THE IMPACT OF LEGISLATURE AND CITIZENS
ON THE BUDGETING PROCESS IN SWITZERLAND:
Lessons for Central and Eastern Europe

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Abstract

Scholars evaluating national and local budget procedures in Central and Eastern Europe generally advocate a greater role for legislative bodies and citizens. Mature federations and decentralised countries in Western Europe are often cited as prime examples of participatory budgeting which is supposed to lead to greater fiscal discipline, a better allocation of public resources and higher administrative efficiency. This paper investigates the strengths and weaknesses of legislative activism in Switzerland, with special regard to its ability to answer the double challenge resulting from a push for new expenditures and lower taxes, on one side, and an attempt to maintain deficit levels close to zero, on the other. While the strong consensus orientation, the careful regulation of revenue and expenditure assignment, as well as the systematic use of voters' right to direct participation are perceived as key to the success of the Swiss democracy, this study also highlights how these features can limit the effective influence of the parliament on budgeting and planning.

Central and East European countries may learn several lessons from the Swiss case, all of which are rather thought to add an input to long-term reforms rather than provide immediate solutions. The analysis points out some serious limitations of the hierarchical budgeting model as well as the consequences of a haphazard and opaque expenditure and revenue assignment. It reminds, however, that the dynamic process of post-socialist transition requires governments and parliaments to preserve a great deal of flexibility in the budget procedure. At the same time, new methods of public management and a greater transparency of public budgets are examples of tools that may be introduced on the medium term without the risk of slowing down the transition process.

Keywords: parliament, legislative, budgetary procedure, direct democracy, intergovernmental fiscal relations, public administration, transition economies, Switzerland

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1. Introduction

Knowledge transfer plays an elementary role in mastering the challenge of post-communist transition. However, standardised models and approved practices of mature federal or decentralised countries do not automatically work in the post-transition environment, as the underlying institutional systems are fundamentally different. The acquisition of modern public management techniques requires domestic professional expertise (Péteri and Zentai 2002: 22) which is capable of a careful selection of those few modules that are applicable in the local setting in the actual stage of reforms.

This paper attempts to show how the federal parliament in Switzerland deals with the double pressure for expenditure increase and tax reduction on the one hand, and enforcing budget balance on the other hand. The underlying motivation of the analysis is to formulate a few recommendations and warnings for Central and East European economies, without pretension of completeness.

Section 2 provides a brief discussion of the current double pressure on budgeting in Western and Eastern Europe and proposes a solution for the legislative to master this challenge. Taking Hungary as an illustration, section 3 highlights some of the major difficulties related to the parliament's budget work in transition economies. Section 4 starts by presenting the intergovernmental political and fiscal relations in Switzerland and shows their relevance for the budget process. It then investigates to what extent the Swiss federal parliament is prepared to address the budget dilemma. In spite of the remarkable differences between the two budgeting models, our tentative comparison allows to formulate a series of interesting lessons in section 5.

2. The Budget Dilemma and the Role of the Legislative

2.1 The Push and Pull Forces of Budgeting

Policymakers throughout Europe are facing an ever growing pressure to meet citizens' demand for more and better public services. Rapidly developing markets in an increasingly competitive economic environment raise the need for elaborating and adopting new technologies, modernising infrastructure, and investing massively in a cleaner environment. Ageing populations push up demand for additional outlays in health care and pension, and the problems of structural unemployment call for more extensive social benefits, while squeezing public revenues through a narrower tax base. On the revenue side, tax competition among subnational jurisdictions exerts a pressure on local and regional public budgets. The same development is observed on an international scale, large-scale tax cuts being on the agenda of several national governments, each of them seeking to enhance the attractiveness of the country's investment climate to spur economic growth. As the development of a pan-European internal market is leading to increased mobility, the migration of production factors has become a serious challenge for national economies. At the same time, the need for fiscal consolidation has never been as urgent as today. Budget balances deteriorated in a large number of countries in the past five years, driving up public debt ratios to worrying levels. The issue of the public household imbalance has become particularly acute since the repeated breaches of the Maastricht Treaty by several members of the European Union (ECB 2005; OECD 2005).

Particularly in the modern representative democracies where expenditure and revenue decisions are directly taken by the legislative (and not by the citizens), this double pressure pushes parliamentarians into a real Kierkegaardian
dilemma. If they fail to keep pace with their voters' demand and are reluctant to fight for new expenditure programmes, they will be punished at the next elections. If they follow the voters' preferences, thus driving public accounts into the red, they will be punished anyway.

This dilemma is all the more puzzling for the parliamentarians in Central and East European transition countries as they need to cope with some of the typical post-transition difficulties in addition to the current problems encountered by all industrialised countries. While the revenue side of public budgets still suffer from the collapse of the socialist economy and the massive loss of Eastern markets, policymakers perceive the need of compensating the "losers" of transition – especially the mid-life and elderly generations and those unable to work – through a vast range of social benefits. At the same time, parliaments in post-transition countries see themselves compelled to appropriate sky-high amounts to national and regional development programmes which would help their economies catch up with Western standards of infrastructure and environmental quality. The international competitiveness of transition countries as well as the future flow of foreign direct investment are heavily dependent not only on the tax rates but also on the existence of a modern education and health care system and the spending on scientific research. These major areas of development and the implementation of thousands of other norms and rules are embedded into the Euro-Atlantic integration process which certainly does not come to a definitive end with the accession of these countries to the European Union and the NATO. Membership calls for a permanent self-development and a proactive participation in the formulation of common policies. At the same time, the affiliation with multilateral donor organisations (World Bank, International Monetary Fund, etc.) and bilateral funding agreements, and more particularly the beneficiary status and the related conditionality of credits, commit these countries to pursue sound macroeconomic policies which lead to debt and deficit reduction. The ambitions of joining the Economic and Monetary Union exert a similar impact on fiscal behaviour. Finally, external pressure is sometimes reinforced by negative examples of other countries: a major driving force behind the adoption of the 1995 ("Bokros") austerity package in Hungary was the recognition – upon the currency crisis in Mexico – that twin deficit can have fatal consequences. Figure 2-1 illustrates the antagonistic forces which mark the process of budgeting throughout Europe.
2.2. Renewing the Role of the Legislative

