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THE FISCAL EQUIVALENCE TRAP – DON'T DECIDE, DON'T PAY - HOW A PRINCIPLE OF FISCAL FEDERALISM MOTIVATES STATE INACTION**by Eva Maria Belser**

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To cite this article:

Belser, Eva Maria; Cattilaz, Géraldine (2023):
The fiscal equivalence trap – don't decide, don't pay -
how a principle of fiscal federalism motivates state inaction,
Cuadernos Manuel Giménez Abad, Special Issue 9.

DOI: [10.47919/FMGA.CM23.0119](https://doi.org/10.47919/FMGA.CM23.0119)**ABSTRACT**

Two questions are crucial in emergency situations: Who has the right – or duty – to act and who must finance emergency measures. In this contribution, we examine the effects of the Swiss emergency powers on the financial system – and vice versa –, and argue that Switzerland's reactions and, as importantly, its inactions can best be explained by examining the distribution of tasks and costs jointly – and not separately as is often the case.

We first briefly recall the essential elements of the Swiss power and resource sharing system, elaborating on the principles of subsidiarity and fiscal equivalence, before presenting the Swiss emergency regime and its controversial use during the Financial Crisis of 2008 and the Covid-19 pandemic. Comparing the two recent examples of extensive use of emergency powers, we show that the Financial Crisis mainly raised democratic issues regarding the horizontal distribution of powers while the Covid-19 crisis also had a strong federal component. We then explain the federal struggles over competences during Covid-19 with a phenomenon we call “Fiscal Equivalence Trap” – a situation in which both (or all) tiers of government refrain from or hesitate to adopt urgently needed measures due to financial considerations.

Keywords: Fiscal federalism, federal power and resource sharing system, principle of fiscal equivalence, emergency powers, crisis management, covid-19 pandemic, financial crisis.

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I. INTRODUCTION

Most emergencies are complex, their resolution, however, does not seem to allow for complexity. Famously, emergencies are hours of the executive – one executive, not many. In federal systems, power concentration hence typically occurs not only horizontally (weakening parliaments and courts) but also vertically (disempowering regional units and local governments). In the interest of effective crisis management, complexity in decision-making must yield. Most federal systems provide for such power concentration in cases of emergencies. However, they often leave the question of fiscal federalism open. How does decision-making by the executive affect the parliament's right to decide on public finances? And how are the costs of emergency replies, taken at the centre but often implemented by the regions, divided by the different tiers of governance? Such financial unclarity and ambiguities, we believe, are important but understudied reasons for constitutional systems to stumble, stutter or become irrelevant in stress situations.

In this contribution, we investigate how the emergency powers of the Swiss federal system affect the emergency financial system of the country. We claim that the country's reactions – and inactions – in emergency situations can best be explained by examining the distribution of tasks and costs jointly – and not separately as is often the case. By stipulating the principle of fiscal equivalence – “who decides, pays” – the Swiss constitutional system links the two elements in an inseparable way. The principle is undoubtedly well-suited to incentivize cautious budgeting and spending: As acting is costly for each governance tier, acting beyond one's competences and tasks is not too tempting to government actors. But what happens if costly state action is urgently needed to deal with an emergency? If one tier has exclusive competences, there is a clear answer to what actor has the responsibility to act – and finance the action. However, if two tiers of governance enjoy concurrent competencies, as is most often the case, or have controversial views about their respective responsibilities, both might shy away from taking costly measures and hope for the other tier to decide and pay. Based on this observation, we claim that Switzerland has suffered from such negative conflicts of competences and that the Swiss fiscal federal system has caused inaction when action was required. This fiscal equivalence trap, as we call it, has thus hampered the country's pandemic reply. However, it is felt and experienced more generally and can lead to illegitimate inaction wherever both tiers enjoy concurrent competencies but prefer not to act. Such can be the case when there is an obligation to take adequate measures to protect and fulfil human rights (only their – passive – respect is generally free) and also when it comes to protecting the climate and mitigate climate change. We hence believe that the problem of the fiscal equivalence trap reaches way beyond crisis management.

To substantiate our argument, we will proceed as follows. We will first briefly recall the essential elements of the Swiss federal system and the principle of fiscal equivalence which constitutes a binding guideline when allocating tasks and costs (chap. 2). We will then present the Swiss emergency regime (chap. 3.1) and its controversial use during the financial crisis (chap. 3.2). In 2008, the Federal Council extensively referred to emergency powers, in particular to bail-out the private Bank UBS. In contrast to the Covid crisis, however, these emergency decisions raised few federal and mostly democratic questions. Correspondingly, the Swiss legislator's initiatives to learn from the financial crisis focused on strengthening the role of parliament in urgent financial matters. However, these learnings from the UBS rescue have, as we will show, not prevented the CS takeover in 2023. We will then turn to the Covid pandemic and the use of emergency powers in that context, examining the distribution of competences and resources according to the Epidemics Act (chap. 3.3), before discussing the fiscal equivalence trap in more detail (chap. 4). In our conclusions, we will show that there is much to learn from these recent crisis situations and discuss some suggestions for improving the financial emergency arrangements (chap. 5).

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II. THE SWISS FEDERAL POWER AND RESOURCE SHARING SYSTEM

Switzerland's federal system relies on a complex and dynamic distribution of powers and resources (2.1). In the two fields which have proved to be crisis-prone in the past – economic policy and health – the constitutional distribution is very differently organised (2.2), leading to dissimilar federal emergency dynamics. The overall regime is guided by the constitutionally guaranteed principle of subsidiarity and of fiscal equivalence. Both principles are not justiciable and only partially implemented (2.3).

1. The Power and Resource Sharing Regime

As in numerous other federal systems, the residual power is vested with the subnational units of Switzerland, the cantons, which exercise all rights not delegated to the Confederation (article 3 cst.). The federal tier is hence only empowered to perform a task insofar as such task is assigned to it by the federal constitution itself (article 42 cst.; Biaggini et al., 2021, p. 154 ff.; Malinverni et al., 2021, p. 380 ff.; Tschannen, 2021, p. 287 ff.).

