Balance and imbalance in the Swiss federal system

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What purpose does comparison serve?

It may seem daring to study Swiss federalism in order to put into perspective the Canadian federal system, given the enormous difference in size between the two countries. Switzerland has barely 7 million inhabitants, while Canada has over 30 million. Switzerland has an area of just over 40,000 km², while Canada has an area of nearly 10 million km². A Swiss person living at the edge of the country can reach the capital city, Bern, 250 km away by train in just over four hours, while a Canadian in the same situation must travel nearly 4,000 km to reach Ottawa.

What, one might ask, is the use of drawing parallels between two such different situations? In my opinion, there are two reasons why such an undertaking is far from futile, not necessarily to copy the systems but to better understand them. First, federalism in the two countries displays important similarities, which bode well for a fruitful comparison. Second, institutions are, so to speak, indifferent to size. The executive and legislative branches and the administrative system resemble each other regardless of the number of inhabitants to be served, the land area to be administered and the distances to be travelled, all the more so as these data are less and less important in a world that is at

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once ‘local’ and ‘global’ in nature. Solutions adopted in one country can therefore, bearing in mind the specific traits of each country, be contemplated in the other.

This paper seeks to put into perspective fiscal federalism in Switzerland, in particular facets pertaining to fiscal balance and imbalance. It is intended to present a “political portrait” of fiscal federalism in Switzerland and provide details that make it possible to better understand interactions resulting from fiscal institutions. Following an introduction to the Swiss political system, I will emphasize the allocation of responsibilities and resources between levels of government. Next, I will discuss how these institutional configurations affect intergovernmental relations in Switzerland, before offering some concluding remarks on the feasibility and plausibility of reforms of the system.

**Federal components of the Swiss political system**

The Swiss federal government comprises a cabinet made up of seven ministers designated by parliament, who exercise power in a collegial manner, i.e. by sharing responsibility for decision-making. The composition of the cabinet follows a “magic formula” whereby the federal government more or less reflects partisan politics in the country: two Social-Democrats, two Christian-Democrats, two Radicals and one member of the Democratic Union of the Centre. Essentially, it is as if Switzerland is permanently managed by a great coalition. During a given year, one of the ministers acts as President of the Confederation, a largely representative function. Under Switzerland’s consociational tradition, parliament also ensures that the government represents linguistic, regional and religious ratios. Until very recently, it was impossible to elect two ministers from the same canton.

The National Council, the lower house of parliament in Switzerland, comparable to the House of Commons in Canada. It is made up of 200 representatives elected by proportional representation in their electoral ridings, i.e. the 26 cantons, for four years. Each canton is entitled to a certain number of seats, based on population. The National Council’s decisions reflect partisan political lines. However, depending on the issues at hand, partisan logic gives way to the formation of regional or even linguistic coalitions.
The Council of States is in some ways comparable to the Canadian Senate, although it functions on a very different footing. Two deputies elected by a majority of cantonal voters represent each of the 26 cantons. In the past, when the cantonal governments appointed the senators, the Council of States operated somewhat like a cabinet of cantonal ministers. Today, the upper house is simply a second chamber in a perfect bicameral system. If the deputies continue to pay special attention to the interests of their canton, many decisions are reached, as on the National Council, along partisan lines. In Switzerland, perfect bicameralism means that the two houses may make proposals and decide on current issues. Unlike the Canadian Senate, however, the Council of States, along with the National Council, may decide on budgetary and financial measures. The budget is evaluated jointly and must obtain the approval of both houses. Should differences arise, the budget shuttles back and forth between the two houses until agreement is reached. The same process applies to any other decision, i.e. regulatory acts, expenditures or taxes.

One particularity of the Swiss system is that certain legislation is also subject to a public referendum. When the federal Constitution is amended, the referendum is compulsory. In the case of legislation, it is optional and may be demanded through the collection of signatures. Some observers deem direct democracy procedures to have a restrictive effect. Although little comparative evidence is available in that respect, this hypothesis seems plausible, since votes often revolve around new programs, and hence new expenditures.