While taxpayers generally welcome a stricter control on government, they also wish to see more programmes and receive more benefits, as has been illustrated in the previous section. Whether the democratic political system of a country is purely representative or semi-direct (the latter implying a regular involvement of citizens in the political decision-making process for a wide range of issues), the institutions sharing the legislative power (predominantly the parliament) play a fundamental role in balancing between the push and pull forces during the yearly budgeting process. One particularly important question in this respect is whether the parliament is likely to reinforce or undermine budget discipline. In the recent literature on public economics, there appears to be a consensus on the fact that, in order to avoid a further ballooning of the government sector in terms of revenues and expenditures, it is essential to revise the role of the legislative. In his recent article about the voice of legislative in the budget process, Schick (2002) sees the parliament's new role in:

(i) promoting fiscal discipline;
(ii) improving the allocation of public money;
(iii) stimulating administrative efficiency.

With this proposition, Schick gently shifts the pointer of the scale towards the pull side, appealing to parliaments for pursuing sound macroeconomic management, while allowing for some adjustment on the expenditure (push) side as
long as it does not make the total of public outlays grow over the limits of the budget. In line with this reasoning, the adjustment is to be done primarily through zero-sum measures of expenditure restructuring and savings through efficiency improvement.

Ad (i) One central feature that is typical of any budget process is the competition for scarce resources. According to the model elaborated by von Hagen and Harden (1996), public budgets resemble a common pool of resources, of which every public institution seeks to get the largest possible share. While expenditure programmes tend to be targeted at individual groups, tax burden is widely dispersed, creating an institutional bias towards excessive spending and debt. This bias can be reduced by a certain degree of centralisation in the budget process, that is, by establishing institutions that strengthen the holistic view of the budget over the particularistic views of spending ministers and parliamentarians. The centralisation is either done through a dominant player such as the head of the government or the prime minister (hierarchical model), or through institutional restrictions on the budgeting procedure such as negotiations or a two-stage budget procedure (collegial model). In practice, however, the most frequent solution is a combination of both models (Alesina and Perotti 1999). In most of the East European and many of the West European countries (such as France or the United Kingdom) the finance or treasury minister has a strong prerogative – at least in principle – to overrule spending ministers. Other countries (such as Switzerland) are closer to the collegial model inasmuch as the competition for limited resources is dampened through a series of cabinet-wide negotiations.

Ad (ii) Improving the allocation of public resources necessitates a programme perspective and readiness to shift money from one expenditure target to another. In this context, much depends upon whether the parliament has sufficient room for manoeuvre to change the existing allocation pattern and hence to adjust the planned expenditure levels to the disposable revenues. On the revenue side, the source of law by which the various tax sources are assigned to the different levels of government is a major determinant of this room for manoeuvre. If tax rates, tax bases and the maximum period of collecting are anchored in the constitution or another strong law, this will obviously reduce the options for the legislative to influence the resource allocation. On the expenditure side, earmarked revenues, subvention programmes, and expenditure limits which are anchored in the law have a similar impact on the freedom of the parliament. At the same time, if the revenue and expenditure assignment shows too little regularity over time, this may destabilise public finances at all levels of government.

Ad (iii) The stimulation of administrative efficiency in the public sector has long been an issue of concern for public administrations. One of the most recent trends is the introduction of output- and outcome orientation in budgeting. This implies that public service delivery is based on performance agreements between the government which has the ultimate responsibility of the function, and the service providers. Experiences in Europe with the so-called New Public Management (NPM) model are still relatively scarce and also very ambiguous (Hood 1995, Schedler and Proeller 2002). There is even less certainty about the actual impact of NPM on the work of national parliaments.

3. The Parliaments' Budget Role in Central and Eastern Europe

As has been stated in section 2, one promising answer to the budget dilemma is the redefinition of the role of the national legislative as the sum of three main components: the vigilance over fiscal discipline, the improvement of the
allocation of public money, and the promotion of administrative efficiency. In this section we will highlight some of the major challenges that national parliaments in Central and Eastern Europe regularly encounter during their work in the budgetary procedure. In order to keep the analysis sufficiently transparent and simple, we will focus on the case of Hungary, in the perverse hope that many of the difficulties raised in connection with Hungary apply to a vast majority of other transition countries as well. Our starting point is the promotion of fiscal discipline.

3.1. Fiscal Discipline

Top-down budgeting procedure. The budget process in Hungary is closer to the hierarchical model than to the collegial one. The finance minister plays a key role in coordinating the budget procedure and defending the cabinet's draft proposal. In committee hearings, the cabinet is most often represented by an official of the Ministry of Finance, which calls in question the identification of line ministries with the cabinet's proposal. The large number of supplemental budget bills submitted to the parliament during the fiscal year is just another sign indicating the top-down character of the budgetary procedure (LeLoup et al. 1999, Szalai et al. 2002). The fact that the budget is discussed and adopted in two stages suggests that the essentially hierarchical model is combined with collegial elements. However, at the end of the first stage the vote on revenue and expenditure totals is often omitted, which makes that the two stages are overlapping and have little impact on the budget balance.

Lack of consensus within the cabinet. During the discussion phase, the various committees of the National Assembly hold regular hearings on the different chapters of the budget proposal. The atmosphere of these hearings suggests that there are serious cleavages between the spending ministries and the Ministry of Finance (LeLoup et al. 1999). While the representatives of the latter usually defend their estimates, the officials of the spending ministries lobby for expenditure increases in the sectoral standing committees.

Spending pressure from the MPs. Encouraged by the attitude of line ministry officials, also the members of parliamentary committees tend to advocate further increases in the expenditure figures (LeLoup et al. 1999), which leads to a ravaging "war of attrition" (Alesina and Perotti 1995) among the participants of the budgeting process. As a consequence, virtually all proposals aiming to cut expenditures comes from the Ministry of Finance. Velasco (1999) sees the reason in the fragmented policy-making: if there is no consensus about the national spending objectives, the various spending authorities engage in a non-cooperative game, drawing on a common pool of public revenues. The resulting situation is similar to the tragedy of the commons. The lack of coordination in the spending ambitions of ministries and other interest groups contributes to the repeated deficits in the public household of Hungary.

