Direct Democracy and Federalism in Switzerland

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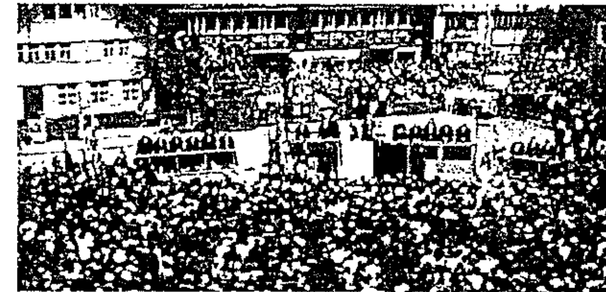
SWITZERLAND IS A SMALL COUNTRY in the heart of Europe. To most people Switzerland is known as the country of cheese, chocolate and natural beauty. More recently, it has also been associated with banks and money laundering, and the younger generation might think of Switzerland as the producer of Swatches.

Switzerland has more to contribute to the world, however, than just its mountains or its goods and services. With its population composed of many ethnic groups, languages, cultures and religions, Switzerland can be looked at as a whole continent in a nucleus. The same holds true for economic and social aspects: per capita income varies strongly between poor and rich cantons, in some regions agriculture prevails while others are dominated by highly technological services (such as banking). The way the Swiss have learned to cope with the problems and conflicts arising from these differences may very well become Switzerland's future main export and is of great importance for all democracies: it is both an idea and reality—the constitution of a modern democracy.

Two institutional features are basic for Switzerland. The first is the widespread use of *popular referenda*, which are of three sorts: obligatory ones for constitutional changes, optional ones for laws (50,000 signatures, or roughly 1% of the voting body are needed), and popular initiatives (100,000 signatures needed). They serve as an effective barrier against the dangers of an unresponsive and sometimes self-seeking "political class". Between 1848 and 1996 there were no less than 431 referenda at the national level. This instrument of direct democracy is used much more intensively in Switzerland than in any other country.



An exercise in direct democracy.

The second fundamental institutional feature of Switzerland is the *federal* structure of the country. Switzerland is composed of federal subunits—23 cantons (of which some are divided into half-cantons) and 3019 political communes. These subunits can, to a larger extent than in any other country, act as independent decision-makers. Most important, they have the power to determine their own personal and corporate income-tax rates. As a result there are communes and cantons situated next to each other with very different tax rates and correspondingly different levels of public expenditures and services. With unrestricted labour mobility, the regions compete with each other for citizens.

> *Two institutional features are basic for Switzerland—the widespread use of popular referenda, and the country's federal structure.*

We argue here that direct democracy and federalism are excellent institutions for producing socially, politically and economically beneficial outcomes. The democratic process is based on the same criterion as the market process—only the individuals' preferences count. Neither a "benevolent dictator" nor an expert nor a politician should therefore decide what is desirable and what is not—this is decided only by the citizens themselves. The citizens can therefore be viewed as the *principals* and the politicians as their *agents*. As in all principal-agent relationships, it is a clear and present danger that shirking occurs and, in particular, that legislators pursue their own goals instead of following their electors' preferences. So, even when leaving the marketplace and entering the political sphere, competition must be the answer to the question of how people's wishes can best and most effectively be represented and co-ordinated in the public sphere.

Neither in economics or politics, however, does it make sense to analyse an unreachable ideal—a fully competitive market without externalities, information asymmetries or monopolies. Rather it is the *relative efficiency* of the decision-making system that matters—in the present case, that of a direct democratic system compared to a representative system and of federalised decision-making compared to centralism.

Direct Democracy

By the end of 1996, Switzerland had held more than 400 nation-wide referenda covering virtually all aspects of poli-

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tics. Referenda were instituted, at the federal level, with the first Swiss constitution in 1848. It declared that referenda were to be obligatory for all proposed amendments to the constitution. The first referendum was held in January 1866 on subjects such as taxation, religious liberty and the prohibition of lotteries. In the constitution of 1874, the optional legislative referendum was introduced. In 1891, the Swiss adopted the constitutional initiative by which citizens could propose and decide about amendments to the constitution.

