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# An Economic Theory of Switzerland

## Abstract

Switzerland is often viewed as a federalist curiosity and a unique form of direct democracy. But this view does not provide a proper understanding of the country. A theory of Switzerland is necessary. A consideration of the initial, exogenous geographical situation of Swiss territory provides a better understanding of the country's development. It was out of the fractured geography that the institutions of federalism and direct democracy as they are known today developed and established themselves. Although there was a trend to internal centralisation in the 20th century, the regional authorities have maintained their autonomy considerably better in Switzerland than in other states. An important factor is that the federal government, cantons and municipalities are each responsible for their own finances and debts. This stabilises not only the budget of regional and local authorities but also prevents interference on the part of the central government.

JEL-Code: H600, H700, N400.

Keywords: fiscal federalism.

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**An Economic Theory of Switzerland***

by

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## Why is Switzerland so federalist?

In the concert of nations Switzerland is often viewed as an irritating fiscal exception, as an annoying country that has chosen a path different from that of the great fiscal states of the civilized Western world, in particular different from that of the European Union. Why can't Switzerland tax foreign financial and real capital in the same way as all the other large nations do? Why is it necessary for the OECD and the G20 to use political pressure before Switzerland agrees? One explanation is that Switzerland itself is not a closed tax system; in many cases the federal government does not have the power to tax. It rather lies (as in the case of holding company taxation) from time immemorial with the cantons. A lack of federal tax regulations has led to alleged "unfair" tax competition, which has increased the annoyance of countries with a large public sector. Swiss tax federalism is gradually being dismantled as a result of pressure from outside but Switzerland is nevertheless still "backward". France, for example, threatened to strip Switzerland of its sovereign status and to degrade it to a "territoire non-coopératif".[1]

## Some theory[2]

The above does not provide an explanation for the exceptionalism of Switzerland, it only asks the question in a different way. We must now explain how this "tax backwardness" arose. The reasons often go back centuries. Switzerland was never an absolutist state in which the prince exhausted his local tax power by using professional tax collectors in a systematic way. But why was Switzerland saved from the yoke of absolutism and in the process its fiscal backwardness preserved? To answer this question, a theory is necessary.

Bean's law, named after the American economic historian Richard Bean (1973), is a good starting point. In the author's view large territorial states can be defended more easily than small fractured dominions as the external perimeter of a dominion grows linearly, the area however by its square. In large counties, relatively fewer resources are required to defend the outer border than in small fractured territories. Based on this simple thesis, additional conclusions can be drawn (Blankart 2011; 2012). In a large state the distance to the border is great, and emigration costs are high. Neighbouring states are far away so that comparative competition is low. Thus the costs of repression for the ruler are low and taxation is high. In contrast, in a fractured state migration costs to the border are comparatively low and comparative competition high. The costs of repression and taxation are thus comparatively high and taxation low.

These considerations lead to two basic models: large states with a natural centralism and fractured states with a natural federalism that are located next to each other. Admittedly, geography no longer plays a central role today. But it is from the geography of the past that the institutions of today arose.

Apart from the pure cases of natural centralism and natural federalism, there are, of course, many mixed forms. However, there is no doubt general agreement that in historical terms, and also for today, Switzerland is closer to natural federalism than natural centralism. Switzerland was difficult to conquer, to rule and to exploit for taxes. The early wars of independence are proof. The Swiss confederates were able to maintain their natural federalism and shake off Austrian rule and taxation. But torn apart by their federalism, they were unable to conduct active foreign policy and despite victorious battles in the 15th century to conquer and rule neighbouring regions, such as the duchy of Burgundy or Milan. Nevertheless they were viewed as unconquerable and thus, in fiscal terms, unattractive. That Switzerland broke away from the Holy Roman Empire in the Peace of Westphalia (1648) was the logical conclusion of a long historical development.

