sup>1</sup>For a discussion of the factors behind increases in federal and provincial-state-local fiscal variables see David G. Davies, "An Analysis of Fiscal Centralization, Decentralization, and the Pattern of Federal and State-Local Taxes," in R. L. Mathews (ed.) State and Local Taxation, Australian National University Press, Canberra, 1977, pp. 65-82.

Table II is the complement of Table I and shows that the ratios of provincial-state-local taxes to total taxes have been generally increasing between the years 1947 and 1981. These statistics support the idea that the forces behind growing fiscal decentralization have been more powerful than those working toward fiscal centralization. All federal countries investigated reveal a pattern of increasing fiscal importance in provincial-state-local governments.

### Decentralization and Separation

The reader should exercise caution in extrapolating the trends reported in this note. The process of decentralization may have within it the seeds and forces necessary to generate change. While in many cases provincial, state, and local authorities can better cater to the preferences of individual voters who are members of various cultural, ethnic, linguistic, racial, religious, or social groups, the effects of decentralized public policy may generate increasing disparities among various governmental units and their citizens. As time passes these differences in the way individuals are treated in subnational governments may stimulate reaction and a movement for central authority intervention to restore more equality and balance, and to set minimum standards by which all provincial, state, and local jurisdictions must abide. Some decentralization may be traded off for other goals.

There is therefore the possibility of a cycling of the centralization and decentralization process. As GNP grows over the long run and time passes, the amount of government taxes, revenues, and expenditures grows, but at times regional economic and social factors cause the provincial-state-local share to grow relative to the federal share while at other times the reverse occurs.

There is no compelling reason to assume, however, that this pattern of fiscal cycling between central and regional governments will continue indefinitely. If the strong desire of regional governments to meet citizen needs and demands for various provincial-state-local governmental services is frequently thwarted, separation from the federation becomes a genuine and attractive alternative. The fact that the data in this paper indicate increasing fiscal decentralization in economically developed federal countries is not prima facie evidence that central governments have been particularly sympathetic and responsive to regional needs or able to satisfy changing aspirations. It may well be that the decentralizing trend of the past 35 years has been neither strong enough nor sufficiently rapid to prevent serious moves toward the separation of non-central governments.

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<sup>2</sup>See Douglas A. L. Auld, "Contemporary and Historical Economic Dimensions of Canadian Confederation," Discussion Paper No. 79-1, Department of Economics, University of Guelph for an excellent history and analysis of fiscal developments in Canada from just before confederation until the present.



TABLE I  
RATIO OF CENTRAL TO TOTAL GOVERNMENTAL TAXES

Year	Australia <sup>a</sup>	United States <sup>b</sup>	United States <sup>c</sup>	Canada <sup>c</sup>	W. Germany <sup>b</sup>	Switzerland <sup>b</sup>
1947		.760	.768	.764		
1948		.731	.742	.718		
1949	.882	.684	.703	.691		
1950	.874	.723	.735	.690		
1951	.981	.757	.765	.725	.590	
1952	.895	.753	.758	.741	.601	
1953	.875	.745	.752	.737	.585	.488
1954	.865	.712	.723	.714	.597	
1955	.858	.719	.730	.709	.598	.492
1956	.855	.711	.724	.709	.582	.525
1957	.849	.703	.719	.676	.561	.464
1958	.843	.681	.699	.644	.557	.516
1959	.828	.652	.705	.651	.547	.476
1960	.826	.675	.700	.648	.530	.497
1961	.836	.663	.680	.636	.525	.473
1962	.824	.662	.691	.593	.529	.495
1963	.814	.661	.642	.583	.537	.470
1964	.815	.640	.672	.590	.539	.499
1965	.825	.640	.673	.573	.548	.469
1966	.827	.601	.652	.581	.558	.486
1967	.820	.629	.675	.567	.556	.452
1968	.821	.639	.679	.561	.549	.464
1969	.820	.638	.680	.569	.545	.447
1970	.826	.602	.651	.559	.552	.454
1971	.835	.577	.634	.560	.551	.438
1972	.810	.580	.637	.559	.513	.448
1973	.787	.580	.647	.561	.522	.408
1974	.797	.609	.609	.588	.511	.405
1975	.801	.583	.651	.576	.523	.378
1976	.744	.594	.659	.574	.518	.409
1977	.798	.586	.639	.512	.514	.401
1978	.797	.586	.648	.491	.517	.416
1979	.799	.602	.665	.500		
1980	.806	.606	.667	.509		
1981 <sup>d</sup>		.618	.643	.537		

<sup>a</sup>Australia has no separate social security tax.