Repetitive budgeting. Annual budgets must undergo relatively frequent revisions because of sudden changes in the circumstances during the fiscal year. This is due to several factors, including (i) political and macroeconomic uncertainties due to the relatively rapid transition from central planning to market economy, (ii) the fragmentation of the national budget and the related problems of information flow, (iii) the asymmetry of information due to the lack of a standardised information system, which makes that line ministries systematically underestimate their revenues and overestimate their spending needs.

Lack of control by citizens. At all levels of government in Hungary, the participation of citizens in the budget process is extremely weak. This may be explained by the fact that (i) both the budgetary procedure and the budget
document lack transparency, and (ii) the visible weakness of the parliament's influence (especially that of the opposition parties) on the budget does not create a supporting environment for active participation (Högye and McFerren 2002). Political institutions still do not recognise what role the average citizen should play in the budgeting process. Also, though Hungarian taxpayers are generally interested in how their elected representatives spend public money, most of them believe that no other public engagement is required than simply casting their vote on ready-made proposals.

3.2. Resource Allocation

Lack of stable revenue and expenditure assignment. Revenue and expenditure assignment is essentially regulated outside the national constitution. Sectoral laws (specific to individual policy areas) contain a number of rules on regular revenue flows to state institutions. Also, the Act on Local Governments (no. LXV of 1990) and its amendments, as well as the Act on Local Taxes (no. C of 1990) list the principal categories of expenditures and revenues assigned to subnational governments, yet these lists are far from being exhaustive, a vast range of further items being defined in dispersed sectoral laws. A considerable share of the adjustment between revenues and expenditures for the various policy areas and the different government tiers is made in the yearly budget laws. The fight for scarce resources among ministries starts over and over again. The haphazard character of the national budgetary procedure results also in a loss of influence for subnational councils on their municipal (and county) budgets. The predictability of intergovernmental revenue flows is relatively low, while on the spending side the frequent amendments to the expenditure assignment scheme require local and county-level governments to rapidly adjust their policies to the changing national legislation. The only stabilising elements in local budgeting are own-source revenues, however, the most important revenue item, local turnover tax, is heavily dependent on the business cycle. These uncertainties are further aggravated by the lack of long-term planning and the lack of a reliable budget information system at subnational levels (Szalai et al. 2002).

Limited influence of the committees. The reallocation of resources is often made behind the back of parliamentary committees. Circumventing the committees is fairly easy in Hungary. Decisions are usually a result of private negotiations between central government officials and the members of own party in parliament. The opposition parties – regardless of which party or coalition is actually in power – have remarkably little influence on the budget figures (LeLoup et al. 1999). The role of the committees, and of the parliament in general, is further limited by time inconsistency: although the cabinet is obliged (by law) to submit its proposal to the parliament until September 30 at the latest, this deadline is very seldom met.

3.3. Administrative Efficiency

Complex and highly fragmented budget system. The state administration, and therefore also the annual budget of the public sector in Hungary consists of four subsystems: the central administration, the budget of the local governments, the social security funds, and the extra-budgetary funds. The accounting models and budget information systems are not standardised among the four subsystems, and the numerous financial flows among them are fairly difficult to
follow. Each subsystem is directly accountable to the parliament and should in principle not exceed their estimates, still some of them run deficits.

Information asymmetry. Partly owing to the lack of a transparent budgetary information system and the lack of reliability of revenue flows, there is an information asymmetry between the Ministry of Finance and line ministries. The latter systematically underestimate their own-source revenues and overestimate their expenditure needs. The Ministry of Finance, on the other hand, tends to overestimate the revenues of spending authorities and underestimate their needs.

No breakthrough with NPM. Since very recently, NPM has come to the forefront of interest in Hungary, too. Modern management methods are appearing in a range of public policy areas, especially in education and health care. Following to an amendment to the Act on Public Servants (no. XXIII of 1992) in 2001, all public sector officials are subject to annual evaluations and their salaries are increasingly dependent on their performance. Also, quality control systems are expanding rapidly, improving the efficiency and quality of decision-making. At the same time, however, there is a growing consensus among public sector economists about the fact that (i) NPM models cannot be imported from Western countries without carrying out the necessary adjustments so that they fit into the local environment, (ii) the positive effects appear only in the longer run, and (iii) presumably the best strategy is to combine traditional public administration methods with selected elements of the NPM such as output orientation, accrual accounting, or bi-annual budgeting.

4. Budgeting in Switzerland at the Federal Level

Before turning to the discussion of how the Swiss federal parliament attempts to meet the double pressure on budgeting, a word must be said about some of the dominant characteristics of the Swiss political system. The basic political facts and institutional mechanisms are summarised in Box 4-1.

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Box 4-1 Basic Political Facts and Institutional Mechanisms

The Constitution of 1848 was a major milestone in the history of Switzerland. It turned the country from a loose confederation of states (Staatenbund) into a genuine multiethnic, multilingual and multi-confessional federation (Bundesstaat). Even though the competences of the federal government have been significantly enlarged in comparison to earlier centuries, the cantons have kept several important features of their sovereignty. Switzerland today has a relatively complex three-level system of government consisting of the Confederation, 26 cantons and half-cantons, and 2815 municipalities which are interconnected in numerous ways.

Beside the vertical power sharing between Confederation, cantons, and local governments, there is also a horizontal division at the federal level into legislative, executive and judicial branches, with mutual checks between these. The Parliament is directly elected by the citizens and consists of two chambers, the National Council (200 members) representing the population as a whole (the seats are distributed among the cantons in proportion to the number of their inhabitants), and the Council of States (46 members) representing the 26 cantons. The executive authority, the Federal Council, is elected by the parliament for a four-year term and consists of seven members as well as the Federal Chancellor. The president of the Confederation is elected for one year from among the members of the

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1 Even though Switzerland is not a confederation any longer, the term "Confédération helvétique" remains in use to indicate the federal level of government (Weber et al. 1992: 23 f.)
3 Switzerland has twenty cantons and six so-called half-cantons as a result of historically motivated divisions: Basel-Town and Basel-Land, Obwald and Nidwald, and Appenzell Outer Rhodes and Appenzell Inner Rhodes. Each canton has two representatives in the Council of States, while each half-cantong delegation delegates one person. The cantons may decide autonomously about their election procedures.
Federal Council and is considered to be *primus inter pares* during his or her mandate. Finally, the judicial authority is exercised by the Federal Supreme Court, the Federal Insurance Court and the Federal Criminal Court.