Competences assigned to the federal level differ with regards to their extent as well as their effect on the cantonal competences. Federal competences can allow the federal tier to extensively regulate an area – so-called comprehensive competences –, they can be limited to specific aspects – so-called fragmentary competences – or only permit the Confederation to lay down principles – so-called framework competences (Häfelin et al., 2020, pp. 353 f.; Tschannen, 2021, p. 302-304).

As to their effect, federal competences can be exclusive, concurrent, parallel or subsidiary. Concurrent competences are the rule. Cantons then preserve their competences even in fields delegated to the federal tier and can still make and apply their own laws, as long as and to the extent that the federal competency has not been made use of comprehensively (Häfelin et al., 2020, pp. 354-357; Martenet, 2021, pp. 157-160; Tschannen, 2021, pp. 300-302). Whenever competences are concurrent, it thus often occurs that both the federal and cantonal tiers are allowed (and sometimes even obliged) to act. Cantonal acts must not violate national and international norms (article 49 cst.) but may complement, supplement and refine them.

The extent and effect of federal competences is often far from clear and must be determined by constitutional interpretation (Häfelin et al., 2020, p. 349). In most policy fields, a complex system of coexisting, juxtaposing and interrelated federal and cantonal competences exists (Biaggini, 2015, Art. 3 Cst., pp. 74 f.; Malinverni et al., 2021, p. 402-405; Martenet, 2021, pp. 162-164). Where concurrent federal and cantonal competences coexist, only the interpretation of federal and cantonal acts in light of the constitution can answer the question of whether the federal norms leave room for cantonal additions and whether a canton is actually complementing or rather contracting federal law.

In the field of resource sharing, the Confederation is vested with a number of exclusive competences (such as customs duties, value added tax, and special consumption taxes; articles 130-134 cst.). In contrast, direct taxes on the income of private individuals and the net profit of legal entities are parallel competences of all tiers of governance (article 128 cst.). The federal, cantonal and local tiers thus autonomously levy and spend taxes, leaving the cantonal – and local – tiers with significant financial autonomy.

Consequently, the Swiss fiscal federalism regime leads to considerable differences: Taxpayers pay different tax rates depending on the canton and commune taxing them, and cantons and communes find themselves in different financial situations depending on their tax levels and resources. It is for the latter inequality that the regime of fiscal federalism is complemented by a regime of financial equalisation (article 135 cst.; see for

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a more detailed account e.g. Hänni, 2021, pp. 270 ff.). Its main aims are to reduce the differences in financial capacity among the cantons and to guarantee all cantons a minimum level of financial resources (article 135 para. 2 lit. a and b cst.). The equalisation of financial *resources* is mostly horizontal (see article 135 para. 3 cst. and article 4 para. 1 and 2 of the Federal Act on Resource and Burden Equalisation [FiLaG]) and enforces solidarity between resource-rich and resource-poor cantons. Resource equalisation is not full (see article 3a para. 2 FiLaG) as it aims at maintaining tax competition and incentives for poorer cantons to develop economically. The equalisation of *burdens*, in contrast, is mostly vertical. The Confederation compensates mountainous regions for special burdens linked to geo-topographic challenges (article 7 FiLaG) and metropolitan areas for extra burdens linked to socio-demographic factors (article 8 FiLaG).

2. The Power Sharing Regime in Economy Policy and Health

In the two fields which have proved to be crisis-prone in the past, economic policy and health, the constitutional distribution of competences is very differently organised:

The Confederation is solely responsible for money and currency and enjoys exclusive competences in the field of currency policy which are implemented centrally by the independent Swiss National Bank (article 99 cst.). In the field of economic policy more broadly, the Confederation is vested with comprehensive but concurrent competencies to take measures to achieve a balanced economic development, and to prevent and combat unemployment and inflation. Consideration and cooperation duties compensate the cantons for their loss of competence: When using its powers, the federal tier must consider the economic development in individual regions of the country and cooperate with the cantons (article 100 para. 1 and 2 cst.). Such concurrency also exists in the field of banking. The Confederation is obliged to legislate on the banking and stock exchange system and may legislate on financial services in other fields. By issuing the federal Bank Act and the Financial Market Supervision Act and by mandating the Swiss Financial Market Supervisory Authority to supervise banks, securities markets and investment funds, the federal tier has made extensive use of its constitutional powers in the field. It has, however, taken account of the special function and role of the cantonal banks (article 98 cst.).

In the health sector, the federal competences are much more limited. The constitution obliges the Confederation to legislate on health insurance (article 117 cst.) but otherwise only provides for very limited parallel and fragmented federal competences. Generally speaking, the health sector is governed by the cantons. One of the few fragmentary federal competences relates to the combating of communicable, widespread or particularly dangerous human and animal diseases (article 118 para. 2 lit. b) on which the federal Epidemics Act is based (see chap. 3.3).

Thus, in the financial sphere, as a rare exception, even implementation is centralised. In contrast, the health sphere is almost entirely in the realm of the cantons which are obliged to implement the few acts the central tier has adopted based on its skeletal set of competences and, for the rest, make and implement their own health policies.