**Natural federalism as reflected in the mirror of history**

Later natural federalism also played an important role in shaping Switzerland. When in 1798 the French revolutionary troops conquered Switzerland, France sought to transform Switzerland into a unitary state, the Helvetian Republic, with a centralised tax system. The decentralised feudal burdens were abolished. But the wealth, transport, income and luxury taxes that were instituted instead did not take hold in the natural federalism of Switzerland, and the grand experiment failed. As quickly as five years later the Helvetian Republic collapsed as a result of internal chaos, bloody revolts and coup d'états. Napoleon Bonaparte thus felt it necessary to institute a new constitution that was less centralistic – a "mediation constitution". In particular the centralistic financial constitution, which ran contrary to Swiss natural federalism, was abolished and the cantons regained their previous financial autonomy. Instead of remitting a monetary tax to France, Switzerland was obligated to provide a non-monetary tax – troops of 12,000 men (for the Russian campaign, among others) – which was not less of a burden but was easier to enforce.[3] The mediation constitution lasted for over ten years. But as soon as Napoleon's troops withdrew behind the Rhine at the end of 1813, the mediation broke apart and the pre-revolutionary order was re-established excluding, however, the subordinate relationships among Swiss territories. Only with a great deal of effort and pressure from foreign countries was the Swiss confederation able to establish a constitution, the Bundesakte of 1815. In it the common defence of the nation was regulated. It did not include a national customs and tax system. The federal government financed itself with contributions, weighted by wealth, from the cantons. Federal laws arose only as concordats of the cantons, membership in which was voluntary.

In 1848, however, a liberal majority of the cantons brought a violent end to this confederation. Disregarding the conservative minority, it established a federal state and secured for themselves an absolute majority in both legislative chambers of parliament and in the executive branch, the Federal Council, for the next 50 years.

The goal of the liberals was primarily to establish a common market in all of Switzerland. As a result customs was declared to be a federal issue as well as the infrastructure network – streets, bridges, post and currency. With respect to taxes (except for custom duty) the cantons remained autonomous. Natural federalism prevailed. The cantons used their freedom and experimented in competition with a number of tax systems. The economic historian M. Spoerer (2002) reports on a discussion in Zurich in which it was debated whether the city could afford an income and wealth tax that was 80 percent higher than that in Basle. A considerable number of other examples indicate that there was intense natural tax competition.[4]

Despite cantonal autonomy in taxes and public expenditure, the liberal majority in the federal government presented a constant threat to the local authorities, which became evident above all in a cultural struggle and the resulting ban of the Jesuits. Only a total revision of the federal constitution could change this situation. This did not happen until 1874. Nevertheless, the revision brought little change in the political majority and power relationship. The conservatives only succeeded in including in the constitution an albeit very important federalist institution – facultative referendums on legislation. For every federal law which passed the two chambers of Parliament, 30,000 (today 50,000) voters could invoke a referendum and thus repeal centralistic and other unpopular laws with a simple majority. Today federal referendums on legislation are still very important, since without a legislative competency of the federal court, it is the only way to repeal unconstitutional laws.[5]

As of 1891 an obligatory referendum on the then introduced possibility of a partial revision of the federal constitution was conducted. In accordance with the importance of the matter, a majority of voters and cantons was necessary. This referendum also placed an effective barrier to the expansion of the federal authorities' competency vis-à-vis the cantons and thus to undermine the federalism. It is important that the existence alone of the referendum forced the federal authorities to take into account the interests of the voters in the cantons. The effect of the referendum was similar to that of a fleet in being.

## The five phases of centralisation in Switzerland

The referendum can be seen as the last great and successful effort to halt the growing competencies of the federal government and to expand federalism. A series of reforms have followed up to today that strengthen the federal government at the expense of the cantons and municipalities. Five stages can be enumerated:

1. In 1891 the possibility of a popular initiative for partial revision of the federal constitution was created. Popular initiatives require 50,000 (now 100,000) signatures and create, if they are accepted by the people and cantons, new federal powers without the government and parliament having to take action. They always entail an element of reproach, the implication being that the government has failed to capture the wishes of the people. Most popular initiatives actually fail in practice, as they do not receive the required qualified majority of citizens' and cantons' votes. However, like the referendum, its very existence is a reminder to the government and parliament to be vigilant and to read actual or perceived wishes from the lips of the citizens, or of the press. As a result counter-proposals to the popular initiative are often presented to the voters.