### 4.1. The Swiss Political Culture

The political culture in Switzerland is marked by several "exotic" principles and mechanisms that point in two opposite directions: some of them ensure unity in the federation while others promote diversity (Weber et al. 1992; Ayrton 2002; Dafflon 2001).

**Semi-direct democracy.** Beside the institutions of representative democracy, Switzerland boasts with a wide range of instruments enabling citizens to participate in the decision-making process at each level of government. The awareness of people for direct democracy has deep roots in the Swiss political culture. A referendum is compulsory on all amendments to the federal constitution, while it is optional (i.e. linked to a popular initiative) on any new law and the amendments of existing laws. Referendum and initiative exist not only at the federal but also at the cantonal level. While the initiative is situated at the beginning of the decision-making process and acts as an impulse, the referendum usually appears at the end and is thus similar to a veto, effectively delaying or even blocking the political process.

**The "magic formula".** It is a pragmatic approach to create a more or less stable political equilibrium in government: since 1959, the allocation of the seven seats of the Federal Council has followed the proportions of the electoral forces of the major political parties, in order to avoid electoral competition at the executive level. Cantons have no such "magic formula", but several of them has adopted a tacit consent according to which the distribution of seats in the cantonal executive should reflect the political forces in parliament. The head of the Federal Council is the first among equals. He (she) chairs the sessions of the Federal Council and performs certain ceremonial duties. The same applies to all cantons.

**The consensus principle.** Political decision-making in Switzerland relies almost entirely on negotiations. The underlying principle is the so-called "Konkordanzprinzip" which means that all stakeholders (political parties, associations, interest groups, cantonal governments etc.) are involved in the debate before any decision is taken. The adoption of new law follows a sable procedure: (1) the executive (e.g. the head of a department) presents a preliminary report (explaining the issue) and a draft law; (2) these are submitted to all stakeholders for consultation and are usually published so that it is broadly accessible; (3) the executive collects all comments and suggestions and prepares a summary which is then published; (4) the final "message" and the bill is put forward for a parliamentary debate. The goal is to reach a reasonable compromise that accommodates the interests of the greatest possible number of stakeholders to ensure a more or less smooth implementation afterwards.

**Sovereignty of the cantons.** Switzerland is a genuine example of bottom-up federalism. Art. 3 of the new federal constitution of 1998 stipulates that "the Cantons are sovereign insofar as their sovereignty is not limited by the Federal Constitution; they shall exercise all rights which are not transferred to the Confederation." The cantons are thus free to design their own institutions and policies following the particular preferences of their constituency. As a result, almost all domains of the public sector (from the education system to personal income taxes) demonstrates a wide variety of different solutions. Cantons (and also communes) are therefore often seen as "laboratories" pursuing
important innovations in public policies. The risk of failure rests entirely with the cantonal authorities, as the federal
government provides no guarantee to bail out failed cantons.

**Co-operative and competitive federalism.** The subfederal levels are characterised by both competition and co-
operation. The most important forms of horizontal co-operation include intercantonal treaties, various summits of
cantonal ministers, and intermunicipal agreements on local service provision. Especially the Conference of Cantonal
Finance Ministers has grown into one of the most powerful political institutions wielding considerable influence
upon the federal legislation. Simultaneously to co-operation, however, interjurisdictional relations are also marked
by a sharp competition for mobile production factors and tax bases. Horizontal tax competition belongs to the most
hotly debated issues at present.

### 4.2. Some Elements of the Swiss Fiscal Federalism

Similarly to the intergovernmental political relations, also the fiscal relations are based on the bottom-up principle, as
opposed to the model of top-down fiscal decentralisation currently taking place in post-socialist economies.

**Expenditure assignment.** Cantons and communes enjoy a considerable degree of autonomy in their budgetary
decisions. The vertical division of power is strongly safeguarded by the federal and the cantonal constitutions so that
the existing pattern of revenue and expenditure assignment cannot be easily modified. The Confederation may only
accomplish tasks that have been assigned to it by the federal constitution. Except for the expenditures on defence and
foreign affairs, which rest almost entirely with the federal level, all major public expenditure functions are shared
among the three levels of government. As a result, the three tiers have a comparable weight in the public sector: the
Confederation, the cantons and the municipalities account for 32%, 42% and 26% of total public expenditures
respectively (FSO 2004a). However, due to the considerable autonomy of the cantons, the distribution of
competences between cantonal and local authorities varies widely across the cantons, so that the importance of the
local public sector within the cantonal economy is different from one canton to another but never exceeds the
proportion of the cantonal expenditures.

**Revenue assignment.** On the revenue side, taxation is the most important revenue source for all three tiers. The
federal government collects the value-added tax (VAT), a part of direct taxes, as well as the major consumer taxes.
As for the direct taxes, however, the applicable maximum rates are specified in the federal constitution, and the
Confederation's right to raise both these taxes and the VAT (which together account for some 60% of the total
federal revenues) is limited in time (art. 128 and 196). The cantons also participate in the direct taxation and enjoy
remarkable sovereignty in the design of their tax systems: though they cannot define the tax base on their own, they
may decide about the rates and tax abatements. For the rest, they primarily rely on shared revenues and other
transfers. Municipalities have a considerably large tax flexibility inasmuch as they are free to determine the extent to

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4 In 1999, the Federal Council launched a comprehensive reform programme to rationalise the current expenditure assignment between the
Confederation and the cantons. The main objective is to “disentangle” the overly complicated system and to clarify the roles of each tier. See
(Wettstein 2002) and (Dafflon 2004).