Referenda, obligatory or optional, enable the voters to state their preferences more effectively than in a representative democracy. In a representative system, deviating preferences, on very specific issues, can only be expressed by informal protests, which are difficult to organise and make politically relevant. If no immediate action is taken, voters have to wait until election time, when they will still find it hard to express specific demands on substantive issues. In a direct democracy, however, citizens may regularly participate in political decisions.

Popular referenda clearly have a long tradition in Swiss history. During the last 150 years, they have proven to be very successful for fighting restraints on competition in the political "market". We elaborate on two aspects: politicians' cartels and information problems.

• *Referenda Against Politicians' Cartels.* The theory of "rent seeking" argues that elected representatives have a common interest in forming a cartel to protect and possibly extend their influence and political rents. Referenda and initiatives are means to break the politicians' coalition against the voters. Initiatives require a certain number of signatures to force a popular vote on a given issue. They are a particularly important institution because they take the agenda-setting monopoly away from the politicians and enable unelected citizens to propose issues for democratic decision, including those that many elected officials might have preferred to exclude from the agenda. As has been shown in public-choice theory, the group determining which propositions are voted on and in what order has a considerable advantage.

A recent referendum made it clear that the political élite's interests do not always correspond with voters' preferences. In September 1992, Swiss citizens turned down two proposals seeking to increase substantially the salaries and the staff of Swiss members of parliament. Both issues would have become law without Swiss voters taking the optional referendum, and both issues would clearly have been to the benefit of the elected officials.

It seems obvious that while politicians may try to secure benefits for themselves, taxpayers are not always ready to pay for such expenses. Privileges, however, do not always appear in the form of direct income for the representatives, but may also result in higher status or prestige. Particularly interesting cases are two referenda on Switzerland joining international organisations or agreements: the United Nations in 1986 and the European Economic Area in 1992. Both proposals were rejected by the citizens even though all major parties, all interest groups including both employers and trade unions, a vast majority of the members of parliament and the government strongly supported them. Though a clear majority—76% of the voters—rejected the referendum on Switzerland joining the United Nations, only a small majority—50.3%—voted against Switzerland becoming part of the European Economic Area.

Empirical evidence suggests that the more direct are the democratic institutions, the less tax cheating takes place.

These two examples of the citizens voting differently than elected officials are no exceptions: In 36% of the roughly three hundred referenda held in Switzerland in the past half-century, the will of the majority of the voters differed from the opinion of the parliament. Thus, in a representative system, the decision by the parliament would have deviated from the people's preferences in more than one third of all cases where referenda were held.

This argument is even strengthened when considering econometric cross-section studies for Switzerland, which reveal that political decisions on publicly supplied goods correspond better with the voters' preferences when the institutions of direct political participation are more extensively developed. Since it is the individual taxpayers and not the elected officials who have to bear the costs of government activities, it is not surprising that public expenditures are, *ceteris paribus*, lower in communities where the taxpayers themselves can decide on such matters. The price of land serves as a good indicator for individuals' desires to live in a certain community. The findings support the notion that, with more developed direct participation options (and therefore the higher degree of congruency between publicly supplied goods and voters' preferences), more people are attracted those jurisdictions. The price of land is therefore higher.