3. The Principles of Subsidiarity and of Fiscal Equivalence

The attribution of tasks and responsibilities to the different government tiers and the way competences are used is refined – amongst others – by the principle of subsidiarity (article 5a cst.). This principle – like the principle of fiscal equivalence which it is closely related to – has been introduced into the constitution in the context of the reform re-organizing the division of competences and the financial equalization scheme in 2004 (Federal Dispatch on the NFE, FG 2002 2291; see also Federal Dispatch on the New

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Constitution, FG 1997 I 1). It is codified as a binding guideline and stipulates that the higher tier of government must only interfere by legislating if unity is required, it must limit legislative unification to the strictly necessary, and it must leave implementation to the lower tier and allow for maximum margin of appreciation in the application of federal acts (instead of many: Biaggini, art. 43a Cst., 2015, N 11 ff.; Tschannen, 2021, pp. 291 f.; Waldmann, 2015, pp. 3-9). The Confederation hence only intervenes – and only to the extent – that a task either overburdens cantons or requires uniform regulation (article 43a para. 1 cst.). Cantons thus enjoy far-reaching autonomy in so-called original matters (issues not delegated to the federal tier) and considerable margin of discretion in so-called delegated matters (issues harmonised by federal acts but autonomously implemented and adjudicated by cantons, article 46 cst.; see also and amongst others: Malinverni et al., 2021, p. 384; Martenet, 2021, pp. 160-162). Even if unity is considered necessary (and the federal constitution amended accordingly), the country typically opts for harmonisation only and accepts cantonal differences even in spheres of federal competences. As the principle is not justiciable, it is, however, regularly disrespected by the constitution-maker itself, by the federal parliament and the federal executive. It has hence only partially fulfilled its aim of serving as a break to ongoing centralisation trends (Bellanger, 2021, N 17; Waldmann, 2015, p. 15).

The same is true for the principle of fiscal equivalence which emanated from the field of economics and was constitutionalised as part of the federalism reform (Tiefenthal, 2021, p. 589; Waldmann, 2015, p. 13). According to the principle of fiscal equivalence, the collective body that benefits from a public service bears its costs and the collective body that bears the costs of a public service may decide on the nature of that service (articles 43a para. 2 and 3 cst.). Somewhat simplified, the principle is often referred to as “who pays, decides – who decides, pays”-principle (Waldmann, 2015, p. 13). Its underlying idea is that those who benefit from a state service must, on the one hand, finance the service (through taxes or fees) and, on the other hand, have a (democratic) say in the determination of the service (Biaggini, 2015, art. 43a cst., N 26). Such triple congruency – maximizing democratic accountability and limiting financial transfers – intrinsically links the distribution of powers to the distribution of resources.

Since its introduction into the constitution, the principle of fiscal equivalence has been controversially discussed (critical e.g. Biaggini, 2015, article 43a cst., N 26; Waldmann, 2015, p. 15; favourable e.g. Schweizer, 2020, N 7; Tiefenthal, 2021, p. 583). It has not fully been implemented in the first place, and has often been transgressed in the second (KdK, 2017; see also Waldmann, 2015, p. 15). Moreover, it is limited by the constitution itself: As the federal competences are most often limited to law-making, cantons must implement federal laws and finance their implementation. While cantons therefore bear the costs of their policy decisions, the Confederation does not necessarily (see e.g. Biaggini, 2015, article 43a cst., N 29). The result is that the principle has a very unequal impact on the federal actors: While cantons tend to shy away from taking on costly tasks, it is a temptation for the Confederation to make laws and ask the cantons to finance their implementation.

In addition, the principle of fiscal equivalence only deploys its hoped-for outcomes when a task benefits a clearly defined territory and when such territory matches a territorial unit (Tiefenthal, 2021, p. 592; Waldmann, 2015, p. 13). This condition is obviously not given in the case of a pandemic and the principle of fiscal equivalence hence ill-designed to deal with rapidly spreading viruses not respecting local, cantonal or any other borders. Furthermore, scholars insist that it might be reasonable in some cases – for reasons of effectiveness or others – to issue national regulations and to provide and finance the corresponding public services at the cantonal level (Tiefenthal, 2021, p. 593). In case of a major health crisis, such arguments are particularly significant and, during the Covid 19 crisis, provoked endless and frustrating debates about the ideal bearer of

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costs for testing, tracing and quarantining – debates which delayed effective actions. Regrettably, the constitution and its principles were not helpful in preventing conflict and saving time by clearly sorting out the financial matters (see chap. 4).

III. THE EMERGENCY REGIME AND ITS USE DURING THE FINANCIAL AND COVID-19 CRISIS

The Federal Constitution provides for an emergency regime allowing for power concentration (3.1). The Financial Crisis of 2008 (3.2) and the Covid-19 Crisis (3.3) are two recent examples in which these emergency powers have been used extensively. In both situations, the emergency regime has been criticized, although for very different reasons: In the first, the decision of the Federal Council to bail out the private bank UBS raised the question of whether such crisis legitimized the use of emergency acts and whether the bypassing of parliament was acceptable – and thus was concerned with the *horizontal* separation of powers; in the second, federal matters of power and resource sharing – matters of *vertical* distribution of competences and obligations – were at the forefront.

1. The Constitutional Emergency Regime

In case of an emergency, the Federal Assembly and the Federal Council acquire special powers. If extraordinary circumstances so require, the parliament can take measures to safeguard the external security of the country, its independence and its neutrality, and measures to safeguard internal security (art. 73 para. 1 let. a and b cst.). Such measures can include federal emergency acts which are exempted from the usual optional referendum that would otherwise delay parliamentary laws from entering into force (article 165 cst.; see for a more detailed account e.g. Belser, 2021, p. 127 f.). The parliament is also empowered to adopt federal emergency acts in fields of cantonal competences. Such acts which do not rely on a constitutional provision establishing a federal competence and hence amend the constitutional power sharing regime must be approved by the people and the cantons within a year (and otherwise be repealed). So far, these parliamentary emergency powers have not been very relevant (Belser, 2021, p. 127). A bicameral parliament relying on numerous mechanisms to seek compromise and make consensus-based laws (Belser, 2018, pp. 168 ff.) is not ideally suited to work under stress.

In contrast, the slightly more restrictive emergency powers of the federal executive are frequently deployed (Belser, 2021, p. 127). To counter existing or imminent threats of serious disruption to public order or internal or external security and to safeguard the interests of the country, the Federal Council may issue ordinances and rulings (articles 184 and 185 cst.). The emergency ordinances must be limited in duration and necessary to protect fundamental legal values such as peace, life, and public health (paras. 3 of articles 184 and 185 cst.). In recent times, the Federal Council has used its emergency powers on several occasions, in particular to enforce international sanctions, to deal with the crisis of the airline Swiss and other international and economic concerns. Most recently, the emergency powers were used extensively to deal with the financial crisis (see 3.2) and the Covid-19-pandemic (3.3).