5 Since it implies an amendment to the federal constitution, the prolongation of the collection period requires the double majority of the cantons
and the people. Until the end of last year, the date limit set in the constitution was the end of 2006. In November 2004, The New Financial Order
was adopted at popular vote, allowing to extend the collection right of the Confederation until the end of 2020.
which they wish to piggyback on the cantonal income and profit taxes. The rest of their budget is composed of intergovernmental transfers, user charges and minor levies.

**Intergovernmental transfers.** At the first sight, the average transfer dependence of cantons and municipalities is not alarming: transfers from revenue sharing account for 6.4% and 3.5% of their aggregate budget respectively, while the share of grants-in-aid to total revenues is 16.4% for the cantons and 14.3% for the municipalities. Here, too, the degree of dependence (shared revenues and grants-in-aid to total revenues) varies widely across the cantons, from 9% in the canton of Basel-Town to 53% in Obwald (see Dafflon 2001; updated for 2002). However, conditional grants-in-aid have a relatively large share within total grant receipts, which leads to a certain dependence between the donor and the recipient government – a trend which cannot be captured by the statistics.

**The size of government.** The size of the public sector (total expenditures) compared to GDP grew from 22% in 1970 to 31% in 2002 (FSO 2004a, 2004b, current values). Compared to other European countries, this proportion is still relatively low. Between 1990 and 2000 the relative share of the public sector to GDP grew by as much as 4% due to the deterioration of the external and internal economic environment as well as to the increasing demand for social aid and unemployment benefits. The degree to which the individual government levels contribute to the growth of the public sector is fairly uneven. While municipalities generated some 140% increase in the relative share of public outlays between 1970 and 1980, their spending share has been continuously decreasing in the past two decades, due not only to better expenditure management but also to a creeping centralisation of expenditure functions towards the cantonal and federal levels (Dafflon 2001). From 1990, the rate of expenditure growth has been systematically higher in the cantons than in the municipalities.

**Macroeconomic management.** At federal level, the so-called debt brake mechanism calls the government to realise a structurally balanced budget on the medium term while allowing for a variation of the actual balance with the business cycle. This mechanism was introduced following a referendum in December 2001 with the aim of absorbing the budget deficit by 2008 and arresting the accumulation of public debt (Danner 2002) and is now anchored in the new federal constitution (art. 126). As for the subfederal levels, the federal constitution does not impose any constraint on their budget. Yet several cantons and municipalities have introduced a balanced budget rule. Probably the most important driving force behind sound fiscal policy is, however, interjurisdictional competition. Cantons and municipalities with wrong fiscal management can easily price themselves out of the market. Voters protest against ill-designed policies by means of initiatives and referenda, or they simply move to another jurisdiction. The fiscally induced migration of production factors becomes particularly evident in large urban agglomerations (Dafflon 2001).  

**The impact of direct democracy.** Empirical research has shown that, wherever it exists, the constitutional right of citizens to initiative and referendum effectively contributes to the sound fiscal management of the public household. Financial referenda, where voters may decide about issues such as taxation, user charges, new investments and the sale of assets, play a key role in this respect. Financial referendum has been introduced in all cantons but one, yet it does not exist at the federal level; for some observers, this could be one reason why the federal budget is so often plagued with deficit problems. Several studies on the cantonal and municipal public sector provide evidence of the fact that direct democracy helps to reduce the volume of government expenditures (Schneider and Pommerehne

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6 For a recent analysis on contemporary federal finances, see (Kirchgässner 2004).
makes public spending essentially demand-driven (Kirchgässner and Pommerehne 1990, Kirchgässner, Feld and Savioz 1999). Besides, it helps to slow down the expansion of the government sector (Pommerehne and Schneider 1978) and to control the levels of deficit and public debt (Feld and Kirchgässner 1999, 2001, Novaresi 2001). Also the volume of public revenues can be effectively controlled through financial referenda (Feld und Kirchgässner 2001).

4.3. The Federal Budget Procedure

Thanks to the constitutional safeguards on expenditure and revenue assignment, budget making occurs in a fairly stable and reliable environment at all levels of government. Legislative bodies draft their current and capital budget before the beginning of the financial year. The budget is considered as the monetary reflection of previously taken decisions; it is by no means a legal basis for the introduction of new fiscal measures. It provides an indication on the means that are needed to execute one task or another but it does not determine the principles of execution (Weber et al. 1992).

At the federal level, the elaboration of the budget follows a strict programme. In February, the Federal Council defines the objectives and main parameters of the budget of the following fiscal year. During the spring season, the federal departments elaborate a detailed budget. Before the summer break, the Federal Council calls the departments to revise and clean the budget so that the objectives can be met. After the summer break it decides about the necessary expenditure cuts and collects estimates on the future development of major macroeconomic indicators. At the end of September the Federal Council submits a final proposal to the Parliament which then discusses it during the winter session up to the date of the final vote. The two Finance Committees (of the National Council and the Council of States respectively) play a prime role in this process. With their members appointed for the term of the legislature, these parliamentary bodies show a great deal of political stability as the distribution of seats among the parties reflects the composition of the respective Councils. The Finance Committees exercise their controlling power in two different areas of activity. Before the start of the fiscal year, they examine the federal budget and prepare it for the plenary discussion in parliament. Once the fiscal year has ended, they scrutinise the accounts of the Confederation.

The Swiss parliament is a "militia parliament" with semi-professional members working part-time and a relatively small administrative apparatus. If during the fiscal year the budgeted amount proves to be insufficient for the execution of a function, it is up to the Parliament to authorise a supplement. At the cantonal level, the procedure is much of the same, with slight regional variations depending on the respective constitutional rules.

4.4. Fiscal Discipline

While in legal terms the two Finance Committees have a substantial amount of power, in practice their hands are tied in many ways. The recent explosion in the demand for additional public expenditures and the increasing complexity of tasks are making the job even more difficult for the Committees and the parliament as a whole. The principal scope of this study is to find out to what extent the Swiss federal legislative power assumes its new triple role defined by Schick (2002).
The status quo among the participants of the budget process being the major determinant of the balance between the push and pull forces, our first round of investigation concerns the nature of the procedure of yearly revenue and expenditure planning.