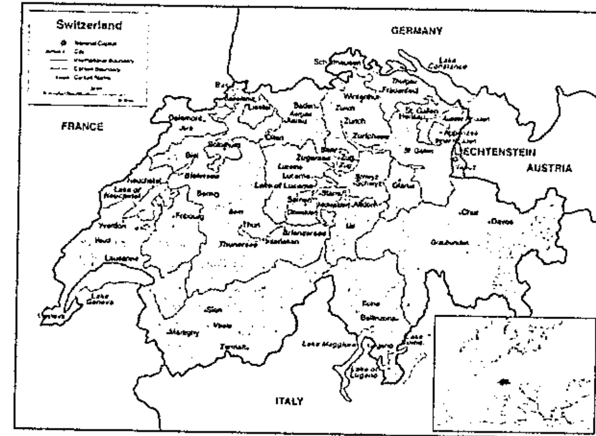
Taxpayers, however, do reward politicians' performance by a high tax morale if they are satisfied with policies in their community. This can be shown for Swiss cantons, which have differing institutional options for citizens' political participation. In some cantons, referenda and initiatives can be taken on virtually all issues, whereas others grant these options only on special issues and under special conditions or rely completely on the institutions of representative democracy. The empirical evidence suggests that the more direct are the democratic institutions, the less tax cheating takes place. Compared to the average of all cantons, almost 8% less income was concealed in those cantons with a high degree of direct political influence. In contrast, in cantons with a low degree of direct participation possibilities and, therefore, low tax morale, undeclared income exceeded the overall average by roughly 8%.

Putting more citizen-oriented public services and higher emphasis on civic duty together, one would expect better economic performance for those cantons in Switzerland that are more directly democratic. Indeed, a recent econometric study showed that cantons with more direct democratic institutions generate a much higher per-capita income than those with less direct democracy.

In addition to breaking up the politicians' coalitions by destroying their monopoly on setting the agenda, refer-

enda induce more competition in another respect: they provide information and stimulate communication.

• *Referenda Against Information Asymmetries.* In economic research regarding politics, the process which takes place before casting the vote has been almost completely neglected. The economics discipline studies how choices are made—particularly the choices between known alternatives. These alternatives, however, have been shaped and defined by a process of verbal exchange. This discourse among the citizens puts new issues on individuals' agendas, raises their perception, and communicates the arguments in the media. The famous economist Friedrich von Hayek called the market a "discovering mechanism". The same could be said about discourse. By talking to one another, people discover the means of fulfilling their preferences. By relating to other people's positions, they find out where they stand. Moreover, the induced discourse offers information free of charge—information that is not only relevant to the issue in question but also to an evaluation of the performance of politicians, parties, and interest groups.



Besides information, communication may also enhance people's willingness to accept the decisions made by a referendum. They feel more responsible for whatever the result of the referendum may be because the process and the rules made them part of the decision. In a representative system, however, it is not difficult to shift the responsibility onto the actual decision-makers—the politicians.

The Swiss experience shows that people's demand for discussion varies, depending on the importance of the issue in question. Some referenda motivate intense and far-reaching discussions that lead to a high rate of voter participation. For example, the 1992 proposal to join the European Economic Area witnessed a participation rate of 79%, compared to the average turnout on referenda in the previous seven years of only 42%. In contrast, referenda considered to be of little importance by the voters engender little discussion and low participation, as low as 25%.

Even though a political decision is formally taken by a referendum, the issue in question does not disappear from public discourse after citizens have cast their vote. A referendum clearly reveals how the citizens feel and who and how large the minorities are. Groups dissenting from the majority are identified; their preferences become visible and part of the political process. A post-referendum adjustment process to please the losers is often observed.

Cantons with more direct democratic institutions generate a much higher per-capita income than those with less direct democracy.

In 1989, for example, a popular initiative demanded that the Swiss army be completely dismantled. To many Swiss, this was considered an attack against one of the most essential, almost sacred, institutions of the country. The "political class" was again solidly against the proposal, and the generals threatened to retire if the initiative was not overwhelmingly rejected. (They expected a share of no-votes close to 90%.) The referendum outcome was surprising to almost everyone. One-third of the voters (and a majority among the young voters eligible for service) voted for the dissolution of the army. After a short period of shock, several parties suggested changes in the army to make this institution more acceptable among the population. These changes, which were considered impossible to achieve before the referendum, were put into effect within a short time. A major innovation—the introduction of a substitute to regular service in the army, which was then mandatory for all Swiss men—had been rejected in several referenda before, the last time in 1984 with a rejection rate of 64%. This change of individuals' preferences seems to have been induced by the discourse that accompanied the previously hotly discussed referendum on the dissolution of the army.

