



OccasionalPaper 87

Non-Centralism

The Swiss Experiment Based on Local Government, Direct Democracy and Tax Competition

Robert Nef

If you wish to support our work:
Commerzbank Berlin
BIC 100 400 00
Donations account: 266 9661 04
Donation receipts will be issued.

Imprint:

Published by the Liberal Institute
Friedrich-Naumann-Stiftung für die Freiheit
Karl-Marx-Straße 2
D-14482 Potsdam

Phone +49 3 31.70 19-2 10
Fax +49 3 31.70 19-2 16
libinst@freiheit.org
www.freiheit.org

COMDOK GmbH
Office Berlin

First Edition 2009

Non-Centralism

The Swiss Experiment Based on Local Government, Direct Democracy and Tax Competition

Robert Nef

Paper presented at the international colloquium "Liberalism and Communal Self-Administration", organized by the Liberal Institute of the Friedrich Naumann Foundation for Freedom, Potsdam, 18 September 2009.

Robert Nef is the president of the foundation board of the Liberal Institute in Zurich, Switzerland and member of several other liberal institutions in Europe. As a trained lawyer, his research topics include the principal questions of liberalism, federalism and institutional competition. From 1979 to 2006 he was Editor-in-chief of the quarterly magazine "Reflexion" and, from 1994 to 2008, of the monthly "Schweizer Monatshefte". In addition to numerous essays and articles on questions pertaining to classical liberal principles, history of ideas and especially criticism on welfare state, he is author of the book "In Praise of Non-Centralism" (in German "Lob des Non-Zentralismus").

Contents

Introduction	5
1. Competition as a Procedure of Discovery	5
2. Confederation, Federal State and Centralized State	7
3. The Principle of Subsidiarity	8
4. Federalism and Subsidiarity	8
5. Redistribution, Subsidiarity and the Majority Rule	9
6. The Future of Subsidiarity	10
7. Non-Centralism and the Tax System	10
8. Reducing the Tax Burden	11
9. Tax Competition and Tax Limitation by Direct Representation	12
10. Competition as a Procedure of Discovery and Learning	13

Introduction

Let me start with a little story that shows how and why cantonal and municipal autonomy really works in Switzerland. I know a mayor of an average municipality in the eastern part of Switzerland with about 5000 inhabitants.

With this mayor I recently had a discussion, if Switzerland should join the EU or not, and we also discussed the costs and benefits of membership – a very Swiss approach. We agreed that there are good reasons for scepticism and he concluded, that if we will join one day, it would not cost him more than about 15 Swiss Francs, which means about 10 USD. I asked him why, and he explained to me: "You know, in my office I have already two big waste-paper baskets for all the official mail I get every day. I have better uses of my time than reading it, and I mostly throw it directly into the waste-paper basket. I have one for all the forms, regulations and other papers I get from the Cantonal Government, another one for every thing they send me from the Federal Government in Berne. And when we become a member of the EU I will need another waste-paper basket, for all the forms and regulations coming from Brussels. This will cost me about 15 Sfr, because I will need a very nice and big one..." Of course he may have exaggerated, but his municipal autonomy is based on financial and fiscal autonomy, which is very important and which explains why he can take the risk of ignoring the mail from the central authorities. Our Swiss tax system is based on a three-level taxation, and the municipal level gets one third of the income taxes – directly from the taxpayers. So municipal authorities have "their own money". They can spend it for the local public services, but they are controlled by the taxpayers, which are more or less identical with the users and the voters.

1. Competition as a Procedure of Discovery

There is no such thing as "the best solution" of structural, financial and fiscal organisation of a state. The less state intervention the better. All we have at hand is the exchange of experiences based on differing historical contexts. Days of simple blind copying of "miraculous solutions" from the USA are definitively over and all countries, including those of Western Europe, look also elsewhere for ideas. With great interest we observe how problems are solved in other parts of the world,

for instance in the New Europe and in Asia. Switzerland is a successful country, we have been very lucky to stay outside the two world wars of the 20th century and we are amongst the top ten in almost every type of rankings, e.g. economic freedom, per capita income, life expectancy and even happiness – if there is any rational method of measuring it, which I doubt.