2. The Financial Crisis

Switzerland was not as hardy hit by the financial crisis as many other countries. It did not escape unscathed but was only slightly affected by recession, quickly regained considerable growth rates and avoided amassing huge debts (Swiss Financial Statistics 2011 and 2012; OECD, 2017, p. 8).

When the financial crisis started to unfold, Switzerland was considered particularly vulnerable as its two largest private banks, UBS and Credit Suisse, were particularly

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exposed in the US subprime bubble. Soon, the Swiss banking sector, in particular the UBS, fell victim of its own high-risk strategy of expansion in the US market and was about to go bankrupt. To avoid this, the Federal Council, using emergency powers, adopted a comprehensive program to support the Swiss finance system and – together with the Swiss National Bank – rescued UBS. The aid plan consisted of a government contribution of 6 billion Swiss francs to restore the banks own funds and a contribution from the National Bank of 54 billion Swiss francs allowing UBS to transfer illiquid securities into a special stability fund (resulting in the National Bank taking over UBS's toxic assets; see CC, 2010). The state intervention was justified by the argument that UBS was “too big to fail” (Federal Dispatch on measures to strengthen the Swiss financial system, FG 2008 8943; see also: Kley, 2011, pp. 133-134).

The use of the executive emergency powers in 2008 was most controversy discussed. In essence, it was viewed critically that the claimed emergency was economic – and private – in nature, and it was disputed whether the bankruptcy of a bank qualified as a serious threat to national security (Belser, 2021, p. 128). At the end, the judiciary took a stance on the issue. When the case was brought to the Federal Supreme Court, the latter decided that the use of the federal emergency powers was not limited to serious threats to peace, life, and public health. Rather, economic and social crises could justify their use as well (Federal Court Decision, BGE 137 II 431, paragraph 4.1.). This decision was criticized by various scholars, who argued that it allowed the use of emergency powers too widely (Belser, 2021, p. 128, with further references).

The (contentious) use of emergency powers has resulted in a number of legislative changes, in particular the adoption of a Federal Act on Safeguarding Democracy, the Rule of Law and the Capacity to Act in Extraordinary Situations, which entered into force in 2011. According to the new rules, the Federal Council now has to immediately inform Parliament – or rather the competent parliamentary commission – when it uses emergency powers (Government and Administration Organisation Act [GAOA], article 7e para. 2). Furthermore, emergency ordinances cease to apply if the Federal Council fails to submit them to Parliament within six months (article 7d para. 2 GAOA). However, not all ambiguities have been removed by the amendments. While it was mostly undisputed that emergency powers do not allow the Federal Council to violate the Constitution, it was controversially discussed whether they allow the Federal Council to go against or amend parliamentary laws (Belser, 2021, p. 128; with further references to: Saxer, 2014, N 101-104; Stöckli, 2020, pp. 24-25). The emergency regulations of the recent past, however, have taken a clear stance in the matter: They frequently amended parliamentary laws, most clearly in the recent decisions providing for the rescue of the bank Credit Swiss by its acquisition by UBS.

Following the financial crisis, the Swiss legislator also promulgated special rules for the stabilisation, restructuring or liquidation of financial institutions which are of a systemic importance to the point that their failure jeopardises the entire Swiss economy. These too-big-to-fail (TBTF) regulations, included in the Banking Act in 2012, oblige systemically important banks to comply with higher capital requirements, increased liquidity requirements and higher requirements in terms of resolvability. The TBTF buffers aim at strengthening the crisis resilience of big private banks. Moreover, they allow for the continuity of systemically important functions in Switzerland in the worst-case scenario of bankruptcy by spinning off the Swiss business arm (Federal Dispatch on the *too big to fail* regulation, FG 2011 4717; see also: Fact Sheet on the *too big to fail* regulation, 2023). These new legislative measures, however, were not implemented in 2023 when the Federal Council and the National Bank, based on constitutional emergency powers, decided on a takeover of CS by UBS thereby creating a bank even bigger and even more likely bailed out in a future crisis. In a few days time, the Federal Council had arranged a deal providing for the takeover of CS by UBS. The Federal Council officially

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“welcoming” this move, but really had designed it and extensively used emergency law to make it happen. The Council allowed the Swiss National Bank to provide substantial additional liquidity assistance and gave a default guarantee for liquidity assistance. In order to reduce the risks for UBS, the Federal Council also granted a guarantee of 9 billion to assume potential losses arising from certain assets USB was taking over from CS (Special dispatch on guarantee credits [CS takeover], 2023). According to the new rules, such emergency measures had to be accepted by the finance commission of parliament and be submitted to the federal assembly. While the finance commission “urgently” gave its approval on Sunday, 19 March 2023, the National Council, quite spectacularly, decided to deny parliamentary approval (National Council, Official Bulletin 2023 N 714 f.). Several factors motivated the members of parliament to express their deep dissatisfaction: the TBTF-regulations provide for a worst-case scenario of bankruptcy (not bailout) in which only the sector crucial for Swiss business would be allowed to continue. The management of the crisis thus contradicted the rules provided for in such a scenario. The effects of the parliaments refusal to approve the emergency credits have been and are still controversially discussed. While some claim that such subsequent decision must be considered as a symbolic protest of parliament, others insist that the parliamentary budgetary powers are at the heart of democratic power control and that therefore all financial promises of the Federal Council must be stopped from being transformed into financial commitments (see e.g. Biner & Gerny, 2023; Gerber, 2023, pp. 5-11). As (most) of the financial commitments have (probably) already been made, the parliamentary power of approving the credit (and of not approving it), raises further unsolved issues. Seen the open questions, the charges and allegations, it does not come as a surprise that parliament has decided – for the fifth time in the country’s history – to establish a parliamentary commission of inquiry. This is the most powerful instrument the Federal Assembly has at its disposal to hold the federal executive accountable (and has been labelled the Swiss variation of a vote of non-confidence).