<sup>b</sup>Excludes social security contributions.

<sup>c</sup>Includes social security contributions.

<sup>d</sup>Through the third quarter of the year.

Sources: Commonwealth Bureau of Census and Statistics and Australian Bureau of Statistics, Australian National Accounts, National Income and Expenditure, various years; U.S. Department of Commerce, The National Income and Product Accounts of the United States, 1929-65, and Survey of Current Business, various years; Dominion Bureau of Statistics, Canada, National Accounts, Income and Expenditure 1926-56, National Accounts and Expenditures by Quarter, 1947-61, and National Accounts and Expenditures, various quarters; United Nations, Yearbook of National Accounts Statistics, 1969, 1972, 1979; OECD, Revenue Statistics of OECD Member Countries, 1965-1971, and OECD, National Account Statistics, various years.

TABLE II

## RATIO OF PROVINCIAL-STATE-LOCAL-TAXES TO TOTAL GOVERNMENTAL TAXES

Year	Australia <sup>a</sup>	United States <sup>b</sup>	United States <sup>c</sup>	Canada <sup>c</sup>	W. Germany <sup>b</sup>	Switzerland <sup>b</sup>
1947		.240	.232	.236		
1948		.269	.258	.282		
1949	.118	.316	.297	.309		
1950	.126	.277	.265	.310		
1951	.109	.243	.238	.274	.410	
1952	.120	.247	.242	.259	.399	
1953	.125	.255	.248	.263	.405	.512
1954	.135	.288	.277	.286	.403	
1955	.142	.281	.270	.291	.402	.508
1956	.145	.289	.276	.291	.418	.476
1957	.151	.297	.281	.324	.439	.536
1958	.157	.319	.301	.356	.443	.484
1959	.182	.348	.295	.349	.453	.524
1960	.174	.325	.300	.352	.470	.503
1961	.164	.337	.310	.364	.475	.527
1962	.176	.338	.309	.407	.471	.505
1963	.186	.339	.308	.417	.463	.530
1964	.185	.360	.328	.410	.561	.501
1965	.175	.360	.327	.422	.452	.531
1966	.173	.399	.318	.419	.442	.514
1967	.180	.371	.325	.433	.444	.548
1968	.179	.361	.321	.439	.451	.536
1969	.180	.362	.320	.431	.455	.553
1970	.174	.398	.349	.441	.448	.546
1971	.165	.423	.366	.440	.449	.562
1972	.190	.420	.363	.441	.488	.552
1973	.213	.420	.353	.439	.478	.592
1974	.203	.391	.391	.412	.489	.595
1975	.199	.417	.349	.424	.477	.622
1976	.206	.406	.341	.426	.482	.591
1977	.202	.414	.361	.488	.486	.599
1978	.203	.414	.352	.509	.483	.584
1979	.201	.398	.335	.500		
1980	.194	.394	.333	.491		
1981 <sup>d</sup>		.382	.357	.463		

<sup>a</sup>Australia has no separate social security tax.

<sup>b</sup>Excludes social security contributions.

<sup>c</sup>Includes social security contributions.

<sup>d</sup>Through the third quarter of the year.

Sources: Same as Table I.

## ECONOMIC ASPECTS OF SWISS FEDERALISM

René L. Frey\*

Together with the United States, Canada and Australia, Switzerland is considered to be a classical federal state. Her federal structure has for a long time been accepted as a matter of course, rarely scientifically examined and seldom really open to doubt. In the post-war period, no wide-ranging studies of Swiss federalism have been carried out, except a few on inter-governmental fiscal relations. The turning point seems to have been reached some years ago with the preparations for the complete revision of the Swiss Federal Constitution<sup>1</sup> and the establishment of the Joint Center for Federal and Regional Studies in Riehen. Not only constitutional lawyers and political scientists contributed to this discussion, but also economists.<sup>2</sup>

In the first section of this paper, a survey of the structure of Swiss federalism is given. Then the current problems are discussed. In sections 3 to 6, some reflections on the possible directions of reform are presented.

### 1. The Structure of Swiss Federalism

Switzerland covers an area of 41,000 km<sup>2</sup> (16,000 square miles) and has a population of 6.3 million. She consists of 26 member states (cantons)<sup>3</sup> and approximately 3,000 local authorities. Table 1 shows the average, maximum and minimum sizes of the cantons and local authorities. Compared to other countries, the Swiss federal structure is extremely small-scale. The entire surface of Switzerland is covered by local authorities.

