TAXATION IN SWITZERLAND

Pierre Bessard

In this set of papers we compare the fiscal systems of several European countries. This chapter is dedicated to the Swiss fiscal system.

We are mostly interested in four aspects of the fiscal systems:

1. The structure of taxation in terms of % of GDP for various taxes and contributions;
2. Administrative complexity of fiscal systems in terms of bureaucratic procedures and required human resources in man-hours;
3. Level of fiscal decentralization, i.e., fiscal autonomy of local government entities with respect to the central administration.

Introduction

The Swiss tax system diverges in several ways from that of most other European countries. The first is the comparatively strong degree of non-centralization, since in a country of 8.1 million residents there are 26 federated states and 2300 municipalities levying roughly two thirds (65%) of the tax burden, while the rest is levied by the central government (35%). The second feature of the Swiss system is the relatively moderate tax burden, measured at 28.4% of GDP (OECD, year of reference 2012), including public social security programs, which make up a fourth of that value (7.1% of GDP). The third feature of the Swiss system is the high level of privately run but compulsory and heavily regulated programs, in particular contributions to old-age pension funds and health insurance premiums. Accounting for these areas, tax and compulsory expenditure make up 39.6% of GDP (Economiesuisse, year of reference 2012), or over 10 percentage points above the ordinary tax burden and social security contributions.

Although a lower level of taxation, lively tax competition among cantons and municipalities, and more privately run programs are usually associated with higher efficiency and translate into better quality of services, this situation relativizes the unqualified view of Switzerland as a “tax haven”.

impresa lavoro
Centro Studi

Levels of taxation

This section shows the evolution of taxation as a percentage of GDP in the last years. Total taxation, including contributions, and receipts from specific taxes such as VAT or Personal Income Taxes are shown. Data are provided by Eurostat in the "Main national accounts tax aggregates" database.

Figure 1 shows the tax receipts as percentage of GDP in Switzerland in the last years, as reported by Eurostat, from 1995 to 2012. The moderation initiated from 2002 results from better control of public expenditure and higher economic growth thanks to the introduction of the constitutional "debt brake" instrument, which limits the ability of deficit spending. It followed a decade of excessive public expenditure and deficits. As a result of the debt brake, Switzerland was one of the few countries that could maintain or improve its financial position in the wake of the 2008 financial crisis, with an overall public debt ratio of 36.4% of GDP for central, cantonal and municipal levels of government as well as social security (OECD, year of reference 2012).

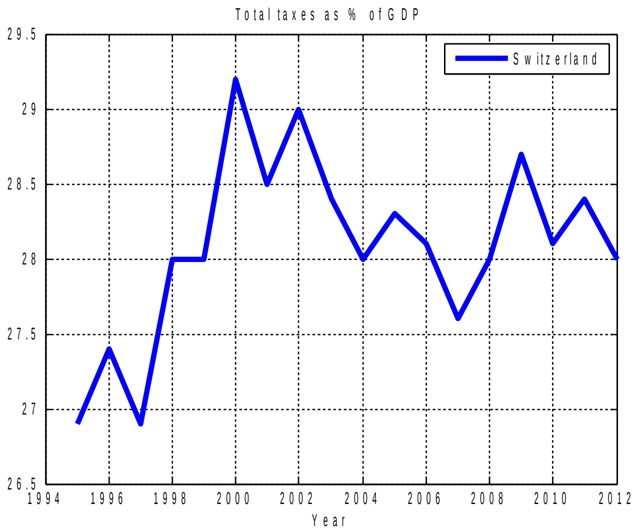

FIGURE 1 – Total taxation

Figure 2 shows VAT receipts in Switzerland. The weight of consumption taxes in relation to GDP is limited in Switzerland, which has a standard value added tax rate that is about half (8%) of the legal minimum rate in the European Union. The emphasis on direct, mainly income taxes has the advantage of raising awareness of the tax burden, as all too often VAT is wrongly viewed as a less harmful tax and used by governments in discretionary ways to raise more revenues as if it were a "free" tax. Yet as the name tells us VAT is levied on value added and depresses economic growth and impeding job creation like any other tax. It also tends to act as an "anesthetic" for taxpayers given that it is paid in small portions by final consumers, thereby encouraging excessive levels of taxation.