3. The Covid Crisis

While the difficulties associated with the use of emergency powers during the financial crisis were mainly related to democratic concerns about the horizontal division of powers, they also involved a federal component in the context of the covid pandemic. This is due to the far-reaching cantonal competences in matters of health, the complex and dynamic power sharing regime established by the Federal Epidemics Act, and the parallel deployment of legislative and constitutional emergency powers – to take epidemic measures on the one hand and to cushion their economic and social effects on the other.

Based on its fragmentary and concurrent competence to deal with epidemics (article 118 cst.), the Federal Assembly has issued an Epidemics Act [EpidA] introducing a three-stage-model to deal with health emergencies (Bernard, 2020). In “normal” situations, it is up to the cantons to prevent and control diseases, but the federal tier – in consultation with the cantons – determines aims and strategies (Belser, 2021, p. 126; Bergamin & Mazidi, 2020, pp. 15–16; Stöckli, 2020, pp.18–19). When the situation is declared “extraordinary” by the Federal Council, the latter may take any measure required for the entire country or some parts of it (art. 7 EpidA). In such situation, competences are thus not only shifted horizontally (from parliament to government), but also vertically (from the cantons to the confederation) as well. In an extraordinary situation, it is not mandatory according to the Epidemics Act – albeit still mandated by the Constitution to the extent possible – to consult the cantons prior to ordering measures (Belser, 2021, p. 126). This extraordinary situation – in which the country found itself between 17 March and 19 June 2020 – is foreseen but not regulated by law and leaves numerous questions open (Bergamin & Mazidi, 2020, N21–22; Bernard, 2020; Stöckli, 2020, pp. 19–21). In particular, it is unclear how far the federal competences reach and whether the cantons are allowed to go beyond the federal rules (Belser, 2021, p. 134).

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Even more controversial is the “special” situation which applies when the epidemic conditions are no longer normal but not (yet or no longer) extraordinary. The Epidemics Act defines a situation as “special” when the ordinary enforcement agencies are unable to prevent or control the outbreak and spread of communicable diseases, and when there is either a high risk to public health or the economy or other sectors, or when the World Health Organization (WHO) has announced a public health emergency of international concern and this emergency poses a risk to public health in Switzerland (article 6 para. 1 EpidA). In such a “special” situation – in which the country found itself during most periods of the Covid crisis – the Epidemics Act empowers the Federal Council with an extra set of competences to take – such as banning events or closing schools –, which would otherwise lay within the competence of the cantons (art. 6 para. 2 EpidA; see also: Belser, 2021, p. 126). However, the Federal Council may order such measures only after consulting the cantons (art. 6 para. 2 EpidA). This duty to consult the cantons compensates the latter for the loss of their autonomy and ensures that their know-how about the situation on the ground informs federal decision-making (Bergamin & Mazidi, 2020, N17–20; Kley, 2020, p. 272; Stöckli, 2020, p. 19). At the beginning of the second wave of the Covid-pandemic, however, it soon became apparent that the special situation was only insufficiently regulated and that the concurrent competencies, combined with the absence of joint bodies monitoring the disease and coordinating actions, raised the risk of negative conflicts in competence (Belser, 2021, p. 126). As it was mostly during this time that the fiscal equivalence trap deployed its effects, we will further explore this situation below (chap. 4).

The specific system of health and epidemic competences established by the Federal Epidemics Act is complemented by the general constitutional emergency regime – and vice versa. Indeed, epidemic measures, such as the testing requirement or the banning of events, were issued by federal and cantonal governments based on the dynamic shifting of competences provided for by the Epidemics Act. In contrast, other (mostly economic) emergency measures, such as financial relief packages, were adopted referring to the constitutional emergency powers of the federal (and cantonal) constitutions (chap. 3.1). As a result, two parallel emergency regimes unleashed unprecedented executive powers at the federal level. These executive powers altered in their nature, their extent and their effect on parliamentary and cantonal powers depending on the measure at stake and the urgency involved. Ambiguities and controversies were not only linked to the constitutional and legal situation, the competences of the federal parliaments and the cantons, and the nature and necessity of measures taken, but also to factual difficulties, in particular the handling of scientific data. Overall, and in international comparison, the country has probably not coped too badly with the crisis; but because in the midst of serious threats there were persisting arguments about responsibilities and duties between the Confederation and the cantons, precisely when there seemed to be no time for such conflicts, the reputation of federalism has nevertheless suffered considerable damage.

IV. THE FISCAL EQUIVALENCE TRAP

The complexity of the division of powers and duties – in the context of emergency situations in particular – can lead to problematic effects and delayed state action. We believe that the principle of fiscal equivalence significantly contributes to these difficulties, in particular, by disincentivising measures which would have been required (4.1), a phenomenon which we call “Fiscal Equivalence Trap”. We argue that the fiscal equivalence trap has been manifest in the context of the management of the Covid-19 pandemic (4.2), but that it is not limited to the context of health emergencies, but can rather cause (or aggravate) negative conflicts of competences in other policy fields as well.

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1. The Principle of Fiscal Equivalence and the Problem of Negative Conflicts of Competence

Conflicts of competences are common in federal systems, be they under stress or not. Most systems are well-equipped to deal with the – seemingly – more common form of such conflicts: positive conflicts of competences. In such situations, both tiers of government deem themselves to be competent, make laws or take other actions. The federal institutions, in general, can deal with such conflicts, mostly by empowering an apex court to adjudicate and invalidate laws and decisions which go beyond the respective competences (*ultra vires*) and are hence unconstitutional.

Conflicts of competences can, however, also be negative. Such situation exists when none of the government tiers claims a competence in a field and both remain inactive (*infra vires*). Inactivity can stem from ambiguous competences that both actors try to escape and from concurrent competences that both actors prefer to leave to the other tier – in general, in fields that require costly action. Few constitutional regimes explicitly deal with such conflicts and, generally, find it more difficult to mandate due action than to prevent undue action. The fact that constraining state power is, historically, at the heart of constitutionalism, should, however, not blur the circumstance that inaction can be as problematic for the rights and freedoms of citizens. Especially in situations where rapid state action is required to prevent harm, such as the rapid spreading of a disease or the breakdown of a health system, emergency action is not a right but a duty of the state. Indeed, in such situations, the controversy over who must decide and act may lead to critical delays or inaction, and by the time the conflict of competence is solved, it might already be too late to (sufficiently) mitigate negative consequences.