With the exception of the customs and some public enterprises such as the Swiss Mail, the federal government has no regionally dispersed administration. Its administrative duties are delegated to the cantons. This makes it almost impossible to clearly separate governmental functions

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\*Professor of Economics at the University of Basle (Switzerland) and member of the board of the Joint Center for Federal and Regional Studies at Riehen (Switzerland).

<sup>1</sup>The results of the work of the group of experts are presented in Expertenkommission (1977).

<sup>2</sup>E. G. Haller (1968), Frey (1974), Dafflon (1977), Frey (1977), Theiler (1977), Bieri (1979).

<sup>3</sup>In 1978 one canton (Berne) was split into two (Berne and Jura).

Table 1: Area and population of Swiss cantons  
and local authorities, 1978

	Area		Population
	in km <sup>2</sup>	in sq.miles	
Total	41,293	15,932	6,320,000
Cantons (26)			
- average	1,588	613	243,000
- largest	7,106	2,745	1,120,000
- smallest	37	14	13,500
Local authorities (3072)			
- average	13	5	2,050
- largest	282	109	380,000
- smallest	0.28	0.11	20

Source: Statistisches Jahrbuch der Schweiz 1978

between the three federal planes. The best, or at least easiest way to do so, is to look at the revenue and expenditure of the federal, cantonal and local governments. Table 2 shows that 37% of the revenue goes to the federal government, 34% to the cantons and 29% to the local authorities. The proportions on the expenditure side are 27%, 42%, and 31% respectively. The gap is filled by intergovernmental transfers (grants-in-aid, revenue sharing, etc.). Whereas the proportion of total public expenditure allotted to the federal government has not greatly changed during the last three decades, the share of federal resources transferred to the cantonal and local governments has increased substantially. Between 1950 and 1976 it has risen from one fifth to one third (see Table 3).

How are the different functions divided among the three governmental planes? The answer is given in Table 4. It shows that a separation of functions hardly exists in Switzerland.<sup>4</sup>

The sources of revenue of the federal, cantonal and local jurisdictions are shown in Table 5. Whereas the federal government finances itself to a great extent by indirect taxes, direct taxation is a matter mainly for the other two jurisdictions. Benefit taxation (non-tax revenues) is of great importance for the local governments.<sup>5</sup> The cantons heavily depend on intergovernmental transfers.

## 2. Current Problems of Swiss Federalism

So far, the structure of Swiss federalism has been described. Let's now look at its shortcomings in view of possible reforms. As far as I can see, three shortcomings can be detected:

1. The insufficient separation of government functions by levels results in the responsibilities for public duties often not being clear enough and the decision-making process being sluggish. This kind of government failure leads to welfare losses.
2. Federal competition in the interests of individual freedom--although still better developed than in other European countries--has lost importance during the last decades because of the need to master new public problems mainly in the fields of transportation, energy, education, R&D and environmental protection. "Competitive federalism" has to a large degree been substituted by "cooperative federalism." From the economist's point of view, this can be considered as a form of cartelization. And cartels normally affect welfare negatively.

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<sup>4</sup>Also see Aufgabenteilung... (1977).

<sup>5</sup>Dass and Bird (1979).

Table 2: Public revenue and expenditure of federal, cantonal and local jurisdictions, 1976

	Federal		Cantonal		Local		Total	
	Billion SFr.	%	Billion SFr.	%	Billion SFr.	%	Billion SFr.	%
Revenue <sup>1</sup>	14.4	37	13.3	34	11.3	29	38.9	100
Intergovernmental transfers	-4.8		+4.8				0	
			-2.5		+2.5			
			+1.0		-1.0			
Disposable resources	9.6	25	16.6	43	12.8	33	38.9	100
Net expenditure <sup>2</sup>	11.1	27	17.4	42	13.0	31	41.5	100
Balance (deficit)	-1.5	58	-0.9	34	-0.2	8	-2.6	100
Total public expenditure in % of GDP	10.4		9.2		7.5		27.2	

1. Without intergovernmental transfers

2. Total expenditure minus intergovernmental transfers

Source: Oeffentliche Finanzen (1978)