Intergovernmental coordination between the Confederation and the cantons also relies on numerous task forces, commissions, and conferences of cantonal directors of finance, education, the economy, and so on. Especially fiscal policy is subject to ongoing negotiation within such coordination structures.

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1 The six half-cantons are entitled to only one deputy each.
2 Failing agreement, the lowest figure takes precedence.
Is Swiss federalism subject to imbalance?

Swiss and Canadian federalism have important points in common. Not only are the systems in both countries established federations but also their federalism is rooted in comparable principles. Both systems seek to reconcile needs for unity and cohabitation with cultural and linguistic diversity and regional and local autonomy. Both systems have found in federalism a means of pursuing the common good while attributing to regional entities some degree of autonomy that should enable them to display and develop their unique situations. Both federal systems continue to engage in self-reflection, in order to call into question established institutions or with a view to perfecting them.

Horizontal imbalance

Switzerland is made up of 26 cantons, six of which are called half-cantons (they are darker on the map below).

*Chart 1: Swiss cantons and half-cantons*
The cantons vary markedly in terms of their socio-economic dimensions (see also Dafflon 2001a, 2001b, 1995). The two most populous cantons, Zurich and Bern, are 70 times bigger than the smallest entity, the canton of Appenzell Inner-Rhodes. From the standpoint of economic disparities, although it is hard to establish a clear distinction between “rich” and “poor” cantons (Gaudard 1989), a similar observation can be made. Over 20% of GDP is generated by the Zurich canton alone, where 16% of the population lives. In 1998, the gross domestic product of cantons such as Basel-City (BS) was double that of Jura (JU). The growth rate in the most successful canton (Schwyz, SZ) was six times greater than in the least successful canton (Bern, BE). The same applies to disparities in income: per capita income in the wealthiest cantons (Zurich, Zug and Basel-City) is almost double the income in the poorest cantons (Uri, Obwalden, Thurgau and Jura). The financial capacity index of the cantons varies between 30 and 218 in relation to the Swiss mean (100).\(^3\)

Chart 2 presents the cantons according to their financial capacity in relation to the mean (set here at zero), ranging from the most privileged to the least privileged.

Financial capacity reflects, by and large, a canton’s tax revenues. The tax revenues of Jura canton are less than half those of Zug canton. While these differences are somewhat mitigated by the cost of living, which is lower in underprivileged regions, they are considerable. Equalization is intended to remedy this situation (see also Dafflon 2001a, 2001b). One-third of direct federal tax, i.e. income tax levied by the Confederation, is redistributed among the cantons according to their financial capacity. However, federal government investment and jobs tend to overwhelm the effect of equalization by favouring the economically strong cantons (Grosclaude and Schwab 1991). The same may be said of conditional transfers, which are common in Switzerland and which, by subsidizing expenditures, essentially favour those cantons that are able to allocate substantial own-source revenues. For this reason, equalization is under review, primarily with a view to eliminating the subsidization of expenses to achieve genuine equalization of revenues (see also Bullinger 2001).

\(^3\) For more details on the calculation of this index, see Dafflon (2001a, 2001b).
Moreover, there are significant structural (and by extension, political) disparities between the cantons: the share of the primary sector ranges from 16% (Geneva) to 48% (Glarus) and the share of services between 46% (Glaris, Appenzell Inner-Rhodes) and 75% (Geneva). While an urban centre dominates a number of cantons (Geneva, Basel-City and Zurich), others are mainly rural (Appenzell and Grisons). These structural differences also reflect the historic development of the cantons and are expressed through politics and political parties. Indeed, each canton is a full-fledged mini political system with its own political and partisan elite. Numerous political parties are organized solely at the
cantonal level. The cantonal and communal sections of national political parties have their own history and pursue their own agendas. However, compared with the Canadian political system, the Swiss partisan system is more homogeneous. The four governmental parties mentioned earlier are established in all of the cantons and contribute to national cohesiveness.