Here are in short the most important facts and figures. Switzerland has a population of 7 Million people, 20 percent of them have immigrated in the last 20 years.

As a whole we have more than 2000 municipalities in Switzerland and 25 Cantons of very different sizes. The smallest municipality counts less than 100 inhabitants and the biggest, the City of Zurich, more than 300 000.

We are not a member of the EU, which in my opinion is good for Switzerland and good for the EU. We cooperate on the basis of bilateral agreements and pay the price of not being on the table when the decisions are taken. But as a small and rich country you have always the risk of being in the wrong camp; you are outvoted when it comes to pay and you are outvoted when it comes to rule.

The Swiss view on the EU can be characterized as follows: The institution is based on four ideas; two of them are good, two of them are bad or at least "old fashioned": 1) Peace, 2) free market – inside and outside, 3) harmonisation of complex systems or the centralized EU technocratic bureaucracy and 4) equalisation by subsidies, interventions and redistribution or the EU-welfare state.

The market is a school without teachers and the most important market is the market of ideas. On this international market it is important to exchange ideas and to share the experiences of what works and what doesn't work. It is more important than any type of public relation.

What is the secret of a successful country? I am quite often invited as a speaker on topics like "The secrets of the Swiss Success"? I think that one of the secrets is the discovery that there is no such a thing as one constructivist formula leading to success. The most important thing is to get more and more open-minded and ready to learn from other people and nations, and to communicate on the basis of peace, enlightened self-interest, contract and friendship. "The right way" is to be found in the competition of ideas, models, suggestions and experiments. So I am here as a student and not as a professor.

2. Confederation, federal state and centralized state

Germany is a quite centralized country and every federation, I don't exclude Switzerland and the US, moves from non-centralisation to centralisation. The difference between confederal, federal and centralised political systems is one of degree, but there is a principal difference too.

The principal one is that a confederation offers the right to peaceful secession, which means that you have much more autonomy and flexibility to define and redefine the basic rules of partnership. From this point of view it offers more advantages for the stronger and richer partner to be in a confederation than to be in a federation.

But if the richer regions have the ambition to be the leader of a unified country, its money, its tax- and social security system, its capital and the power of the central government, they can favour the more centralist model. But the price of this model of predominance of one part of the country may be much too high. A potential dominator takes the risk of losing the spirit of cooperation, of friendly competition and even of peace.

Switzerland has an experience of transformation from a free community based on a complex network of political treaties and contracts, first to a confederation and at least to a federation. We have successfully avoided the model of leadership or predominance of one part of the country. The first period of nation building lasted about 500 years, the second 50 years – between 1800 and 1848.

The Swiss federal constitution is more or less a copy of the Constitution of the US.

But there are at least three important differences.

We have no powerful president, because this institution is based on the rotation-principal like in the EU. It changes every year – one of the 7 Ministers is president – as the *primus inter pares*.

We have no powerful constitutional court like the Supreme Court in the US and the *Bundesverfassungsgericht* in Germany.

We have no federal officials on the cantonal and local level – the same principle as in the EU, e. g. no federal police.

3. The Principle of subsidiarity

The principle of subsidiarity means: Common problems must be resolved at the lowest possible level. The higher level is to intervene only if social and political support is required.

The principle of subsidiarity has become topical since it was used as a cornerstone of the EU Treaty of Maastricht and Amsterdam. Everybody speaks about it, but nobody actually knows exactly what it should mean. The Swiss subsidiarity is rather sceptical of the centre and, as this is very close to my heart, I would like to put forward some arguments for this kind of subsidiarity that asks for taking away power from the central state. The principle as such is based on a fundamental division of the individual, the state and the society. It is the opposite of the socialist and the national-socialist approach (which is in fact very ideologically very close of each other) that the community is always more important than the individual. Subsidiarity means that we have to try to find the solution of political, social and economical problems in the most private and the most local framework that is possible.