Table 3: Structure of federal expenditure, 1938-76

	Proportion of federal expenditure to total public expenditure in %	Proportion of transfers to federal expenditure in %		
		to cantons	to firms (subsidies)	total
1938	37.2			
1950	42.4	20.0	20.1	40.1
1955	41.5	16.1	22.4	38.5
1960	40.4	17.9	25.4	43.3
1965	40.1	28.6	23.3	51.9
1970	38.6	31.4	24.6	56.0
1975	35.9	31.4	30.4	61.8
1976	38.4	32.5	32.2	64.7

Source: Oeffentliche Finanzen (1978)

Table 4: Governmental functions, mid seventies

Level of Competence	Entirely	Predominantly	Mixed (vertical cooperation)
Federal	Foreign Affairs Telecommunications	Defense Agriculture Social Security Railroads Air-traffic	Universities R & D Flood and Avianche Control Energy Supply
Cantonal		High Schools Health Jurisdiction Relation to Churches	Elementary Schools Public Assistance Police Forestry, Hunting, Fishing Physical Planning Sewage and Water Purification
Local		Water Supply Sanitation and Waste Disposal Fire Brigade Culture, Sport	Housing Roads General Administration



Table 5: Sources of revenue by government level, 1976

	Federal		Cantonal		Local		Total	
	Billion	%	Billion	%	Billion	%	Billion	%
	Sfr.		Sfr.		Sfr.		Sfr.	
Taxes on income and wealth								
- individuals	4.4	31	7.6	40	6.3	45	18.3	47
- corporations	1.1	8	1.7	9	1.3	9	4.1	10
Taxes on consumption	7.3	51	0.7	4	0.02	0	8.0	21
Non-tax revenues	1.5	10	3.3	17	3.7	27	8.5	22
Intergovernmental transfers	0	0	5.8	31	2.5	18	(8.4)	(22)
Total	14.4	100	19.0	100	13.9	100	38.9	100

( ) not included in total

Source: Oeffentliche Finanzen (1978)

3. Cantonal autonomy is increasingly restricted by the federal government. Sometimes this is done for good reasons. Often, however, it results from the mere fact that the cantons are forced to obtain financial resources from the federal government because their own taxing possibilities are inappropriate. Furthermore, the boundaries of the cantons in many cases do not coincide with economic regions so that spillovers lead to welfare losses if no centralization of competences from the cantonal to the federal level is realized.

### 3. The Economic Theory of Federalism

In order to design a reform of federalism, it is necessary to build on theoretical foundations. As an economist, I want to build on the economic theory of federalism as developed by Buchanan (1950), Tiebout (1956), Tullock (1969), Olson (1969), Neumann (1971), Oates (1973), Hirschman (1970), Breton and Scott (1978) and others.<sup>6</sup>

<sup>6</sup>Also see the articles in Musgrave (1965) and Oates (1977).

The main argument in favour of the federal structuring of a country is that this contributes to limiting governmental power and to giving fuller scope to the individual. There exists a parallel between federal decentralization and economic decentralization as realized in markets. In both cases decision rights are given to a great number of units, thus creating a situation of competition that results in welfare gains for the community as a whole--at least in principle, that is to say if a number of prerequisites are met. Federal decentralization helps to increase welfare for the following four reasons:<sup>7</sup>

1. Individual preferences do not only differ between groups (e. g. rich and poor, young and old), but also between regions. If the differences between regions are great enough, it is easier to meet the individual's needs in a federal state than in a centralized one.
2. In federal systems minorities are better protected. They have a greater chance to get what they want from government by voting by feet, i. e. leaving jurisdictions which do not offer them the preferred bundle of public goods, and moving into jurisdictions that do better in this respect.
3. Normally information and decision costs are lower at the lower government levels, for the citizens as well as for the politicians and for public administration. The reason is that the distance between government and citizen is smaller and the incentives for good political decisions are greater.
4. The innovative capacities of federal systems are presumably higher.

If because of these arguments a country were organized in a purely decentralized manner, welfare losses would be the consequence. The following technological, economic and political reasons make some degree of centralization necessary even in federal states:

1. Often not only the inhabitants of one jurisdiction are affected by political decisions of their own government but residents of neighbouring jurisdictions, too. When no compensation is paid for such spillovers, this might lead to a false level and a false structure of public activity.
2. Many public goods are characterized by minimum optimal supply size and economies of scale. Local (and in Switzerland even cantonal)

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<sup>7</sup>In this paper, the division of responsibilities between the private and public sector is considered as given. The terms "public goods" and "merit goods" are therefore not used in a normative sense.

jurisdictions are often too small to deliver their goods efficiently.<sup>8</sup>

3. Some public goods show technological interdependencies, which create a certain pressure for vertical and horizontal coordination and cooperation between governments and administrations.