The principle of fiscal equivalence has the potential to exacerbate the problem of inaction and the threats linked to it. Indeed, if the consequence of being competent to decide on a matter is that the respective state level has to pay the costs of its decisions and their implementation, both the federal and the cantonal state actors tend to be less inclined to claim competences. The occurrence and relevance of negative conflicts of competences is hence increased by the principle of “whoever decides, pays”, as it can be more appealing not to decide and not to pay. The principle of fiscal equivalence, too, is thus tailored to positive conflicts of competences. It meaningfully contributes to establishing a cooperative partnership between the Confederation and the cantons: Acting beyond one’s competences is less tempting when costly. However, when pricey action is urgently required, the principle of fiscal equivalence can lead to a fiscal equivalence trap. When the competences of one tier or the other are clear and exclusive, some legal remedies – and numerous political ones – are at hand. However, when the respective duties of the tiers are concurrent or ambiguous, one’s inaction can easily be legitimized by pointing to the other tier.

2. The Fiscal Equivalence Trap in the context of the Covid-19 pandemic

Shortly after the first Covid-19 case in Switzerland on 25 February 2020, the Federal Council declared a “special situation” under the EpidA. From then on, measures to prevent the spread of the virus were taken at the national level. Cantons had to respect and implement these measures, but were still left with their own set of competences to deal with the crisis. At the beginning, for instance, the Federal Council banned large-scale events involving more than a thousand people; the Cantons were obliged to implement the ban, and competent to issue additional health measures relating to such events, or to ban even smaller events.

Despite these measures, the infection rate increased exponentially, which is why in March 2020, stricter rules were introduced on the federal level, before the Federal

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Council declared an “extraordinary situation” according to the EpidA on 6 March. Following this declaration of the extraordinary situation, a set of strict rules and measures was issued and continuously amended at the federal level, the cantons being left with only a minimal set of competences, such as taking their own economic relief measures, and considerable implementation duties. The Federal Council also adopted comprehensive economic relief measures to cushion the effects of the lockdowns. During this stage of the Covid-19 pandemic, even though the concentration of power at the federal level was – after some time of shock unity – not completely undisputed, the vertical distribution of competences did not lead to negative conflicts of competence. Indeed, it was clear that the federal authorities were the main actor and that the role of cantons was reduced to implementing the national pandemic responses.

There was, however, a debate whether cantons more heavily affected than others or more willing to lockdown activities were still allowed to issue their own emergency regulations. The fact that the federal authorities declared their regime to be exhaustive did not silence the controversy. The negative effects of the conflict of competences on the pandemic reality nevertheless remained minimal. After all, the federal measures at this point were relatively strict and did not leave a large regulatory vacuum the cantons were not permitted to fill. However, the cantons were affected differently by the pandemic, and some cantons, such as the Ticino and many French-speaking cantons, strongly argued in favour of them being able to issue stricter rules, an argument that was supported by scholars (Belser et al., 2020, p. 4-7; Belser & Mazidi, 2020). Furthermore, the fact that the cantons were less involved in the making of the federal measures as was usually the case led to the introduction of some measures that were found to be difficult to implement by the cantons (Belser, 2021, p. 134). Hence, some disputes about the vertical distribution of competences did arise after all. These disputes, however, took the (more usual) form of positive conflicts of competence in the sense that both the federal states and (some of) the cantons wanted to act.

The federal decision not to allow cantons to issue stricter lockdowns than the federal executive was presumably motivated by financial concerns. Cantons issuing complementary measures (and their populations) were expected to ask for more financial support from the national emergency relief arrangement (Belser et al., 2020, p. 4-7; Belser, 2021, p. 134). Thus, financial considerations, in particular disputes about financial responsibilities corresponding to the respective competences, already played a role at this stage of the pandemic response (Belser, 2021, p. 134).

The vertical distribution of competences did start to be very controversial and disputed when the Federal Council declared the downgrading from the extraordinary to the special situation on 19 June 2020. Indeed, the special situation is characterized by the coexistence of federal and cantonal competences and, hence, particularly prone to negative conflicts of competences. Contrary to what has been the case in the first phase of the pandemic, the federal government now no longer considered itself to be the main actor of the pandemic management and called on the cantons to act (Belser, 2021, p. 135). The cantons – which before had been complaining about their downgrading to mere implementation agencies – were caught by surprise by the Federal Council’s sudden retreat from leading the pandemic management (Belser, 2021, p. 135).

This is when a negative conflict of competence became manifest – both the federal and the cantonal authorities being reticent to take measures. The Confederation, exhausted by costs and critics, was quite willing to hand over responsibility, the cantons, however, unwilling to take it up. After all, while pandemic measures seemed urgently required as temperatures went down and infection rates up, the perspective of issuing cantonal restrictions was unattractive – politically and also financially. Indeed, according to the fiscal equivalence principle, taking measures (“decide”) meant bearing the costs

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of the measures (“pay”). Both tiers therefore remained passive while the second wave of the pandemic started to badly hit the country. At that time, federalism was blamed for failing the citizens – and it did. It was also at that time, when the Confederation and the cantons insistently blamed each other for inaction, that a journalist coined a new term for federalising, ‘föderalen’, meaning to shift responsibility and guilt to the cantons when it is inexpedient to act (Karpiczenko, 2020).