Important differences are also apparent from an administrative viewpoint. Administrative structures vary even more strikingly than political institutions (Germann 1986: 356). Those of the big cantons are characterized by a high degree of professionalization and differentiation (Urio 1986). The small rural cantons have more traditional administrative models. They maintain a strong participatory cultural and assign numerous duties to non-professional volunteers in conjunction with commissions and corporations (Linder 1983: 340-341; Urio 1986: 109-111). These differences do not stem solely from disparities in resources but also from the cantons’ organizational autonomy. The federal Constitution empowers the cantons to organize their administration, including its municipalities, as they see fit. The same autonomy prevails with respect to political structures, which, however, have been subject over time to much broader convergence.

**Vertical imbalance**

The two variables of vertical imbalance in any federal system are the division of jurisdictions and the distribution of resources. As for the division of jurisdictions, the Swiss federal Constitution stipulates a strict concept of subsidiarity, i.e. unless the Constitution attributes a jurisdiction explicitly to the Confederation, it is within the competence of the cantons. Moreover, the power of the cantons stems from the delegation to them, either by the Constitution, through legislation or even by means of statutory instrument, of numerous federal responsibilities (see Faganini 1991: 51ss; Delley 1984: 343; Klöti 1988). In Switzerland, this delegation of implementation to the cantons is referred to as “executive federalism,” which results from the principle of cooperation that characterizes the Swiss federal system (contrary to the principle of separation or competition that prevails in more dual federal systems such as Canada).

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4 These figures are based on the number of employees in the production and service sectors and are drawn from the 1991 federal business census.
Executive federalism can be perceived as a vertical imbalance to the extent that the Confederation now is given important decision-making powers, while the cantons are responsible for executing these responsibilities.

The Confederation has to fight, often unsuccessfully, to obtain new jurisdictions. It achieves this end often by promising the cantons additional financial resources but leaving them full leeway to implement the responsibilities. Because of this imbalance, the Swiss federal system has, in the post-war era, simultaneously undergone centralization in respect of decision-making and decentralization from the standpoint of financial and organizational resources. While growing numbers of responsibilities have been transferred to the federal government in recent decades, especially in such areas as land use planning and development, environmental protection and energy policy, the cantons have maintained considerable power with regard to implementation (Germann 1986: 348; Kriesi 1995; Linder 1983: 335-339; Nüssli 1985: 258-260). This shift has been accompanied by an increase in conditional transfers to the cantons.

Even fields that are formally fairly centralized, such as transportation policy and social security, are in fact administered by the cantons. Only the public economy (in particular, agriculture) is largely funded by the Confederation despite the formal sharing of jurisdictions by the two levels (Nüssli 1985: 353).

Table 1: Breakdown of expenditures by function (in %, 1998)

<table>
<thead>
<tr>
<th>Function</th>
<th>Confederation*</th>
<th>Cantons*</th>
<th>Communes*</th>
<th>Share of total federal expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign affairs</td>
<td>100</td>
<td>0</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>National defence</td>
<td>93</td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Finance and taxation</td>
<td>78</td>
<td>42</td>
<td>34</td>
<td>7</td>
</tr>
<tr>
<td>Public economy</td>
<td>74</td>
<td>56</td>
<td>11</td>
<td>5</td>
</tr>
<tr>
<td>Transportation</td>
<td>64</td>
<td>40</td>
<td>21</td>
<td>11</td>
</tr>
<tr>
<td>Social security</td>
<td>52</td>
<td>44</td>
<td>23</td>
<td>21</td>
</tr>
<tr>
<td>Justice and police</td>
<td>7</td>
<td>70</td>
<td>27</td>
<td>5</td>
</tr>
<tr>
<td>Education</td>
<td>14</td>
<td>64</td>
<td>42</td>
<td>18</td>
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<tr>
<td>Health</td>
<td>1</td>
<td>63</td>
<td>48</td>
<td>12</td>
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<tr>
<td>General administration</td>
<td>19</td>
<td>39</td>
<td>45</td>
<td>6</td>
</tr>
<tr>
<td>Culture and recreation</td>
<td>13</td>
<td>32</td>
<td>58</td>
<td>3</td>
</tr>
<tr>
<td>Environment and land use planning and development</td>
<td>15</td>
<td>29</td>
<td>75</td>
<td>4</td>
</tr>
<tr>
<td>Confederation*</td>
<td>Cantons*</td>
<td>Communes*</td>
<td>Share of total federal expenditures</td>
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<tr>
<td>39</td>
<td>48</td>
<td>33</td>
<td>100</td>
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</tr>
</tbody>
</table>