4. Federalism and Subsidiarity

Both principles are open to interpretation and therefore often misused to justify a transfer of powers upwards.

However, all phrases like "being able to", "the smallest possible" or "efficiently fulfil" need further elaboration. The principle can be endangered by "different interpretations" of conditions and efficiency definitions under which the higher-up rank is, after all, justified in taking over some powers. There are always so called "good reasons" for centralising.

Numerous constitutions and written sets of rules often lead to a highly "homogenised equal distribution" of wealth and to large subsidies to problematic or marginal areas.

One of the weakest points in the German Constitution, the Grundgesetz, is the aim of offering equal conditions of life in the whole territory of the nation state. Maybe this is the true reason for Germany experiencing its current structural problems after 50 years of successful development. Interventionist and protectionist support, redistribution through regional, structural funds and massive subsidies are some of the favourite roles of the central government, and I include the EU Commission. Politics then degenerates into a general fight of all against all for more and more subsidies and interventions. It is the worst case scenario of the future of the EU. This is why I am sceptical of all forms of redistribution by the central government and especially of redistribution that takes place on the interregional level. Relatively poor taxpayers of rich regions transfer taxmoney to relatively rich people in poor regions, which invest it again in rich regions.

So it can be shown that a substantial part of the money from general taxation that subsidises the marginal regions ends up back in the centre. The only effect of interregional redistribution is to strengthen the dependency of the periphery on the centre and to stifle any beneficial competition between jurisdictions. But this would provide enough material for a separate paper, I merely wanted to allude to these problems here.

5. Redistribution, Subsidiarity and the majority rule

Local authorities, financed from "above" or by the centre are usually dependent and corruptible. Time and time again there appear situations in political life where all active steps and policies achieve the very opposite of what they were hoping to bring about. The subsidiarity principle is thus often misused to "justify" a transfer of powers upwards to reach an allegedly better solution.

Things get even more difficult when the increased centralisation is "justified" by inability of the lower jurisdictions to provide sufficient financial backing for the task. A centralised system of taxation will obviously deprive the lower level of cantonal and municipal taxation, and it is obvious that such impoverished communities and regions will find themselves unable to raise their own taxation towards their own tasks. A route to centralisation of tasks is thus opened if we start by centralising the taxation system. It is obviously a strange system which collects the money centrally and decentralises only the tasks.

Perhaps the worst solution in this case would be an artificial decision from the centre about the distribution of money among the lower levels in a federal system for the completion of tasks. The best solution, then, is not to centralise the taxation system at all and leave the lower jurisdictions in care of both the expenditure side and the taxation side. A failure on this account has often discredited the principle of subsidiarity.

6. The Future of Subsidiarity

Subsidiarity means priority for smaller or private units. It calls for decentralisation, privatisation and deregulation. In the 21st century the concept of subsidiarity must be made more precise and radical to suit the current environment. These days the principle should be that any higher jurisdiction should give up its competence, powers, responsibility and financial backing to a smaller jurisdiction closer to the root of the problem as soon as there appears a first problem on the higher jurisdiction in effective fulfilment of the tasks or financial affordability. I am fully aware that this is a bit of a utopia, for who has ever seen a layer of central government prepared for an "orderly demise"?!

We should all stay optimists, but I try to be honest about the weak points in the – so called – Swiss model. We have not yet been able to stop the trend of welfarization and redistributionism, neither on the interpersonal nor of the interregional type. Both are very popular, more popular than all the rhetorics on decentralisation.

7. Non-Centralism and the tax system

There are four principles of a sound tax system: No taxation without representation; the more concerned, the more involved; no representation without taxation and no tax spending without tax paying. The tax system, the monetary system and the social security system are the realistic base of any political system, and the legislation on these matters is more important than the Constitution.