4. Some public goods could easily be supplied by regional or local jurisdictions from a purely technological or economic point of view. When these goods are considered to satisfy merit wants, however, it might be decided politically that they should be supplied to the whole population of a country independently of residence. The reasons for a (nearly) equal quantitative and qualitative supply to all may have equity reasons or be the consequence of option values.

Thus, both federal decentralization and federal centralization have their advantages and disadvantages. The problem is to find the optimal degree of centralization.<sup>9</sup> As its determinants are not only of a technological but also of a political character, it is not surprising that this optimum differs from country to country and changes over time.

#### 4. Forms of Centralization

The optimal degree of centralization is a rather theoretical notion. It can be operationalized for Switzerland in the following way. First, specific types of public goods are distinguished. Then the appropriate forms of centralization are sought for each type of good. The results of considerations of this kind may be summarized as follows:

1. For purely regional public goods (i. e. public goods only affecting the inhabitants of a single jurisdiction), pure decentralization is adequate (e. g. public parks and other recreational facilities).

2. Public goods with interregional spillovers--they may be called inter-regional public goods--can be dealt with in several ways:

- cooperation between jurisdictions of the same level  
(e. g. interlocal transportation);

- special regions. Special regions are public (or semi-public) organizations supplying one public good only. Their boundaries are determined by the range of spillovers of the good in question (e. g. university education);

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<sup>8</sup>In Switzerland, e. g., only eight of the 26 cantons have a university. All Universities except the Federal Institute of Technology are cantonal and mainly financed by cantonal taxes.

<sup>9</sup>Tullock (1969). For alternative approaches, see Wittmann (1973), Aufgabenteilung... (1975).

- federal skeleton laws. In skeleton laws the federal government has to set general prescriptions as to the quantity and quality of a public good. The cantons then have a wide scope of detailed arrangements in supplying them (e. g. high schools).<sup>10</sup>

It cannot be said generally which solution should be favoured. Amongst other things it depends on the financial arrangements (see section 6).

3. Those public goods which, for technological reasons, satisfy the needs of all inhabitants to a more or less equal degree are called national public goods. They have to be decided on unambiguously by the federal government (e. g. defense).

4. National public goods for merit want reasons can either be dealt with by

- federal skeleton laws. This solution is to be preferred when the merit element is rather weak;
- vertical cooperation; or
- strict centralization. There are good reasons for this solution when there is a strong political wish for equal supply of public goods to all inhabitants irrespective of their residence.

In Switzerland the merit want argument plays only a minor role (mainly in education). The contrary is true for the Federal Republic of Germany. In the Basic Law (federal constitution) of this country, a "uniformity of living conditions" is called for.<sup>11</sup>

5. Of course, international public goods (i. e. public goods with international spillover effects as e. g. foreign aid or pure research) must be in the competence of the federal government, if not of supranational organizations. Although this could be considered as a federal problem, too, it shall not be discussed here.

The next step consists in associating all government functions with one of the five types of public good and finding out the optimal form of centralization. For reasons of space, I cannot go into all the functions here. Let me simply draw some general conclusions:<sup>12</sup>

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<sup>10</sup>Skeleton laws can also be combined with other forms of centralization, especially special regions.

<sup>11</sup>The economic aspects of this constitutional article are discussed in Neumark (1978).

<sup>12</sup>See Wittmann (1973), Galliker, Calvori & Meier (1975), Frey (1977, Ch. 4), Elemente einer Neuverteilung... (1977), Modell für eine Neuverteilung... (1978).

1. In Switzerland only few public goods exist on which the federal government should have absolutely no say.
2. Vertical cooperation, today the dominating form of inter-jurisdictional cooperation, should be pushed back in favour of skeleton laws and special regions.
3. The trend in the direction of more intervention by the federal government need not be accepted as unavoidable.
4. In Switzerland only few governmental functions unambiguously have their responsibility at the wrong level today. Housing, e.g., should be transmitted to the cantons and local authorities. The federal government needs more far-reaching competences in physical planning, energy, and environmental policy, on the other hand.
5. Some of these conclusions only hold if reforms are put into practice, especially concerning taxation and intergovernmental fiscal relations.