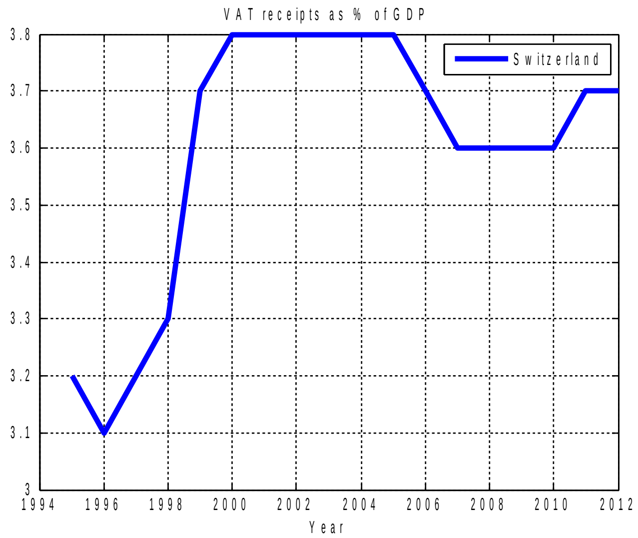

FIGURE 2 – VAT receipts

Figures 3 shows total income taxes in Switzerland, including personal income taxes (dashed), and corporate income taxes (dotted), all as fraction of GDP. The relative stability of the tax burden in recent years follows sharp increases in the 1990s due to lower economic growth, a situation corrected in part by the debt brake mechanism and corporate tax rate cuts in many cantons in the last 12 years, as well as a relatively large increase in the resident population under the free movement of people within Europe, which have all resulted in more economic activity.

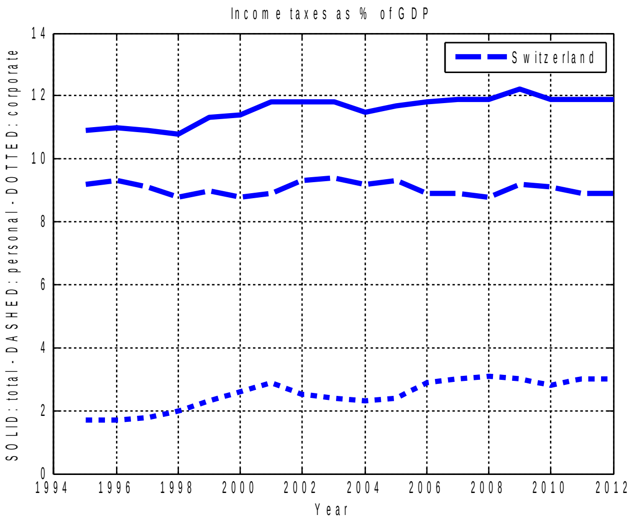

FIGURE 3 – Income tax receipts, total, personal and corporate (for Switzerland)

Figure 4 shows social security contributions in Switzerland. Contributions as percentage of GDP have remained relatively stable. The distinction between employers and employees is purely formal as all contributions must be taken off the value added by labor activity. In the meantime 30% of social security expenditure is paid for directly by taxation (most notably VAT), whereas contributions cover 70% of the costs of handouts.

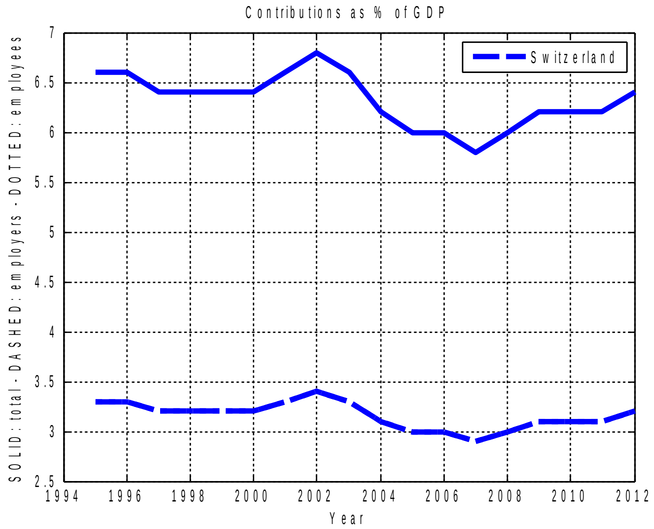

FIGURE 4 – Compulsory contributions (paid by employers, employees, and total). Employers' and employees' contributions are equal and the two lines are superposed.

