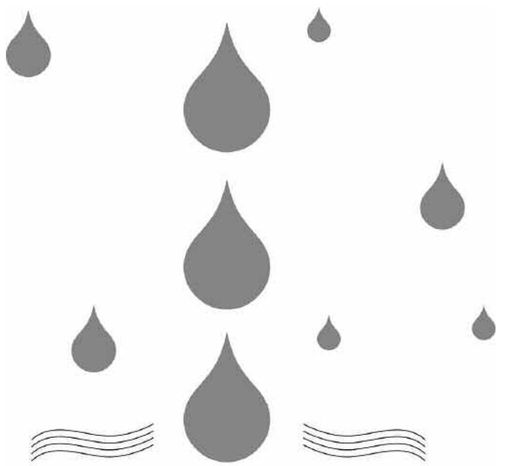
Extended abstract

Municipal Financial Equalisation in Switzerland and some Suggestions for Rural Municipalities in Spain



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Highlights:

1. The Swiss Confederation is a traditional federal state with two levels of government: the federal state and the cantons.
2. The local system - and thus the municipal financial system - differs considerably from canton to canton.
3. Swiss municipalities have the power to approve surcharges or reductions on the tax rates resulting from cantonal laws.
4. The sources of municipal revenue come from service charges, contributions and cantonal or, exceptionally, state transfers.
5. Cantonal transfers are levelling or equalising, i.e. they approximate the ordinary (tax) revenues of individual municipalities, depending on their financial capacity and spending needs.
6. Compensation for greater spending needs favours smaller municipalities and some large ones because of their status as large cities or metropolitan centres, and higher spending on some basic services.

Abstract: The financing of small and medium-sized municipalities is one of the relevant factors in the public strategy against rural depopulation. One of the lessons learned from the experience of other countries is the implementation of specific funding mechanisms that cater precisely to the specific characteristics and needs of small or rural municipalities. This article analyses the case of Switzerland, using the example of the cantons of Zurich and Bern. It should be borne in mind that in the Swiss federal structure, local financing, as well as all matters relating to local government, is an exclusive competence of the cantons. Examples of typologies of revenue source structures are analysed, and the particularities of the sophisticated model of financial equalisation, which is present at both cantonal and municipal level (and concerns both revenue equalisation and different types of compensation for special charges), are highlighted. It concludes with some lessons that can be drawn from the Swiss experience.

Keywords: Federalism, local governments, municipal financing, financial equalisation.

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Extended Abstract

Municipal Financial Equalisation in Switzerland and some Suggestions for Rural Municipalities in Spain

The Swiss Confederation is a federal state with a classical or traditional format that is structured around two territorial levels of government: the federal state or *Bund* and the federated states or cantons. Article 50 of the Federal Constitution recognises the existence and autonomy of the municipalities as a kind of institutional guarantee, but refers almost entirely to the provisions of the individual cantons' constitutions and laws (Kägi-Diener, 2014). This means that the local regime - and thus also the municipal financial regime - differs significantly among the different cantons.

The cantons normally *replicate, for their municipalitie*s, the financing system in force in the *Bund* and in the canton itself. In this sense, the Swiss municipalities have similar or parallel taxes to the cantonal ones. And just as the Bund provides for equalisation transfers to the cantons (Art. 135 of the Federal Constitution), the cantons also have transfers for the financial equalisation of the individual municipalities within their territory.

Swiss municipalities have several local taxes, regulated by cantonal laws, but with a certain degree of tax autonomy for each municipality. As in many other countries, cantonal financial laws distinguish between mandatory taxes (not available to municipalities) and voluntary taxes.

A distinctive feature of Swiss local financing is the municipal authority to approve surcharges or reductions (Steuerfusse, centimes additionnels) on the tax rates that result directly from the cantonal laws (Bern, 2021). These laws fix or determine the tax liability, which can be increased or reduced by each municipality through a multiplier coefficient or a percentage of the tax liability. However, this system operates differently across the different cantons.

In most cantons the multiplier consists of a number equal to, above or below one: if a municipality sets the Steuerfuss at "1", it means that the tax liability aligns with what is directly prescribed by the cantonal finance law. Consequently, there is only a real surcharge (or reduction) occurs only if the Steuerfuss is higher or lower than 1. The same principle applies when the surcharge is fixed as a percentage of the tax liability: in this case, a percentage of 100 % indicates no surcharge, whereas a higher or lower percentage indicates a surcharge or reduction of the municipal tax liability.