2. Additionally the proportional electoral system for the National Council, which has existed since 1919, has positively influenced centralisation. Instead of a majority party there are now several minority parties ruling the National Council. In addition to the liberal party there are parties representing farmers, catholic conservatives and social democrats. The parties all have to establish a profile by transforming their minority wishes into majority wishes via logrolling (i.e. together with other minority parties). The result is that every coalition formed by the logrolling of two or more parties leads to the creation of two or more new federal laws. Centralised regulation is increasing.

3. To finance defence expenditures, a "military tax" and a "commodity sales tax" at the wholesale level were introduced as federal taxes in 1915 and 1941 respectively. Neither of these was repealed later and both exist today as a "direct federal tax" on income and a "value added tax" on consumption. These two taxes are an important source for financing the goals agreed by the logrolling coalitions arising from the

proportional voting system. The last notable control is the constitutional provision requiring that these two tax laws be approved every ten to fifteen years by the people and the cantons as a whole and, if rejected, are not renewed.

4. The tax harmonisation law of 1990 represents a powerful intervention in the canton's and municipal tax autonomy. The federal legislator requires the cantons to levy certain taxes, including an income and wealth tax on natural persons, a profit and capital tax on legal entities and a withholding tax from certain natural and juristic entities, and a real property gains tax. Thus with this federal law the taxpayer, tax base and tax deductions are givens. As a result the cantons and municipalities are only free to determine material taxation i.e. tax allowances, tax rates and tax exemptions. Tax competition is thus intensely focused on these three parameters and the scope for innovation is very limited.

5. Furthermore, the federal court has become more intent on expanding its own interests by extending its political competency to include federal laws. It has intervened in the area of material taxation by determining that degressive income taxation (even if in the process the absolute tax burden rises) is incompatible with a the ability-to-pay principle. It thereby limits the ability of tax-poor cantons to restore their finances using attractive tax rates and thus forces them to depend on the federal government.

## Results: federal taxation in Switzerland today

The conditions described above characterise taxation in Switzerland in five ways:

1. Figure 1 gives the impression of a confused tax situation. High and low marginal income tax rates coexist. Rates in Schwyz (SZ) and Zug (ZG) are very low; Vaud (VD) and Geneva (GE) have very high marginal rates. It must be kept in mind that all the columns in Figure 1 assume a fixed base of 11.6 percent of direct federal taxation for the top tax bracket under consideration. The federal tax is highly progressive: it begins with an income of more than 50,000

Swiss francs and a rate of 0.5 percent. The remaining differences in the cantonal and municipal taxes are expressions of tax competition. Just as competitive markets are always characterised by different prices due to search processes, the cantons and municipalities are characterised by different tax rates in a system of competitive federalism. For this reason, there are always smaller discrepancies in tax burdens. Some people consider this element of tax competition to be unfair. But because of this competition, pressure is exerted as a whole on the tax burden, which would hardly be expected in a tax cartel or if taxes are set at the federal level.