Source: adapted from *Eidgenössische Finanzverwaltung (2000).*

*Certain expenditures appear more than once, which explains why the totals exceed 100%.

The Confederation and the cantons both deplore this entanglement of responsibilities. The cantons are deprived of decision-making power that would allow them to fully enjoy their autonomy, while the Confederation complains that it lacks the power to ensure that its responsibilities are executed as prescribed. For this reason, current reforms of the Swiss federal system are aimed at untangling responsibilities. Such untangling is geared to re-establishing decision-making and fiscal responsibilities with a view to enhancing the efficacy of the Swiss federal system. Such efforts, if they succeed, will inevitably lead to some degree of withdrawal by the Confederation from cantonal affairs, which must be offset by the strengthening of financial equalization, mentioned earlier.

The second variable in vertical imbalance concerns resources. A comparison of changes in the revenues and expenditures of the three levels of government suggests that the Swiss federal system has avoided fiscal imbalance.

*Chart 3: Evolution of revenues and expenditures*

However, it has to be kept in mind that the flow of funds between the three levels is considerable. The cantons’ share of federal revenues stands at 8.3% (*Office fédéral de la statistique 1999: 462, 473*). Some 26.8% of cantonal revenues come from federal funds, only 6.4% of which are unconditional (*ibid.: 472*). Most federal contributions to the
cantons are in the form of conditional transfers (matching grants). The latter enable the Confederation, which is largely lacking in power to guide the cantons, to prompt the cantons to act, e.g. to build roads, cover the needs of the poor in the realm of health insurance, or to foster scientific research in the cantonal universities.

The well-known problem stemming from this configuration is that, first of all, it is difficult to direct resources where they are the most needed. Second, the resources steer the cantonal budgets toward “paying” activities. Third, different levels of government can avoid blame for the financial situation. As for the first criticism, research is unanimous in showing that the financially strongest cantons also benefit from the biggest conditional transfers simply because they have the means to raise sufficient revenues in order to obtain a big share. Moreover, the less financially advantaged cantons often take time to embark upon a program and leave empty-handed when subsidies dry up. The second criticism concerning the poor allocation of the cantons’ budgetary resources also seems justified, at least in the realm of investment. The typical example of this phenomenon is the construction of bomb shelters: in order to take the fullest possible advantage of federal subsidies put in place during the cold war to increase the availability of such shelters, the communes have eagerly equipped each school, local home and sports centre with shelters, to the extent that some communes have created considerable overcapacity (Kissling-Näf and Wälti 1999). To the contrary, subsidies intended to make health insurance affordable for low-income earners are underutilized, especially in those cantons that need the subsidies the most. Unlike the first two criticisms, the third criticism concerning the avoidance of blame seems to be unfounded. In comparison with the Confederation, the cantons and communes are now less threatened by deficits. As Chart 4 shows, the situation was reversed toward the end of the 1970s, in light of the observation that the cantons and communes became indebted following the oil crisis, while the Confederation continued to record surpluses. The Confederation now shoulders over half of the public debt (53.4% of GDP in 1998).
Chart 4: Change in budget surpluses as a percentage of revenues