In the historically crucial role that systems of taxation have played in the past and continue to play in the present, it is shocking how very little is written about them in a way understandable by the man on the street. There are whole libraries full of technical expositions of the most efficient or most yielding ways of taxing the population, as well as detailed guides of the best ways of legal and semi-legal and non-legal ways of tax-evasion from the other side of the barricade. What usually goes unnoticed is that the whole of political history is at least 50 percent also the history of the systems of taxation, and that most historical revolts and revolutions originally started as revolts against the system of taxation. A peaceful civil society can be characterised by a relative absence of explicit rules and technical prescriptions about social infrastructure, where conflicts are solved privately under the rule of law between the affectors and the affected.

8. Reducing the tax burden

Three ways lead to a reduction of the tax burden: The reduction of interpersonal redistribution, the reduction of interregional redistribution and fiscal competition.

The financial system is an all-important part of the political and economical system whose fundamental role is often underrated. The aim of the tax-system as a whole exercise is not to create some patchwork from year to year to provide, with a lot of improvisation, sufficient funds for the given year.

The classical liberal objective is to limit clearly the access to the fiscal revenue and thus arrive at the best possible method of reducing the scope of the state and of improving the health of the economy as a whole. The bulk of the tax burden could be drastically reduced by a reduction of inter-personal and inter-regional redistribution and by a fiscal competition of municipalities, cantons, states and federations.

9. Tax competition and tax limitation by direct representation

The Swiss Tax system is competitive, divided among the levels of federation, canton and municipality, and dependent on the majority decisions of the taxpayers. In Switzerland it is the citizens and taxpayers who decide in a direct democracy by a majority rule about the tax rate. Such a model cannot be directly applied to other systems and local conditions. Time and time again it is doubted that the government can and should leave the "power to tax" in the competence of the citizens themselves. The fact that the majority decides on the levels of taxation in all levels of the institutional hierarchy provides good grounds for not making the tax system overly progressive and inducing the richer end of the spectrum to leave if they cannot achieve lowering of their burden. In a competitive system there are good reasons to have only a very mild form of progression. One-member-one-vote rule can only be functional in a one-member-one-taxrate system.

Competing systems of Swiss taxation and the division of direct tax revenue among all three federal levels (municipal, cantonal and federal) allow for a good field for experiments. It may not be completely and in every aspect optimal, but it works and we are able to combine a relatively low level of taxation with a good quality of public services and infrastructure. There is such a thing as voting by foot in Switzerland, especially in view of the small size of jurisdictions in the federation as a whole. Even then, a departure of an important rich taxpayer from an area usually leads to a substantial populist campaign in the media against "the rich" and in favour of a new more centralist system, where there is no possibility of voting "by exit". The system of competing jurisdictions and competing tax rates may be one of the best systems, but it is not one of the most popular and – under the pressure of democratic decisions – not the most sustainable. Democracy has always a centralist tendency.

The Swiss taxation levels are providing many wealth-creators with a welcome refuge, and this country can make a profit out of the European overtaxation of the rich. Rich people are welcome in Switzerland. In no way do I feel any sense of guilt for this.

The more direct the democracy, the stronger will be the discussion about taxes and the uses made of them and the role of public officials in both these aspects. A mature taxpayer is then identical with the mature citizen who supervises at all times the value-for-money he gets from the public services, demands efficiency,

no wasting and transparency, and is prepared to react to any deficiencies in the system.

10. Competition as a procedure of discovery and learning

Admittedly, non-centrality can also have its disadvantages. The least efficient player is worse off in a competitive field than he would have been under a centralist averaging system of "harmonisation" of well-being.

Yet from the liberal point of view, there may be indeed some painful deficiencies in so called underdeveloped areas and the price of inequality may be quite high. Diversity is always connected with inequality. History keeps telling us, however, that these backward underdeveloped structures have turned into the modern and more effective ones in the end, bringing a very welcome spur of the general well-being in their wake. Centralisation contains, however, the danger of "unifying all jurisdictions, all parts of a federal system, to the latest trend in scientific and political errors and mistakes". The classical liberals, the free marketers, do not assume a monopoly on the truth and on the correct practical solutions.