Table 1

Current and expected final accounts of the Swiss cantons 2008–2014

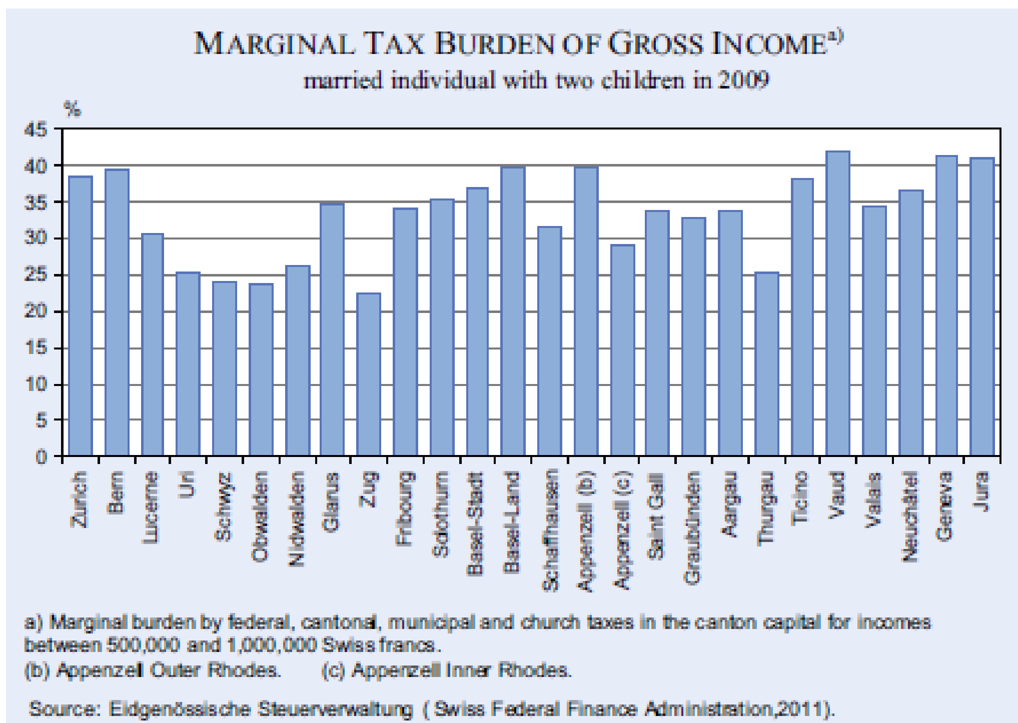
| | Balance in millions of Swiss francs | Surplus ratio as a % of GDP |
|---|---|---|
| 2008 | 3,409 | 0.6 |
| 2009 | 2,228 | 0.4 |
| 2010 | 2,338 | 0.4 |
| 2011 | 2,132 | 0.4 |
| 2012 | 3,052 | 0.5 |
| 2013 | 3,879 | 0.6 |
| 2014 | 5,102 | 0.7 |

Source: Swiss Federal Finance Administration.

2. As already mentioned, the tax-harmonisation law channels tax competition basically in the direction of tax rates, tax allowances and some tax exemptions. The law allows little scope for other tax niches. Therefore, tax competition in these areas is particularly intense. It could even assume oligopolistic features if the number of cantons were smaller. If, on the other hand, the cantons had more

freedom in the design of taxation, competition could have more of the character of niche competition with possibly lower rate differentials.

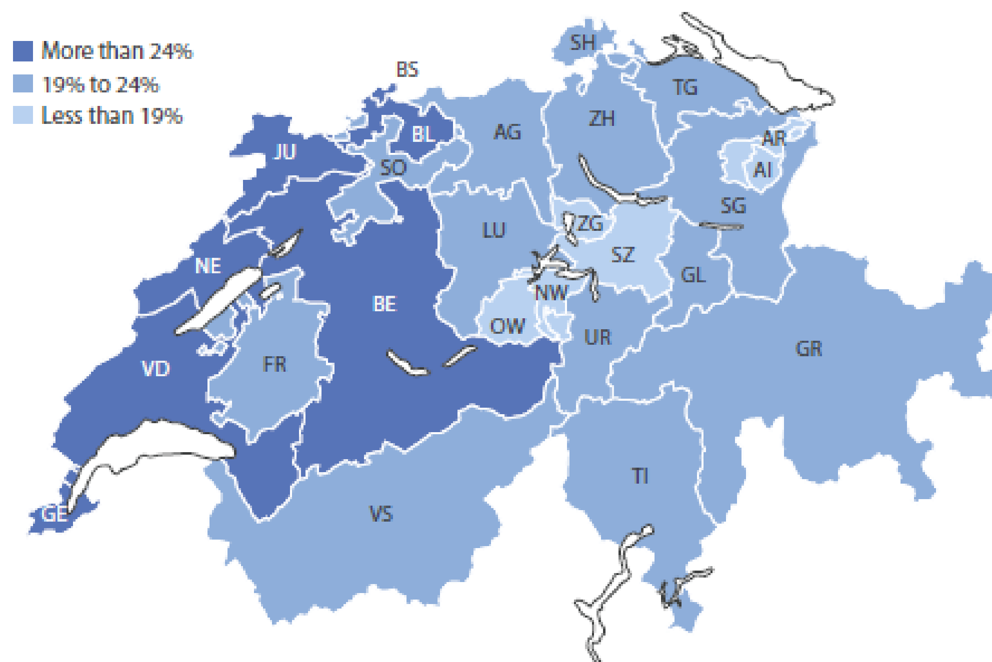
**Figure 1**




3. On the map in Figure 2 (Feld 2009) and taking into account the central locations in Switzerland, Krugman's law becomes apparent according to which central locations can afford higher taxes, while peripheral locations must have lower taxes in order to have a chance to develop (Krugman 1997). Thus, Zurich (ZH) has high taxes in comparison to the surrounding cantons of Schwyz (SZ), Zug (ZG) as well as Obwalden and Nidwalden (OW and NW). On the other hand, Fribourg (FR) as a non-central location has lower taxes than Bern (BE), Vaud (VD) and Neuchâtel (NE).