The Swiss federal budget process is much closer to the collegial model than to the hierarchical one. Institutionalised consultation procedures and well-structured negotiations are dominant elements of the model, in accordance with the principle of consensus democracy outlined in section 4-1. The budget is prepared in a two-stage procedure in which revenue and expenditure totals are determined at the end of the first stage, whereas in the second stage all amendment proposals must be deficit-neutral. While this approach is sometimes interpreted as a restriction on the influence of parliament (LeLoup et al. 1999), it is also a successful instrument of controlling the growth of public expenditure. Quite independently from this rule, the Finance Committees have a basically prudent behaviour with regard to fiscal balance. In their endeavour to enforce fiscal discipline the Finance Committees are strongly backed by the Swiss people who voted already several times in favour of introducing a constitutional rule that would ensure a return to budget balance at the federal level.

In addition, the right to direct democratic participation effectively alleviates the common pool problem: experience shows that voters care more about fiscal discipline than their elected representatives (Feld and Kirchgässner 1999) and that their preferences have a real impact on fiscal performance (Dafflon and Pujol 2001). This suggests that bottom-up budgetary procedures – where elements of direct democracy exist – could be even more promising to reduce the level of public debt than the top-down procedures proposed by von Hagen and Harden (1996). Today, the conclusions of this widely acknowledged study are challenged by the recent development of public deficit and debt in some member states of the European Union. Heavyweight countries such as France, Germany and UK have been showing a relatively weak performance in terms of fiscal discipline, notwithstanding the strong top-down character of their budgetary procedures. The same phenomenon is observed in six of the ten new East and South European member states (Poland, Czech Republic, Slovakia, Hungary, Malta and Cyprus). However, it is not yet clear to what extent the specificities of the budgetary procedure have contributed to the emergence of budget deficits in these countries. The investigation of this problem goes beyond the scope of this paper.

4.5. Resource Allocation

As has been stated in section 2.2, improvements in the structure of public expenditures is conditional upon a programme-based holistic vision as well as a minimum flexibility to shift resources from one spending target to another. For the federal Finance Committees, the reallocation of public money is a fairly difficult job. In the current legal order, it is essentially the Swiss people who decide about the level of tax revenues by means of financial referenda. With their vote they automatically set the expenditure limits for the federal government and the parliament. The range of the available federal tax instruments and the rates of these taxes are anchored in the constitution and other laws whose modification is subject to referendum. In addition, as has been noted earlier, for

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7 This applies to the cantonal and communal levels as well.
8 This is well illustrated by a recent decision of the Finance Committee of the National Council (February 2005) to make a motion for an expenditure cut, which would allow by 2006 to close the federal fiscal gap of 799 millions of Swiss francs planned by the Federal Council (whereas the latter would also be satisfied with reaching a balanced budget as late as in 2008).
The power of the legislative and the executive is restricted on the expenditure side as well, for several reasons (Rey 1990: 52):

- The revenues accruing from certain taxes are earmarked for financing specific expenditure functions;
- There are a number of laws which oblige the Confederation to disburse conditional grants-in-aid (e.g. grants to cover the current expenditures of the cultural foundation Pro Helvetia);
- Subsidies are assigned in advance to specific infrastructural programmes as well (e.g. wastewater treatment, maintenance of the sewer system);
- For certain functions there is an upper limit to spending (e.g. subsidies to universities, humanitarian aid, old-age pension and health insurance benefits).

This latter restriction is the only one which allows the parliament to control the growth of public expenditures and thereby make financial planning more effective. Though it seemingly reduces the parliament's room for manoeuvre (similarly to the other three limiting factors), the Finance Committees are much in favour of the expenditure cap as a controlling instrument and have already proposed to extend it to further expenditure areas.

One decisive step against budget automatism has been the abolition of the bailout mechanism for several state-owned enterprises. Until recently, the federal budget had to cover the deficits of the Swiss Federal Railways, Swisscom and the Swiss Post. Today these enterprises are obliged to enter performance contracts which provides them a global budget in exchange for an agreed volume and quality of public services.10

4.6. Administrative Efficiency

The quest for better administrative efficiency in Switzerland is related to the improvement of the transparency of the budget information and accounting system, as well as the application of output- and outcome oriented budgeting and performance contracts wherever it is possible.

Since the 1980s there has been a continuous harmonisation of budgeting and accounting techniques between the three tiers of government. The Annex to this paper shows the harmonised account model including the mechanism of balancing the budget. For the moment, however, the harmonised account model is applied only at the cantonal and local levels. The federal level is continuously approaching this system but has not yet fully adopted it.

Despite the fairly modern organisation of the budgetary procedure at all levels, the rate of development in budgeting and accounting techniques is widely different across the various tiers of government. Accounting at the federal level continues to be cash-based, with additional accrual ("shadow") accounts in those domains where it is needed, while budgeting is input-oriented. Discussions about a possible introduction of accrual based accounting and output- and outcome oriented budgeting at the federal level started in the mid-1990s (Schedler 1995, 2002). Since 1997, lump-sum budgets have been accorded to public institutions on condition that they properly maintain their cost accounts

9 The entire revenue from consumption taxes on tobacco and alcohol, for instance, are assigned to the funding of old-age and invalidity pensions. Similarly, a part of VAT (of which the normal rate is 7,6%) is used for three different expenditure goals: 0,3% contribute to balancing the federal budget (a clause that has never been respected), 1% goes to the budget of the old-age and invalidity pensions, and 5% to 6,2% allows to reduce the health insurance fees for low-income persons.

10 In contrast, cantonal parliaments are still obliged by law to cover the losses of cantonal hospitals and nursing homes, at least up to the limit of the budgeted deficit.
and are ready to enter performance agreements. Yet the debate about a possible reform has still not been intensive enough to provoke a substantial change to the federal accounting and budgeting model. One argument of the federal authorities for maintaining the cash-based method for accounting is that 2/3 of all federal expenditures are transfers which can only be recorded in terms of cash. However, such a position risks to ignore the remaining 1/3 of federal outlays for which accrual-based shadow accounts must be run parallel to the cash accounts, and this is certainly a costly practice (Schedler 2002: 252). The revision of the Federal Finance Act is under way, envisaging the introduction of a new accounting model with the above-mentioned characteristics as well as the application of several elements of the International Public Sector Accounting Standards (IPSAS) to the federal accounts. There is, however, considerable divergence of opinions between the legislative and the executive: while the Finance Committees wholeheartedly endorse the reform, the Federal Department of Finance shows little enthusiasm for it.