Given the overlapping in federal and cantonal finances, it is hard to ascertain the extent of fiscal imbalance in Switzerland. What is important from the standpoint of autonomy is the freedom the cantons enjoy to make independent budget choices. This freedom is not entirely the same as regards expenditures and revenues. In terms of expenditures, the cantons are closely tied to federal budget choices (Braun et al. 2000). A large part of their revenues come from transfers, which, contrary to those in Germany, for example, are for the most part tied to the accomplishment of certain responsibilities. Having said that, the Confederation has fairly limited means of controlling the allocation by the cantons of these resources and often confines itself to a political denunciation in the event of overly free implementation (Linder 1987; Wälti 1996). As for revenues, the link is not as strong. The only truly “shared” tax is direct federal tax, which is levied by the

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5 See also Dafflon (2001a, 2001b) and the Commission intercantonale d'information fiscale 1998.
Confederation on income and of which the cantons receive one-third. Roughly one-fifth of federal revenues are derived from this tax, whose legal basis must be renegotiated every four years. The Confederation relies, by and large, on its exclusive right to levy the value-added tax, now set at 7.5%, and various consumption taxes (tobacco, alcohol, mineral oils, duty on heavy vehicles). The cantons enjoy considerable fiscal autonomy and are free to determine the taxation base and tax rates. Generally speaking, most cantonal revenues come from personal and corporate income tax. Most of the cantons also levy taxes on property, gifts and inheritances, property sales, automobiles, games and entertainment and the production of hydroelectric power.

**Interplay**

The horizontal and vertical imbalances in the Swiss federal system, as described in the preceding sections, are at the heart of the federal dynamics in Switzerland. This dynamics, of which incrementalism and the balance of powers are the hallmarks, gives rise to interplay that I would like to briefly describe below.

**Interplay with regard to the execution of responsibilities**

Studies of the political process in Switzerland have highlighted the problems stemming from the vertical imbalance in the division of responsibilities, especially shortcomings in implementation (Linder 1987: 188ss). The Confederation’s lack of monitoring instruments (or rather, its failure to use them), gives the cantons considerable leeway with respect to implementation. Such leeway is all the broader since the opening up of the legislative process in Switzerland to interest groups with the power to organize referenda makes the legal bases vague and subject to interpretation (Knoepfel 1996; Kriesi 1995: 314ss). The cantons use, or indeed abuse, such leeway in order to pursue their own objectives.

This dynamics is not contested, but its interpretation is subject to debate. Some observers emphasize that, as a result, Swiss federalism has been emptied of its content and that the cantons have become simple executive entities (Knapp 1986: 50). Others regret that the cantons are also entitled to a portion of other, less important taxes, i.e. the withholding tax, federal stamp duties, the tax on the exemption from military service, and road duties.
central government is not sufficiently strong to face issues such as environmental protection, the completion of major infrastructure projects or foreign policy (Germann 1994: 57). One intermediate viewpoint consists in focusing on the functional nature of a certain balance of power between the Confederation and the cantons, especially as regards the resolution of conflicts (e.g., Linder 1987: 194; Wälti 1996). The federal authorities may obtain new powers in exchange for financial transfers and the delegation of implementation to the cantons (Faganini 1991: 54; Kriesi 1995: 76). As a result, despite the absence of a genuine joint decision-making power such as it exists in Germany, the cantons carry weight in the federal decision-making process.

Along those same lines, the vertical imbalance that characterizes Swiss “executive federalism” is part of the Swiss consociational model in which the cantons, like interest groups and political parties, appear as players with interests, resources and strategies (Lehmbruch 1993: 51; Duchacek 1986: 99). The ability to play both the centralization (of jurisdiction) card and the decentralization (of implementation) card makes it possible to achieve compromises and attain solutions involving mutual gains that would be otherwise unattainable.