**Figure 2**

CANTONAL AND (WEIGHTED) LOCAL INCOME TAX BURDEN FOR A MARRIED INDIVIDUAL WITH TWO CHILDREN AND A NET INCOME OF ONE MILLION FRANCS IN 2006




Source: Eidgenössische Steuerverwaltung (Swiss Federal Finance Administration) according to Feld (2009).

4. It is not uninteresting to note in Table 1 that the Swiss cantons, on average, have balanced budgets or even surpluses.

5. Finally, the particular features of the dynamics of tax competition are pointed out in the literature. The self-employed, for example, react more strongly to lower tax burdens than salaried workers and retirees; young, well-educated Swiss react more strongly than older residents. But also the cantons react to tax rate differences: the lower the tax burden in the neighbouring canton, the more a canton lowers its own taxes. A decline in public services has not yet been observed (for an overview, see Feld 2009).

## Individual responsibility: the advantage of being disfavoured

The results in Table 1 need further explanation. The inter-cantonal and inter-municipal tax competition results in lower taxes. However, the cantonal and municipal governments do not let themselves be pushed into a low-tax policy at any price. Public debt is not seen as a way out. How can this be explained? How is it that the Swiss cantons, despite competition, have quite satisfactory public budget results and on average take on hardly any new debt, whereas in other countries local governments especially run up debts on a large scale? The riddle is not solved by asserting that politicians in Switzerland are particularly responsible. Instead, this raises the question of what incentives there are that induce Swiss politicians to behave comparatively responsibly.

Usually this is attributed to the existing debt brakes which are supported by direct democracy in many cantons (Kirschgässner 2004; Feld and Kirchgässner 2008). But what is behind the debt brakes? Why have politicians and voters imposed such limits on themselves, and why do they stick to them? The governments of the EU countries also have debt brakes. They are required to adhere to the deficit and debt limits of the Stability and Growth Pact. But their budget discipline is weak. Currently, most EU countries exceed the current deficit and debt limits. The same is the case for the governments of the German federal states. They are supposed to follow the "golden rule", which requires that the annual budget deficit should not exceed the level of investment, before in 2020 a zero-debt limit takes effect. But this rule is often flouted already today. This is not surprising, since behind these debt brakes is the implicit promise of the federal government to rescue the state authorities should they not succeed in applying the debt brake.

In Switzerland, the cantons and their voters are in a different position. They know that if they fail to balance their budgets and encounter financial difficulties no one will rescue them. When the cantons of Bern, Solothurn, Geneva, Vaud, Appenzell Ausserrhoden and Glarus got into trouble in the 1990s due to the large losses of their cantonal banks, they were on their own. The question whether the federal government would provide financial help was not even raised. Instead, the Confederation

and the cantons assumed that the no-bailout principle applied, whereby each canton is responsible for its own finances.6

But why would the Confederation not help the cantons in financial trouble? The answer is because it cannot pass on its debt to third parties. The Confederation itself does not belong to a contractual system (such as the euro group), which could rescue it if necessary. Rather, it is well aware that no foreign state whatsoever will rescue it in case of a financial crisis. On the contrary, many would be pleased if the successful and hated little state of Switzerland were to do poorly for a change. But unpopularity also has an advantage. The no-bailout principle for the federal government is inevitable. The only political option is to conduct a solid budget policy and thus to establish a good reputation in the minds of the financial market actors, which is then reflected in favourable interest rates for government bonds. The debt brakes which were introduced by the government itself are aimed at providing a signal of the government's fiscal reliability to the financial markets. And in fact they are largely being complied with.[7, 8]

Just as the Confederation is subject to a no-bailout principle so too the cantons have to follow this principle. The Confederation cannot afford to provide financial support to the cantons without endangering its own rating. Thus the cantons have to conduct an earnest budget policy just as the Confederation does, so as to signal their reliability to the credit markets. For the cantons the debt brakes also have the function of signalling to the credit market that their fiscal policy is in order. The dividends they thereby earn are indicated in their budget surpluses as shown in Table 1.