#### 5. Federal Tax Structure

Public expenditure must be financed either by taxation, borrowing or transfers from other jurisdictions. Of course, the revenue system and the expenditure system are interrelated. They cannot be designed independently.

The first questions to be looked at when preparing an optimal finance system is whether, as a matter of principle, every jurisdiction should raise the money it needs by itself. This would create strong incentives for the efficient provision of public goods. Besides, it would be somewhat strange to remedy spillover biases on the expenditure side and at the same time create spillovers on the tax side. There is a real danger that the lower level authorities pass on public goods bills mainly because they think they can make others bear the financial burden.

There are, however, good arguments against this principle of equivalence. First of all, many taxes cannot be levied by local and cantonal jurisdictions in an efficient manner and without welfare losses. In Switzerland, the lower level governments are too small to levy sales taxes. Furthermore, for equity reasons the tax rates for income and wealth should not differ too much between jurisdictions. And, finally, if they did they would cause interregional migration which is politically not accepted. If the Swiss mountain cantons were forced to finance their expenditure themselves, they would soon lose all their inhabitants.

Summarizing the various arguments, it can be said that in a federal system like the Swiss one, the optimal degree of centralization on the tax side must be higher than on the expenditure side.

What does this mean for the reform of the Swiss tax system?<sup>13</sup>

1. The taxation of personal income and wealth, capital gains, and estates and gifts should be regulated in a skeleton law: the federal government decides which taxes the cantonal and local authorities have to levy and what their structure must be. The cantonal and local authorities have a free choice of the tax rates and deductions, within certain limits. Thus the lower level governments are free in deciding on the level of taxation. Yet excessive tax competition can be avoided.
2. The taxation of the profits of corporations--today a matter of all three levels--should be transferred to the federal government. The present system causes distortions in the locational structure. It cannot be overlooked, however, that this proposal leads to a loss of instruments of economic policy for the lower level authorities. In the case that this loss is weighted strongly, federal skeleton laws must also be passed for corporation taxation.
3. It cannot be disputed that in Switzerland the sales taxes must lie entirely within the competence of the federal government, as is the case today.
4. Regulatory and Pigou taxes<sup>14</sup> are best put in the hands of the authority which has the decision competence for the duty in question.

#### 6. Intergovernmental Fiscal Relations

Maybe even more important than the reform of the tax system is the reform of intergovernmental fiscal relations. Today they are hardly transparent and their effects are often presumed to be counterproductive.

The federal structure of Switzerland as sketched in this paper implies an intergovernmental transfer system consisting of five elements:

1. Revenue sharing is essential because many, and especially the important taxes, can only be efficiently levied at the federal level but decentralization on the expenditure side makes welfare gains possible.
2. Unconditional grants serve the efficient improvement of interregional income distribution. This element is an important condition for federalism to remain functional and politically acceptable.

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<sup>13</sup>Also see Höhn & Meier (1975), Wittmann (1975).

<sup>14</sup>Pigou taxes serve the internalization of external costs.

3. By conditional grants, the federal government creates financial incentives so that the lower level jurisdictions act in line with general interest. They are necessary in connection with skeleton laws and the vertical cooperation.
4. Repayments must be provided for as compensation for the member states undertaking functions delegated by the higher authority.
5. The regional compensation scheme, finally, represents a form of horizontal grant. It serves to recompensate the services of one local or cantonal authority in favour of the residents of another, i. e. to internalize spillover benefits. It is a necessary condition for the cooperation of local and cantonal authorities of the same level and the functioning of special regions.<sup>15</sup>

## 7. Concluding Remarks

The economic concept for a new Swiss federalism, as designed here, differs to some extent from the proposals made by other scholars. It greatly stresses the competitive element in federal decentralization. It therefore tends to bring (or bring back) the member states into a situation of competition with one another. This is apparently rather difficult for non-economists to understand. Their proposals for the reform of Swiss federalism normally take the direction of either cooperative federalism or changes in the decision-making rules (e.g. changes in the rights of the member states in decisions taken at the federal level). Whereas the former direction of reform is rejected by most economists having studied Swiss federalism, the latter must without doubt be included in the considerations. The fact that this has not been done here does not mean that the economist has nothing to say about it. Questions of decision-making mechanisms<sup>16</sup> form a part of public choice as do questions of the division of competence among the different government levels in a federal state.

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<sup>15</sup>The regional compensation scheme (Regionaler Lastenausgleich) is discussed in Frey (1979).

<sup>16</sup>This question is treated in Frey (to be published).

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