Problems with Referenda

Democracy is not concerned with end states; solutions are not simply adopted, but developed. In the course of the direct democratic process, information is produced and preferences are shaped. Voters are confronted with political issues they have not considered before, and which they learn to evaluate according to their basic values. Sceptics, however, worry about the intellectual capability of the citizens to cast votes on complicated, technical issues. This task, they argue, should be left to an élite.

Following the individualistic view and taking individuals' preferences as the normative base for evaluation, such a charge is unacceptable. Compatibility with the citizens' preferences should be valued higher than any possible technocratic

brilliance. The voters, moreover, need not have intimate knowledge of the details, but rather a general knowledge of the broad issues. These are not of a technical nature but involve basic decisions—perhaps value judgements—which a voter is as qualified to make as a politician. It has even been argued that politicians are a group particularly ill-equipped to make such decisions because, as professionals, they spent most of their life in sessions and commissions, and meetings and cocktail parties, and therefore know much less about reality than ordinary people.

It is not clear why the citizens should be trusted to choose between parties and politicians in elections but not between issues in referenda.

This argument only holds, of course, if voters are given the opportunity to make their choices seriously. As *The Economist* reported in the case of California, this is not always the case: "Last November any Los Angelano voter was allotted ten minutes in the ballot booth to make over forty different electoral choices, varying from state-wide propositions to local judgeships; in 1990 the total was over 100."

Such obviously ineffective institutions not only keep a direct democracy from functioning effectively but also prevent voters from making serious "electoral choices" and, thus, might even lead to worse outcomes than in a representative democracy. Furthermore, it is not clear why the citizens should be trusted to choose between parties and politicians in elections but not between issues in referenda. If anything, the former choice seems to be more difficult because electors must form expectations about politicians' actions in the future.

We do not argue that there is no room for a political élite, for a parliament, and a bureaucracy in a democracy. Even Switzerland is only a semi-direct democracy—combining representative elements with the direct participation of the citizens. The representative elements are indispensable to provide information, work out the details, and assess the consequences of the various political issues at hand. But this technical expertise must be weighed against the human competence of the citizens, a process which seems to have led to a recent trend in Europe: important political issues are referred to the population even in representative democracies. Recent examples are the popular referenda on entry into the European Community held in the Scandinavian countries and the United Kingdom, or on the Maastricht Treaty in Denmark, France, and Ireland.

Critics also point out that well-organised interest groups might utilise direct democratic procedures for their own benefits. Compared to the unorganised taxpayers, it is the pressure groups that have the financial and human resources to mobilise supporters of their interests, to be agenda-setters by starting initiatives and engaging in referendum propaganda before an issue is decided at the polls. It cannot be denied that well-organised and financially potent groups wield relatively more power than the poor and the unorganised. This, however, is true in any political system. The important question, thus, is under which institutional arrangements organisational and financial advantages play a more important role. Empirical evidence suggests that pressure groups have much less influence on political outcomes in a direct democratic system than in a representative system. In the 1980s, it was the pressure groups that most intensively fought against adopting direct democratic institutions in American states (especially in Minnesota, New Jersey and Rhode Island). The reason for this seems simple: pressure groups may use other means of influence such as direct lobbying of the representatives, while these channels are not easily accessible for unorganised interests. For the European Union, it is argued that pressure groups are able to exert more power in Brussels than in the former nation-states exactly because the EU is less democratic than its member states. On the other hand, the experience of Switzerland shows that, even if pressure groups and the political class are united, they cannot always have their way, particularly on important issues.

Swiss Federalism

Federalism is the other important institution that serves to establish competition within the political arena. Federal competition provides for the third possible market failure in politics—political externalities. Such external costs develop for the general population if certain groups are able to appropriate the benefits of a publicly supplied good but do not have to pay the price for it. These groups may be the politicians and the bureaucrats who are self-interested rent-seekers or special-interest groups that try to "capture" the relevant decision-makers. The basic idea behind these externality costs derives directly from the standard monopoly theory for a conventional goods market: not only monopolistic firms derive rents by selling their goods above the market price but also governments with monopoly power may provide their services at higher tax prices than would competitive governments. Although it is not argued here that politicians and bureaucrats always and exclusively pursue their own selfish objectives to the extent of actively exploiting the citizens and taxpayers, taking governments to be completely responsive to the population's wishes is equally unrealistic. Competition in politics is therefore as important as it is in markets.