The no-bailout principle also protects the cantons against interference by the Confederation. If the federal government interferes too much in the policies of the cantons, it also must assume responsibility, i.e., ultimately assume a bailout. Most Swiss politicians are afraid to take this step. In Germany, in contrast, the concept of federal-state interweavement was adopted as a constitutional principle in 1969 with the result that in the event of a financial emergency the federal government can hardly avoid being drawn into granting a bailout.

## The ability of federalism to correct mistakes: the no-bailout principle and debt breaks

Institutions only survive in federalism when they are consistently successful. In Switzerland the canton governments must continually be vigilant and monitor their institutions in order to survive in intercantonal competition. That is why mistakes are eliminated more quickly in federalism than in centralistic systems. An example will illustrate this point:

The federal and canton governments have clearly recognised that no-bailout and debt brakes are complementary instruments. The two instruments support each other and thus have to be implemented in combination. The governments of the euro states were also of this opinion in 1999 when the Stability and Growth Pact was established, in addition to the already existing no-bailout clause (Art. 125 AEUV) in the Treaty of Amsterdam. But soon these principles were no longer taken so seriously. Without the competition of currencies, every member state of the euro zone was hoping to rely on the other member states. That functioned for a while until in the wake of the Greek crisis the belief in both principles collapsed.

Today, after the Greece crisis, the European Council and Commission do not appear to see the debt brake and no-bailout principle as complementary but rather only as substitutive instruments. Both authorities have stated that they will no longer use the no-bailout clause 125 AEUV of the Lisbon Treaty to its full extent. Instead, following the suggestions of the Van Rompuy working groups they intend to strengthen the debt brake contained in the Stability and Growth Pact. This policy fails to recognise the complementarity of both instruments. If there is not a no-bailout principle behind the Stability and Growth Pact, the latter loses its credibility. A member state can speculate that if it does not succeed in fulfilling the requirements of the Stability and Growth Pact, it will be bailed out. This is in fact the plan of the new European Stability Mechanism (ESM), which gives priority to the debt brake followed by liquidity help before a possible debt restructuring. The opposite order would, however, be the credible one: first a debt restructuring, and then, if necessary, liquidity help.

It is at this point that federalist competition is missing, which would immediately punish an action such as that of the ESM and introduce a self-correcting mechanism. The euro states can – for the moment with impunity – embark on a dismal path well aware that their policy is not sustainable. Economists have pointed out the dangers of this endeavour. In a mixed times series cross-section analysis for 43 OECD countries, E. R. Fasten (2011) has shown that the observance of debt limits as described above diminishes if they are no longer autonomous and supported by a no-bailout policy but rather imposed upon by the central government and thus indicative of a possible bailout. Furthermore, the budget discipline continues to increase if there is a move towards a unitary state. This makes sense because in a unitary state the territorial sub-divisions have all lost their autonomy. As administrative units their only task is simply to spend the money allocated to them from above for the determined purposes on a one-to-one basis. Acquiring a debt is forbidden. If the euro states were to experience that their debt brake (without a no-bailout principle) would not be successful, their only choice would be to join the march towards a unitary state. This is the nightmare I see coming towards us. Everything that we in Europe appreciate in terms of cultural diversity and wealth of ideas, all that defines Europe – from science to the performing and fine arts – is threatened by Brussels' bureaucracy in a unitary state.[9]

## The Debacle of Leukerbad: A Greek Default en miniature

"Europe is at present a copy at large of what Greece was formerly a pattern in miniature", David Hume wrote in 1742. His admiration for Greece was great. But that somehow a bankruptcy of Greece at the time would affect Europe in any way never occurred to him. He was absolutely right on this point and this should also be the case today. Greek GDP comprises only 2 percent of EU GDP, its government perhaps only 1 percent and a Greek default would be only about 1/2 percent of EU GDP. Actually, a quantité négligeable. Nevertheless, the tiny Greek crisis has turned into a European crisis. The reason, in my opinion, is that the self-

correcting mechanisms of federalism have been deliberately set aside. Again, there are important lessons to be learned from Swiss federalism.