Each canton also has its own transfer system for municipal financial equalisation. Most often - although some cantons do not follow this model - cantonal laws articulate equalisation around two criteria: the source of the equalisation (horizontal or vertical); and the function of the equalisation (for lower revenues or higher expenditures). Regarding the first criterion, the cantonal laws consider both transfers from the cantonal administration to the municipalities (vertical equalisation) and transfers from municipalities with higher revenues to those municipalities with lower revenues (horizontal equalisation).

Under various names (Ressourcenausgleich, Finanzausgleich), the cantonal laws provide for equalisation transfers in favour of municipalities with lower revenue-raising capacity through municipal taxes. For the most part, this equalisation is essentially horizontal. That is, the richer municipalities in each canton allocate part of their own revenues (from their local taxes) to improve the revenues of the poorer municipalities (for Bern, Lienhard et al., 2021). The implicit assumption is that small municipalities (and among them, especially those in mountain areas) have a limited tax collection capacity, due to the smaller number of taxpayers and lower taxable bases of the different municipal taxes.

The cantons also have financial compensation schemes for the increased financial needs of some municipalities. In contrast to equalisation for lower revenues, transfers for higher spending needs of some municipalities are mainly covered by the canton. Sometimes this higher spending is due to special needs, while in other cases it is due to the higher cost for some municipalities of running the same municipal services. Compensation for greater spending needs, unlike income equalisation, not only favours smaller municipalities (especially those in mountain areas), but also some large municipalities. This is because, as large cities or metropolitan centres, they face higher expenses for some basic services.

The concept of expenditure or "special charges" (Sonderlasten) varies from canton to canton, as does their technical articulation. In general, a distinction is made between (i) compensation for geography or topography (Geografisch-topografischen Lasten), which mainly takes account of the mountainous or sparsely populated nature of each municipality; (ii) compensation for special socio-demographic burdens (Soziodemografischen Lasten), also vertical, which takes account of the special population structure of certain municipalities; and (iii) special centralisation burdens (Zentrumslasten) relating only to specific towns, explicitly identified in the cantonal laws. In addition to these three types of burdens, the cantonal financial laws also provide for specific transfers in particular situations of unspecified financial need, e.g. for municipalities facing high tax pressure.

The broad typology of equalisation criteria included in the various cantonal financial systems is designed to achieve two primary purposes: to objectify and make transparent equalisation transfers (both horizontal and vertical) and to ensure that all municipalities, regardless of the greater or lesser strength of their tax bases and without prejudice to special geographical or socio-demographic conditions, are able to exercise their competences and provide adequate and comparable municipal services. It can be considered, also in principle, that the two stated objectives are reasonably achieved. However, there are some possible objections, mainly related to those transfers for "special burdens", which disproportionately favour larger cities. These transfers have the potential to distort the overall balance of each cantonal equalisation system.

Firstly, although the criteria and quantification of transfers are highly regulated (and therefore objectified), there are still elements that are not fully transparent. And secondly, (vertical) transfers for "special burdens", when high, can be used by some of the richer cities to recoup the transfers they have provided through the (horizontal) revenue equalisation mechanism.

The first potential lesson for Spain is to observe that transfers from central and regional governments to municipalities serve an equalisation function that is today practically non-existent in the general system transfers from the central government (the so-called PIE, or participation in revenues of the central government) and is moderately present in the local cooperation funds of some regions. While Swiss transfers are primarily aimed at equalisation, PIE transfers are aimed at ensuring the financial sufficiency of the most populated municipalities. Following the lessons learned from the Swiss cantons, transfers from the central government should be redirected towards financial equalisation.

The Swiss cantons also show that vertical transfers (those coming directly from the cantonal government) must pay attention to the great diversity of spending needs in the different municipalities. The legal identification of determining circumstances for higher spending, such as the orography, the higher number of immigrants, or the metropolitan function of some cities, allows the economic and social situation of each municipality to be addressed in a differentiated manner. Criteria such as these simply do not exist in Spain's system of unconditional transfers from central government (PIE), and are only partially present in some regional funds for local cooperation. It would be advisable, once again, to link at least part of the transfers from central government to various real circumstances other than the simple number of inhabitants, such as population density, orography, or population ageing, because all these circumstances indicate greater spending needs that cannot be met by rural and/or small municipalities.