In the cantons and, to a lesser extent, in the municipalities, accrual accounting has achieved a major breakthrough. After thirty years of experimentation with various accounting models, the Conference of Cantonal Finance Ministers devised a standard system in 1981. In the 1990s, financial indicators were developed in addition to facilitate comparisons between jurisdictions of the same level. Yet the new accrual accounting system has not yet allowed to reap the expected benefits: cost transparency remains weak and the maintenance of overly detailed accounts costs cantonal and local governments both time and money. Besides, a large number of cantons still lacks real task orientation though they are strenuously trying to achieve it. Municipalities entered the so-called "managerial phase" in the 1990s. Currently, some 70% of all local governments apply accrual accounting, with widely diverging experiences (Schedler 2002: 250).

One of the driving forces behind the transition from cash-based to accrual accounting nowadays is the expansion of New Public Management (NPM). Not surprisingly, cantons play a pioneer role in this reform movement—except for a few which gave it up after a failed experiment (Thom et al. 2004)—, and approximately 1/3 of all municipalities have already adopted some kind of a results-oriented accounting and budgeting model. By contrast, at the federal level the breakthrough is still ahead (Lienhard 2004).

Though the first political debate about NPM in Switzerland dates back to 1994 (Schedler 2002: 247), numerous elements of this philosophy were already present in the Swiss public sector long before the 1990s. With most of the Swiss parliamentarians being non-professional and a majority of the civil servants working part-time, policymakers have a certain proximity to the private sector. From the early 1990s, however, a number of new arguments for a broader institutional reform appeared: the volume of public expenditure responsibilities and the degree of their complexity rose at an unprecedented rate, imposing an additional burden on public finances (Kettiger and Moser 2004). Managerialism, liberalisation and deregulation pushed the Swiss public sector further towards a comprehensive accounting and budgeting reform. In 2000, a "tailor-made" version of NPM was launched in Switzerland under the label of "results-oriented management" at all levels of government. After several years of pilot experiments, today it is in the implementation phase, at least at the subfederal levels of government. At the same time, while some cities are still targeting at a full-fledged NPM because it is "en vogue", a surprisingly large number of municipalities have turned away from NPM realising that it provides fairly little additional benefit against the disproportionately high set-up costs. Local governments are now coming back to their original management methods.
that are not entirely new but nonetheless very efficient, allowing a performance-based funding of public services while preserving the traditional structure of the public budget.

As opposed to other countries, NPM in Switzerland is not limited to leaning public organisations and a better management of tasks but is extended to include a comprehensive reform of the political governance of the public sector. The pace of implementation is relatively slow, reflecting the ambition to set up a new system that is acceptable for all stakeholders. Due to its political sensibility, the reform of the power relations between parliament, executive and bureaucracy requires special attention in this process.

As in every other domain of the Swiss public sector, the implementation of the NPM is marked by substantial differences across the jurisdictions of the different tiers, though the objectives are largely the same (Ladner et al. 2003). Different solutions appear:

(i) in the design of the political governance models which affect the power relations between legislative, executive and bureaucracy, with special regard to the role of the legislative in the formulation of desired outcomes and its control over the performance agreements;

(ii) in the introduction of additional instruments to facilitate parliamentary intervention in the budget process (institutionalised tools such as comments to the government's planning documents, motions to amend global budgets etc.)

(iii) in handling the influence of direct democracy. As the specific bundles of legal norms for public service provision are increasingly replaced by lump-sum budgets, bureaucracy enjoys a larger room for manoeuvre. This implies, however, that citizens will no longer have an opportunity to influence operative decisions. This may weaken the content of direct democracy. At the same time, due to the continuing delegation of expenditure functions, the right to initiative and referendum will apply to an increasing number of issues.

On the basis of the similarities between the cantonal and federal levels in terms of horizontal power sharing and the functioning of the legislative branch, it can be assumed that the lessons learnt by the cantons during the introduction of NPM will be of high value for the federal level as well. On the same ground, the budget role of the federal parliament is expected to undergo mutations that are similar to those at the subfederal levels.

The reaction of federal and cantonal legislatures in Switzerland to the adoption of NPM is fairly ambivalent: initial enthusiasm is mixed with the feeling of great uncertainty. There is a strong anxiety over a possible competence shifting between executive and legislative. Interestingly, shifts in both directions provoke fear: some parliamentarians fear a loss of competence, while others are afraid of work overload accruing from enlarged competences.

The advocates of NPM argue that the system of output and outcome-based performance agreements is not going to replace legislation: the democratically legitimated norms continue to be the primary tools of public sector management. The output and outcome targets – whose achievement will be subject to regular evaluations – are expected to be auxiliary instruments that only strengthen the legislating power of the parliament. The framework of global budgeting, that is, the groups of public goods and services and the corresponding performance agreements, will help the legislative to reallocate public resources in a more efficient way. One counter-argument against this hypothesis is the constitutional rule which submits all new legislation to a referendum (whether optional or compulsory). This leaves not much reason to believe that the parliament would be able to easily get their proposals
accepted by the people. Also the slow pace of both the adoption and the amendment of laws hinders the legislative to make rapid changes to the resource allocation.

Advocates cite at least one more argument in favour of the adoption of NPM. With this new framework, medium and long term planning is likely to receive a greater significance compared to annual budgeting. This implies that parliament will be increasingly involved in planning and strategic management instead of getting immersed in the operative details (Lienhard 2003). This advantage, however, has rarely been observed in practice. Most often, financial planning at the cantonal level is done by the executive council which then informs the parliament about its previsions. The legislative prepares the annual budget upon this basis. Even in those few cantons in which the legislative is in charge of budgeting as well as planning, parliamentarians experience serious difficulties translating the long term prevision into annual figures, as they feel continuously restricted by their own planning.