3. The Effects of Fiscal Equivalence on Federal Finances

One could wonder whether the principle of fiscal equivalence – and the trap it can lead to – had effects on the financial situations of the different federal actors. Looking, firstly, at the development of the financial situation in Switzerland more generally, one finds that the financial situation in Switzerland has been relatively stable over the years. Indeed, data consolidated by the OECD on the evolution of debt and public expenditure in Switzerland during the 1999-2021 and 1995-2021 period respectively shows that these economic indicators have remained relatively stable, even during and in the aftermath of the 2008 financial crisis. A significant rise in government expenditure and debt affecting all three levels of government can be identified in 2020 due to the Covid-pandemic. The data for 2021, however, already indicates a return to financial normalcy.

Consolidated government expenditure as percentage of GDP

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Central	15.28	15.04	15.75	15.49	16.32	15.87	14.62	15.57	15.37	15.33	14.99	14.08	13.47	13.32	14.26	14.05	13.98	19.82	14.1	14.02	14.32	14.53	14.45	14.03	14.16	17.22	15.91
State	10.44	10.81	10.85	10.71	10.82	10.71	11.05	11.42	11.73	11.71	11.5	10.86	10.67	11.18	11.78	11.73	11.84	12.24	12.84	12.47	12.55	12.4	12.38	12.29	12.32	14.15	13.71
Local	7.43	7.51	7.36	7.29	7.19	6.92	6.93	6.99	7.1	6.89	6.76	6.45	6.12	6.3	6.7	6.59	6.55	6.63	6.69	6.78	6.75	6.74	6.88	6.66	6.78	7.09	6.87

Debt as percentage of GDP

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Central	26.83	27.39	25.6	30.02	28.95	29.87	30.18	26.72	24.46	23.71	22.56	22.1	22.1	22.23	20.87	21.09	20.8	19.72	20.58	18.79	19	21.12	19.87
State	14.91	14.46	14.37	15.17	15.74	15.73	15.67	12.34	11.43	10.2	10.25	9.84	9.65	10.34	10.53	11.43	11.71	11.84	11.82	11.51	11.72	13.01	12.25
Local	12.28	11.86	11.83	11.82	11.48	11.37	11.13	9.61	9.21	9.45	9.8	9.66	9.75	9.79	9.86	9.66	9.78	9.30	9.51	9.16	8.6	9.07	8.58

Source: OECD Fiscal Decentralisation Database.

Looking at the context of the covid-19 pandemic a bit more closely: The Swiss Financial Statistics expected the gross debt of government – which was stable between 2012 and 2019 – to rise significantly in 2021 due to funding requirements caused by the measures of the pandemic management (Swiss Financial Statistics 2021, p. 10). It was also predicted that the Confederation would be most affected as it had carried the main financial burden of supporting enterprises as well as sports and cultural event organisers in 2020 and 2021 while the contribution of the cantons and local governments remained comparatively small (Swiss Financial Statistics 2021, p. 4). Despite these extra costs burdened by the federal tier (in a first phase of the pandemic at least), the Swiss Financial Statistics expect a debt reduction for the Confederation between 2022 and 2025, but an increase of the gross debt of the cantons and the communes (Swiss Financial Statistics 2021, p. 5 and 10).

One year later, the Swiss Financial Statistics of 2022 confirm that the Confederation was more heavily affected in 2020 – when it was leading the pandemic reply – and slightly less in 2021, when cantons reacquired concurrent competences and were asked to use them. The federal government’s participation in the Covid-19-related expenditures amounted to 16.7 % in 2020 and was reduced to 15.6 % in 2021. The opposite applied to the cantons whose participation was lower in 2020 (2.7 %) but significantly higher in 2021 (6.7 %) (Swiss Financial Statistics 2022, p. 10). However, and in contrast to the estimates of 2021, the 2022 financial statistics estimate the government’s gross debt to peak at the end of 2023 only, after which it is expected to steadily decline (Swiss Financial Statistics 2022, p. 13).

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The financial situation of the cantons is (not yet) fully conclusive. A study elaborated in 2021 by PwC in close cooperation with the Swiss Association of Cities on the financial impacts of the pandemic on the Etats of the cantons, cities and municipalities, in which 15 cantons were analysed more closely, indicate that the cantonal debts will rise significantly in 2021, 2022 and 2023 (Schegg & Engeler, 2021, p. 12). However, the study also shows that it is the municipalities that are likely to suffer the greatest financial impact, their debt rising substantially more significantly than the cantonal debts. When looking at specific cantons, however, the situation is diverse. To illustrate this, we will have a closer look at the financial situations of the cantons of Vaud, Ticino and St Gallen, cantons not only representing the three linguistic regions but also cantons particularly hit during the second wave and choosing very different approaches to managing the crisis.

The canton of Vaud was amongst the cantons asking for the competence to implement stricter measures during the extraordinary situation and then one of the cantons actually implementing bans and closures relatively early during the special situation in summer 2020. Even though the canton assumed high expenditures to manage the pandemic, it posted a financial surplus in 2020 and in 2021 and its public debt did not increase in those years (Annual Accounts VD, 2020 and 2021). In 2021, it was even one of the donor cantons in the fiscal resource equalisation – which wasn't the case in the years before and after. The situation was quite different in the canton of Ticino. As was the case in the canton of Vaud, the canton of Ticino was particularly affected and was amongst the cantons issuing (strict) measures earlier than others. Contrary to what has been the case in the canton of Vaud, these circumstances were also reflected in the canton of Ticino's financial results. Indeed, it posted a negative annual financial result in 2020 and the cantonal debt increased notably (Financial Report TI, 2020, pp. 35 f., 48, 52 and 58 in particular). The canton of St Gallen – even though particularly hit by the second wave – opted against autonomous cantonal pandemic replies and limited its actions to implementing the measures mandated by the federal level. Even so, it had to shoulder extra expenditures – mostly due to the financing of the (cantonal) implementation of the federal measures –, but was able to cover them without increasing its cantonal debt (Annual financial account SG, 2020, pp. 10 f., 14 f. and p. 42 in particular).