It is little known that Switzerland has its own Greece "en miniature" – the municipality of community Leukerbad, a small town in the canton of Valais with 1700 inhabitants in 1998. In terms of size Leukerbad, roughly speaking, is to Switzerland and the Swiss banking sector what Greece is to the euro zone and the euro banking sector. Leukerbad wanted to become the greatest and most modern Spa in Switzerland if not in Europe. After a series of high-flying investment projects, primarily for the tourist industry with the corresponding (partly fraudulent) debts, the municipal council of Leukerbad declared insolvency and went into state receivership on 21 October 1998.

Why did the creditors allow matters to go this far? Did they mistakenly assume that there would be a government bailout? This is unlikely, because there is a bankruptcy law for municipalities that regulates in detail the modalities for the debt restructuring of insolvent municipalities.[10] And even if there mistakenly had been bail-out expectations, it would have been canton Valais' responsibility to oversee the financial situation of the municipality of Leukerbad.

It obviously failed to do so, otherwise the debacle would not have occurred. A more plausible explanation is a failure of control of Leukerbad's finances on the part of the creditors. With the unusual size of the debt, 346 million Swiss francs, and the complexity of the credit relationships with intertwined creditors,[11] the control problem turned into a public-goods problem. None of the creditors wanted to bear the controlling costs alone, each of them relied on the others, and since to that point there had never been problems with municipal financing, the public authorities also failed to undertake major action. The financial situation worsened until Leukerbad became insolvent.[12]

What should the creditors do in this situation? Unlike in a private bankruptcy procedure, they were not able to break up the municipality. Only a few assets were left to liquidate. Instead, the creditors strove for an assumption of the debts by the canton Valais. Its government, however,

rejected any responsibility for the debacle, which induced the creditors to take the case to the Federal Court in Lausanne.

In Switzerland, the problem was resolved federalisticly. If, on the contrary, the approach had been centralistic, as in Greece, the federal government in Berne would have said: Leukerbad could trigger a banking crisis, so we must save Leukerbad from collapse so that the creditor banks, including Credit Suisse (CSFB), do not go bankrupt. But this never happened. The Federal Court was courageous. It sided with the position of the government of the canton of Valais and dismissed the suit brought by Credit Suisse (CSFB) and the other lenders. The no-bailout principle was enforced with no “ifs” and “buts”.[13]

The no-bailout course was clearly the right way to go. With its verdict, the Court gave a very clear signal. It is up to the creditors to examine the actual creditworthiness of their borrowers. But how were the creditors able to get reliable information, given the often complex relationships on the true situation of the debtor? There was a demand for credit information but no supply. But due to market forces, this gap became occupied by a private credit rating agency and several rating departments of large banks in the years following the Leukerbad debacle. They assess the creditworthiness of municipalities according to their finances and the possible bailout or no-bailout expectations, depending on the constitutions of the cantons in which they are located. In addition credit ratings for cantons were developed.[14] The Federal Court’s verdict not only prevented Leukerbad’s bailout, but it helped new institutions to arise from the bankruptcy, rating agencies, which helped to overcome the existing market failure. It would have been difficult for government to have achieved such a reform so swiftly. Had the Federal Court forced Canton Valais to assume the debt, the opportunity to implement an institutional reform would have been abandoned (Figure 3). Or put another way, if the European Commission had studied the case of Leukerbad in good time, it would probably have made more successful decisions in the case of Greece.

**Figure 3**

How the Inefficiency of the Market Municipal Credit Can Be Overcome Endogenously to the Market

| Phase | Characteristics |
|---|---|
| Phase I<br>Inefficiency | Asymmetrical information<br>*Creditor* < *debtor*<br>Losses<br>Loss-loss situation |
| Phase II<br>Learning process | No-bailout<br>Rating agencies<br>Evaluation |
| Phase III<br>Efficiency | Symmetrical information<br>*Creditors* = *debtors*<br>Win-win situation |

## Conclusions

For a long time, Switzerland was not a special case in Europe. In the Ancien Regime, Switzerland, with its 13 traditional states, was very much in line with the governance system of the time, especially the Holy Roman Empire, with its 327 autonomous states and territories. But Switzerland was also a useful complement to the great powers, France and Great Britain. Furthermore, even with the reorganisation of Europe after the Congress of Vienna, the pluralistic European world of states remained by and large intact, with Switzerland in the middle.