On the organisational side, the working processes of the parliament – with special regard to the committees – will need to be adapted to the new instruments of budget control. Besides, the reform will certainly impose additional requirements on the parliamentarians' skills and working capacities, though this elevated workload might possibly return to its original level once the transition is done. The question of how to empower parliaments with the necessary personal, technical and financial resources is still not resolved. The fact that the legislative power in Switzerland consists of militia parliaments presents a particularly serious challenge in this respect.

5. Lessons to Learn

The foregoing brief comparison of the budgetary procedures in Switzerland and Hungary sheds light on several important issues related to the influence of the legislative. These can be summarised as follows.

1. The observed differences between the two systems confirm the hypothesis of Poterba and von Hagen (1999: 11). They suggest that, in any country, there is a close connection between the design of the budget process and other features of the constitution such as the power relations between the executive and the legislative, the presence (and strength) of instruments of direct democracy, or the type of the electoral law. Budgetary institutions and rules that work in one constitutional context may not be effective in others because they fail to provide the proper incentives to promote and enforce agreement among stakeholders on the levels of public spending and deficit. It follows that there is no one-size-fits-all model of budgeting and, most importantly, it is impossible to "import" entire models from one country to another: the maximum that one can realistically expect is to pick up the best practices and learn from each other.

2. The hierarchical model of budgeting is not conducive to sound fiscal management unless the dominant player is strong enough to overrule all other stakeholders. If the finance minister (or treasury minister, prime minister) is overwhelmed by the spending ministers and the parliamentarians, the bias towards excessive deficit and debt cannot be corrected, and a result is a shift towards the "push" end of the balance. This tempts us to conclude that the theory conceived by von Hagen and Harden (1996) is largely contingent on the personal qualities of the finance minister. While an assertive and charismatic finance minister can credibly and effectively enforce fiscal discipline in the budgetary procedure, a weak and hesitating minister is not likely to have enough power to counterbalance the push of the line ministries for expenditure increase.
Because of the regularity of parliamentary elections and the fluctuation of ministers even within one election period, the fact that the person of the finance minister is so decisive brings additional uncertainty into the process. One could argue that if the finance minister is weak then the budgetary procedure is automatically shifted towards the collegial model, negotiations and budget balance rules taking over the lead from the ministry of finance. In practice, however, the participants of the budget process cannot be realistically expected to change their working routines and procedures every four years or even more frequently.

3. The clarity and the relative stability of expenditure and revenue assignment schemes in Switzerland allows decision-makers at all government levels to pursue multi-annual financial planning. There is a great scope in Hungary for laying down the fundamental rules of tax revenue sharing (proportions in %) and intergovernmental grant allocation either in the constitution or in laws whose amendment necessitates a 2/3 majority in parliament (such as the Act on Local Government). Currently, the central government can effectively adjust its fiscal policy to the changing macroeconomic environment by means of an annual variation in the allocation parameters. At the same time, however, it creates uncertainty at the subnational levels which leads to vertical fiscal imbalance in most of the jurisdictions. It is important to remind here that the budget is not a legal basis for the introduction of new policies. Rather, it is a means to authorise spending on tasks that have been anchored in the law, so that its sense lies rather in the implementation of previously taken decisions.

4. In the Swiss model, the practice of earmarking several revenue categories for specific expenditure functions, and the automatism observed in the financing of various spending targets and institutions (section 4.5) severely limits the room for the legislative to change the existing allocation of public funds. Any amendment to the existing laws is subject to referendum, and even without the referendum, the amendment procedure itself is relatively lengthy. In Hungary, the voters' direct control on the legislation is significantly weaker, and for lack of a long consultation procedure, the amendment takes comparably less time. This leaves more freedom for parliamentary members to intervene on the funds allocation. However, the relatively low impact of the committees weakens their potential influence on the budget.

5. The transparency and consistency of the budget process is a condition for effective parliamentary influence. This requires that every participant of the process keeps to the procedural rules and deadlines. The harmonisation of the various budget information systems through a standardised accounting framework for all budgetary subsystems and/or government levels is another important step towards transparency. The public access to the budgets and accounts of the different government levels, as well as to the federal government's reports and analyses on various policy areas, is a crucial element in the exercise of democracy. This presupposes, however, that each of these document types has a uniform structure so that those who are interested can follow them without difficulty.

6. Finally, the remarkably cautious attitude of the Hungarian policymakers towards NPM may be justified by the preference for incremental and sustainable reform over radical and short-lived changes. Nonetheless, the lack of a comprehensive reform is likely to delay the decision to redefine the roles of parliament, executive and bureaucracy. This could hamper the legislative in starting multi-annual planning and performance control in the public sector.
These lessons suggest that the budget procedure can be very transparent even in a highly complex federal country such as Switzerland, where the different government levels and the ethnic, linguistic and confessional minorities have an extensive sovereignty on all budgetary issues. The example of the Swiss militia parliament shows that effective legislative influence on the budget is possible even if the parliament has only a modest endowment in financial and human resources – a complaint often heard in Central and East European transition economies. Devastating "wars of attrition" for scarce public funds can be avoided if both the voters and their elected representatives show credible commitment towards prudent fiscal management. A stronger focus on consensus in the budgeting procedure as well as the direct participation of citizens contributes to a better understanding of common budgetary objectives and enhances the acceptance of the final result. On the other hand, consensus-seeking and the exercise of direct democratic rights are likely to increase the reaction time of the legislature to the changing environment, creating a non-negligible trade-off between effectiveness and timeliness in budgeting. In the light of the inherently dynamic character of post-socialist transition where budgets must adapt to rapidly changing national priorities and external circumstances, this trade-off presents a particular challenge.

References


Annex

The harmonised system of public accounts in Switzerland

Current account
- Personnel
- Goods and services
- Interests paid
- Grants paid
- Special expenditures
- Internal expenditure flows
- Depreciation
- Revenue surplus
- Taxes and user charges
- Revenue shares
- Grants received
- Reimbursements
- Revenues from wealth
- Special revenues
- Internal revenue flows

Capital account
- Investment grants
- Capital expenditures
- Net capital outlay

Borrowing
- Financing from own revenues
- Net capital outlay

Source: (Dafflon 1998: 83).