These results show a diverse picture that is not easy to interpret. Some of the cantons particularly hit by the pandemic issued stricter measures than the Confederation and carried the costs of their decisions (in addition to the costs caused by federal measures) but did not suffer financially, i.e. the canton of Vaud. Others, acting in similar ways, suffered from considerable financial hardship, i.e. the canton of Ticino. The canton of St Gallen, which decided against a cantonal tightening of federal measures (and the obligation to finance such measures), reported large covid-related expenditures but did not suffer an increase of cantonal debts. The (financial) effects of cantonal strategies to deal with Covid – and the financial impact of the principle of fiscal equivalence – thus remains controversial and requires further research. The financial data nevertheless suggests that the fiscal equivalence principle had an effect on financial results: When the Confederation extensively used its emergency powers to manage the crisis, issued extensive economic relief measures and even shouldered some cantonal implementation costs (e.g. by contributing 50% to costs linked to testing), it suffered from significant financial impacts which decreased when the cantons were required to issue and finance their own measures. The results, however, are far from being unequivocal – especially when looking at specific cantons which were very differently affected by the crisis, not least because of their very different economic starting points, different economic sectors that are important for the cantons, and different exposure to foreign pandemic measures.

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V. CONCLUSIONS

There is no doubt that unclear attribution of competences and financial obligations can lead to inaction and delays which are highly problematic when (timely) action is necessary. When taking rapid action leads to unplanned costs, acting is awfully unattractive and can lead to responsibility- and blame-shifting whenever competences are concurrent or otherwise blurred. This is not only true in the context of the management of the Covid-19 pandemic, but (potentially) applies to other policy areas as well.

Hopefully, the recent experiences will motivate a more general rethinking of the federal finances and the principle of fiscal equivalence. The Covid-19 crisis has raised awareness for the fact that the principle of fiscal equivalence can be an appropriate tool to deal with positive conflicts of competence and disincentivise cantons (and communes) to act (and pay) beyond their tasks. It is ill-suited, however, to prevent costly measures to be taken by the Confederation which can turn to the cantons for their implementation. More generally, the principle of fiscal equivalence can hamper cantonal and local action and motivate hesitation and inaction, and blame-shifting in cases of concurrent competences. It is hence in the interest of effective governance to clarify the distribution of (financial) responsibilities whenever costly action is required to comply with costly state tasks stemming from national or international law.

The conference of the cantonal governments, in its own evaluation report, also concluded that the Covid-19-pandemic questioned the principle of fiscal equivalence (KdK, 2020, p. 18). The cantons were most critical about the financial arrangements during the extraordinary situation. Their main complaint was that the federal government, during the period classified as extraordinary situation, issued numerous costly measures in spheres which would normally fall under cantonal responsibility, without defining (or debating) the financial implications with the cantons. In many ways, the conclusions of the conference of the cantonal governments confirm the existence of a fiscal equivalence trap: The respective financial responsibilities – regarding the direct costs of implementing health measures and the indirect social and economic follow-up costs – repeatedly led to conflicts that were detrimental to the interaction between the two levels of government (KdK, 2022, p. 11). The cantons hence recommend that the Confederation and the cantons agree on clearer principles regarding the sharing of the financial burdens linked to crisis management. They urge all actors to sort out financial responsibilities (who has to pay the costs of testing, quarantining, lockdowns, etc.) at the moment such (costly) measures are adapted or as soon as possible – and not only subsequently (KdK, 2022, p. 11). More generally, the cantons suggest that a chapter on financial responsibilities (and financial aid) is added to the Federal Epidemics Act, guiding and framing the (vertical) distribution of financial responsibilities and competences by setting out objectives, criteria and procedures with regards to special health costs (KdK, 2022, p. 12). The ongoing revisions of the Federal Epidemics Act will hopefully sort out ambiguities by either making it clear that the Confederation covers the costs of epidemiological measures, in total or in part, or by stating that cantons carry the cost of implementation in normal, special as well as extraordinary situations. Either solution will help the actors involved to plan accordingly – and to act in case of need. However, it remains to be seen whether the revised Epidemics Act will take up these recommendations.

Overall, it seems clear that the principle of fiscal equivalence must be complemented by other mechanisms. It is ill-suited to distribute burdens when the benefits of state measures are not limited to the territory of a canton or a commune – and the costs of inaction also easily spread across borders. The role of the principle of fiscal equivalence must hence be reconsidered when it comes to dealing with epidemics – or other situations such as climate change – that (potentially) incentivize free-riding. In addition, it is not sure that the Swiss version of executive federalism should be linked to cantonal

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obligations to not only execute – but also finance – federal decisions. The full implementation of the principle of fiscal equivalence, in fact, should rather lead to a federal obligation to finance the implementation of federal acts – and to burden the cantons only with the costs caused by cantonal variations of implementation.

The Covid-19 crisis management revealed further weaknesses – other than the principle of fiscal equivalence – of the Swiss pandemic management. Among the shortcomings which negatively affected the crisis reply and trust in governance more generally are the lack of information and the numerous communication hiccups between the different actors of the federal tier, the cantons, intercantonal conferences and the communes. During the pandemic, the escalation from the normal and the special epidemiological situation to the extraordinary situation and, more importantly, the transition back to special and normal could have worked more smoothly, if the different tiers would have communicated better (KdK, 2020, p. 10).

More generally, a look at recent events makes it clear that the country finds it difficult to return to a normal mode of governance. Before one emergency fades out, the next kicks in – as has been shown not only by the CS-takeover in spring 2023, but also by the energy crisis which hit the country while it was still phasing out from and evaluating its crisis management after the pandemic. Such a situation – in which crisis management becomes the “normalcy” – makes it even more important to examine Swiss crisis governance and its impact on democracy, federalism, and the rule of law. Currently, emergency measures limit the power of parliament and the competences of the cantons and lead to horizontal and vertical power concentration. The recent attempts of the federal parliament to regain control (by adapting its own emergency regulations) have not proved very successful. It hence does not come as a surprise that new measures to strengthen the role of parliament during emergency are currently debated. Future improvements must be twofold: Find new ways and instruments to uphold democracy and power-sharing under stress and, as importantly, increase the resilience of all actors in order to strengthen their capacity to act under pressure and decrease the necessity to refer to emergency law.

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