New paths were embarked on with European unification after the Second World War. Competition among the companies of the different countries of Europe was to be governed by fixed, European Union-wide rules. The European Commission was able to achieve competitive markets without

having to take into consideration the protectionist concerns of individual interest groups. But with the completion of the Single Market in 1992, the Commission's role was largely fulfilled. What still remains is a largely non-functional bureaucracy not subject to democratic controls that with its regulations seeks to consolidate its position within and outside of the European Union.

Switzerland has also been affected by this development though not a member state of the European Union. It is interested in deepening bilateral trade relations with the European Union. But the Commission's negotiating doctrine requires that Switzerland first adopt EU law before talks can begin about free trade and the freedom of establishment for companies. Switzerland, on the other hand, refuses to grant unsecured concessions in EU law without having achieved free-trade concessions. It would like to negotiate this step by step, which the EU Commission rejects. The Commission rightly argues that Switzerland would have to adopt EU law in any case (for example, the chemical directives REACH) if it does not want to lose all of its markets in the EU. For the Commission it is a matter of applying sufficient pressure on Switzerland. The EU Commission, in turn, is not willing to admit that somewhat more competition from the outside would also be good for its own industry. And so Switzerland remains an unpopular special case in an increasingly organised Europe.

**Footnotes**

[1] AFP commented: “C’est une attitude fortement regrettable qui pourrait conduire la France à considérer la Suisse comme un territoire non-coopératif susceptible de figurer sur (la) liste noire”, Le Matin (ch), 16 December 2009.

[2] The historical parts of this section are based on His (1920; 1929), Historisch-Biographisches Lexikon der Schweiz (1924; 1927; 1929) vols. 2, 4 and 5, Historisches Lexikon der Schweiz online (2002 ff.).

[3] In addition Switzerland was required to buy 200,000 centners of French salt annually.

[4] Meyers Konversations-Lexikon (1888).

[5] The federal court does not have the right to question the constitutionality of federal laws in the abstract.

[6] Of course private, systemic large banks such as the UBS were rescued by the Confederation during the bank crisis of 2008/2009.

[7] The Swiss federal constitution also assumes a no-bailout principle. According to Art. 44 BV, the cantons are in fact required to help; however they are not obligated to monitor and thus are not liable for each other.

[8] Furthermore, debt brakes help the federal government defend their responsible budget policy vis-à-vis the interest groups of domestic policy. The establishment of debt breaks in a direct democracy grants them legitimacy.

[9] On 14 June 2010 and again on 21 July 2011 Chancellor Merkel reafirmed that we need “a stronger economic government than we now have”. A common European economic government, a binding debt brake for all euro countries and a financial transaction tax are planned. On 3 June 2011 ECB President J. C . Trichet advocated a common euro finance ministry.

[10] Federal Debt Collection Act vis-à-vis municipalities and other entities of cantonal public law of 4 December 1947 (2006) comparable to Chapter 9 U.S. Bankruptcy Code.

[11] Including Credit Suisse, insurance companies, municipalities, Migros, von Roll, ESG.

[12] A key role was played by the “emission centres of the Swiss municipalities” (ESG) as loan brokers, since the packaged municipal loans into larger bundles and offered them to the banks, which in turn were able to place the larger lots more successfully and thus grant more favourable interest rates and conditions. As a result, with the ESG there was thus a two-tier principal-agent problem, by which the controlling problem was made even worse. As a result of Leukerbad, the ESG became insolvent and was forced to cease activities until they were finally taken over by Credit Suisse on 17 May 2001.

[13] On the Leukerbad case, see Blankart and Klaiber (2003; 2004, 2006) and Blankart and Fasten (2009).

[14] In May 2011, of the 26 cantons seven received the highest rating: AAA. In the AA segment were 15 cantons and only four were rated with a single A (Source: Aargau Cantonal Bank).

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* CESifo Dice Report 3/2011. Interested readers will find a more detailed version of this article in the monograph Öffentliche Finanzen in der Demokratie (Blankart 2011).

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