Governments with monopoly power may provide their services at higher tax prices than would competitive governments.

Federalism is the central institution allowing for competition within the political arena. Just as members who do not see their preferences fulfilled by a sporting club withdraw from it, unsatisfied citizens may leave a jurisdiction. This "exit" possibility provides a safeguard against politicians' taking unfair advantage of their discretionary power. A decentralisation of decision-making thus enables the citizens to "vote with their feet".

Federal competition may lead to an increase in economic spillovers. Many

economists, therefore, argue that centralised regulation must be introduced to correct market failures such as the underprovision of public goods and of redistribution. Taking the trade-off between political efficiency (the responsiveness of the political representatives induced by federal competition) and economic efficiency (the optimal provision of public goods and redistribution by centralising and harmonising certain policies) seriously, means comparing the costs that arise if one aspect is neglected. A recent study for Switzerland, for example, presents compelling empirical evidence that federal competition does not inhibit redistribution. Even though taxes vary enormously between Swiss cantons—from the highest tax rate in the canton of Wallis with 55% above the average to the lowest in the canton of Zug with 40% below the average—the high-income recipients do not, for the most part, move to the low-tax cantons. Thus, all cantonal governments are able to successfully redistribute income.

As the discretionary power and thus the rents of politicians and bureaucrats are higher the more a government resembles a monopolist, governments do not tend to favour federal competition. This might be one reason why many European countries do not know the institution of federal competition at all; the most prominent examples are France, Great Britain and Sweden. Others, such as Germany and Austria have introduced competition between autonomous local governments only to a limited extent. However, the potential offered by federalism to establish a vigorous competition between government units has so far not been rationally designed by any country.

Taking the Argument a Step Further

Federalism and direct democracy are closely connected. On the one hand, federalism is a prerequisite for an effective direct democracy and thus their relationship may be characterised as complementary. On the other hand, both political arrangements are means to create incentives for the politicians to take citizens' preferences into account and may therefore be considered as substitutive mechanisms.

Wherever introduced, we believe that federalism should extend down to lower governmental levels. Most important, political communes should have the constitutional right to form new jurisdictions with other communes (even if they belong to another nation) in order to better fulfil certain *functional* tasks. Nothing should prevent a particular unit from belonging to various such functional jurisdictions. A commune may also choose to join another jurisdiction if it expects to be better served. The possibility to freely exit and enter jurisdictions establishes competition among different suppliers of public services, and tends to improve quality and decrease cost. Of course, each jurisdiction must have the right to raise its own taxes to finance the respective public services demanded and approved by their constituents. These new political units can be called Functional Overlapping Competing Jurisdictions, or FOCJs.

FOCJs are based on the theoretical propositions advanced by the economic theory of federalism discussed above. They form a governmental system completely different to the one so far suggested in the literature. Traditionally the focus has been on the behaviour of existing political units at different levels of government; in contrast, FOCJs emerge in response to the "geography of problems". An example would be a commune in Alsace forming a jurisdiction with a German commune on the other side of the Rhine to provide fire protection or medical care. At the same time, it could participate in a jurisdiction with other French communes to supply elementary school services and be part of a jurisdiction composed of communes from various nations dealing with environmental problems and transportation.

The experience of Switzerland reveals that federalism and direct democracy *can* work (in spite of the gloomy predictions) and that it is consistent with, and actually strongly supports, a high level of individual and collective satisfaction. The experience also shows that citizens may express and have their demands best fulfilled when federalism and direct democracy are closely integrated. Though it would be naive to transfer the example of Switzerland directly to other regions of the world, the basic features of federalism and direct democracy, suitably adjusted, can well be applied to other regions. The idea of FOCJs is worth pursuing. Though the concept departs from conventional thinking about the organisation of states, it is in the best economic tradition. ♦

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