What they do advocate, however, is a system with small competing units that commit a lot of different smaller errors and mistakes. In this kind of systems, there is a chance for learning by comparing. This may be less of a risk than a highly centralised system, where big errors and mistakes are more dangerous. Learning by doing, learning by comparing, learning by taking risks and committing and admitting errors should be our common aim. The smaller the units are, which start in this adventure, the better the chances are to be successful and to avoid the big central mistakes!

Occasional Paper

Liberal Institute of the Friedrich Naumann Foundation for Freedom
Other publications under www.libinst.de

- [86] Fred E. Foldvary
**THE PRIVATE PROVISION OF PUBLIC GOODS:
THE HISTORY AND FUTURE OF COMMUNAL LIBERALISM**
- [84] Thomas Cieslik
THE AMERICAN DREAM – JOB MIGRATION INTO THE UNITED STATES
- [82] Philippe Legrain
**MIGRATION MATTERS
HOW GERMANY AND THE WORLD CAN BENEFIT FROM A FREE MOVEMENT OF PEOPLE**
- [78] Indur M. Goklany
**ADDRESSING CLIMATE CHANGE IN THE CONTEXT OF OTHER PROBLEMS –
A PLEA FOR REALISM OVER IDEOLOGY**
- [56] Thomas Lenk
**REFORM OF THE FINANCIAL EQUALISATION SCHEME IN GERMANY:
A NEVER-ENDING STORY?**
- [55] Julie Simmons
TREATY FEDERALISM: THE CANADIAN EXPERIENCE
- [54] George Herbert
THE TREATY OF LISBON – A THREAT TO FEDERALISM?
- [51] Lincoln Allison
SPORT AS VIRTUE ... AS LOVE ... AS COMMERCE
- [50] Jutta Braun
FOOTBALL AND POLITICAL FREEDOM: THE HISTORICAL EXPERIENCE OF DIVIDED GERMANY
- [49] Raymond D. Sauer
SPORT, THE STATE, AND THE MARKET
- [48] Tom G. Palmer
FREEDOM PROPERLY UNDERSTOOD
- [47] Temba A. Nolutshungu
CIVIL SOCIETY? NGOISM AT WORK
- [46] Martin Froněk and Jiří Schwarz
KYOTO – SEVERAL YEARS AFTER BY
- [45] Doug Bandow
HUMAN RIGHTS IN DANGER? MYTHS AND REALITIES IN THE UN
- [44] Parth J. Shah
CSR: CAPITALISM AT ITS BEST OR AN ANTI-CAPITALIST MENTALITY?
- [43] Frank Vibert
SOFT POWER AND INTERNATIONAL RULE-MAKING
- [42] Erich Weede
NATION-BUILDING IN THE MIDDLE EAST: THE NEW IMPERIALISM?
- [41] Dr. Wolf-Dieter Zumpfort
THE CRISIS OF THE WTO
- [40] Juan Carlos Leal Sosa
**A MARKET DRIVEN CRITIQUE ON THE ROLE OF THE INTERNATIONAL
FINANCIAL INSTITUTIONS IN THE DEVELOPMENT PROCESS IN LATIN AMERICA**
- [39] Liisa Heinämäki
EARLY CHILDHOOD EDUCATION IN FINLAND
- [38] Patricia Morgan
THE IMPACT OF TAX AND BENEFITS ON FAMILY STRUCTURE
- [37] Jay Belsky
**QUALITY, QUANTITY AND TYPE OF CHILD CARE: EFFECTS ON CHILD
DEVELOPMENT IN THE USA**

Other papers of the colloquium
„Liberalism and Communal Self-Administration“,
18 September 2009

[86] Fred E. Foldvary (2009)

 THE PRIVATE PROVISION OF PUBLIC GOODS:
THE HISTORY AND FUTURE OF COMMUNAL LIBERALISM

[87] Robert Nef (2009)

 NON-CENTRALISM
THE SWISS EXPERIMENT BASED ON LOCAL GOVERNMENT, DIRECT DEMOCRACY
AND TAX COMPETITION