Administrative burden of fiscal procedures

The additional costs incurred by corporations and households because of tax receipts are not the only costs related to the fiscal systems. Paying taxes takes time, requires a certain number of administrative procedures, and may require additional resources, such as those incurred to have the services of accountants.

Especially for small firms, huge fixed costs incurred in the process of paying taxes may be a severe obstacle to efficiency and competitiveness.

Table I shows the World Bank's Doing Business data on Switzerland regarding the subfield of the index called Paying Taxes. The Doing Business index ranks economies against several dimensions related to public policies and services related to the quality of the environment in which businesses operate. The "Paying Taxes" sub-index is of course mostly interested in the fiscal system as it applies to corporations.

Country	Ranking	Procedures	Time	Total Tax Rate
Switzerland	16°	19	63	29,1
OECD High Income	-	12	175	41,3

TABLE I – Switzerland's Performance in the Paying Taxes field of the Doing Business report

Although Switzerland certainly has room for improvement (one area of high complexity and corporate administrative costs is typically VAT law), it penalizes wealth creation less than most high-income countries and the fiscal bureaucracy tends to be less cumbersome.

Taxation and federalism

The Swiss government sector is divided into three levels: the central government, the cantons (which are the original states that delegated some functions to the central government), and the municipalities (considered as local governments by the OECD).

The federated states and local municipalities in Switzerland enjoy a relatively high level of autonomy, with strong symmetry between taxes, spending, and application of decisions. This lack of centralization explains why Switzerland, although it is marginally less socialized than other countries, enjoys a relatively efficient public sector. Local autonomy leads to more control over taxes and spending, encourages competition, innovation, and emulation of best practices. Voters generally have strong incentives to oppose “prestigious” public works and excessive expenditure due to moral hazard problems arising from a disconnection between users and taxpayers.

The growth of central government, centralized welfare state institutions introduced in the late 1940s and transfers between levels of government or across regions undermine this self-discipline. In the case of Switzerland these features have clearly led to some cantons being kept backward in terms of governance and economic development, in particular in heavily subsidized mountainous or “peripheral” regions. Yet the comparative experience of competitive cantons and of those adopting competitive policies (such as slashing tax rates) shows on a very small geographical scale that institutions, not location or geographical features, are key determinants of good governance and economic development.

Figure 8 shows the “fiscal autonomy index” for Switzerland in the last years. The cantons and municipalities are autonomous to a large extent. However, the cantons are entitled to a portion of federal income tax revenues (17%), which they levy for the central government.

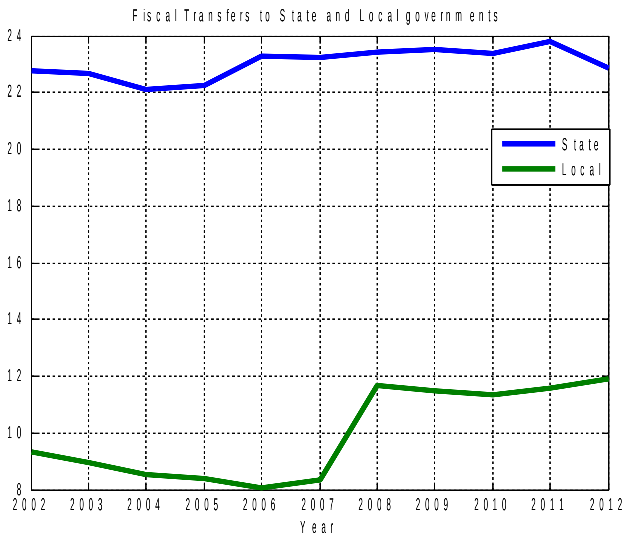

FIGURE 8 – Fiscal dependence of local governments on transfers

Conclusion

Swiss fiscal system can help to explain why this small country (without natural resources and with a long history of poverty and emigration) is from many points of view a positive exception in the European scenario.

Switzerland is not member of the European Union, but it is connected in many ways to this large community whose is now an enclave. In the last decades this country had tried to obtain all the advantages of this large cooperation (mainly the internal open market) without suffering too much for the regulation of the Eu directives. In this way it had the opportunity to preserve some aspects of its peculiar social system, based on a limited government intervention in the economy and on a large political autonomy of cantons and communes.

Now the good performance in economy of Switzerland (specially high incomes and low unemployment rate) is largely a consequence of its relatively low taxation, large presence of private run programs for pensions and health, strong fiscal decentralization. The other European countries could learn something from this experience.