**Interplay with regard to the distribution of financial resources**

As is true of responsibilities, neither the Confederation nor the cantons may unilaterally reduce, increase or reallocate resources. If the Confederation seeks to increase or decrease its resources, the cantons will very likely intervene in parliament. As for the first possibility, the cantons would hesitate to agree because they would be deprived of a portion of the tax base. The Confederation has a somewhat simpler task in the realm of shared taxes since the cantons also benefit from such taxes. If the Confederation wishes to increase its own resources, e.g. the value-added tax, the cantons may intervene through their representatives on the National Council and the Council of States. However, their veto power in this instance is more limited than that of the German Länder, for example.

Why would the Confederation hesitate to unilaterally increase its own revenues? First of all, because it always needs to rally a partisan majority behind its proposals (it should be remembered that the parties have strong regional loyalties) and second, because such a
decision is subject to a referendum. The cantons have considerable weight in the referendum process.\footnote{In the case of the compulsory referendum, voters in the majority of cantons must approve the measure. In the case of the optional referendum, this requirement is eliminated but the cantonal political elites always play an important role in the electoral campaign.}

If the Confederation intends to reduce its own revenues, the cantons would, \textit{a priori}, have fewer objections. To the contrary, one might even wonder why the cantons do not exercise pressure more often in this respect. There are two reasons: first, the cantons are hardly inclined to relinquish the numerous transfers (often equalizing) financed by these resources, and second, in the case of shared taxes, they actually benefit from them. However, the cantons could step into the breach and collect their own resources instead, one might be tempted to say. In reality, fiscal competition between the cantons poses limits on such unilateral logic. Most of the cantons, even the wealthiest ones,\footnote{The wealthiest cantons benefit most from the direct federal tax. It is true that the cantons’ share is redistributed in the manner of equalization payments, which means that the wealthy cantons transfer part of their revenues to the less privileged ones. At the same time, the wealthiest taxpayers live in the resource-rich cantons and have the greatest exposure to direct federal tax because it is more progressive than cantonal taxes. Despite equalization, the most privileged cantons ultimately receive a larger share of the direct federal tax.} accept the existence of a certain pooled tax harvest, instead of exposing themselves to growing fiscal competition. (At this stage, federalism is functioning like a club in which the members have understood that they are facing the prisoner’s dilemma and that cooperation is more profitable than competition.)

Since few tax revenues are genuinely shared between the Confederation and the cantons, a vertical reallocation of such revenues, as regularly occurs in Germany, in particular, is not possible. At best, reallocation occurs indirectly if one level of government modifies its tax base. As Chart 3 indicates, the distribution key remains relatively stable.

A reduction or increase in or the reallocation of expenditures is subject to similar constraints but gives rise to different types of interaction since, in the realm of expenditure, the levels of government depend more heavily on each other. It is in the intrinsic interests of the cantons with more limited resources and which are more strongly dependent on the Confederation to broaden the resources at their disposal. For this...
reason, new expenditures are adopted quite readily. However, this dynamics is curbed insofar as the cantons must, so to speak, “buy” the new resources, which they usually receive in the form of conditional transfers. The reduction in or the reallocation of such transfers is hard to achieve but feasible since new expenditures are often adopted for a limited time. Moreover, the budget process in Switzerland deals with revenues and expenditures on the same footing and through the same commissions. Consequently, each new expenditure calls for an increase in or the reallocation of resources and will thus be of limited scope.

**Conclusion: feasibility and plausibility of reforms**

The history of the reform of horizontal and vertical imbalances in Switzerland is lengthy and fraught with failure and incrementalism. During the 1960s and 1970s, coordination and intergovernmental collaboration were the watchwords. In the 1980s and 1990s, the paradigm shifted to competition, fiscal equivalence and untangling. The change, which is characteristic of all federal systems, also obtains in Switzerland where pressure for reform is now pointing in the direction of broader fiscal responsibility for the cantons. By reducing and untangling vertical financial flows, officials hope to avoid problems of free-riding jumping and fiscal irresponsibility, i.e. the so-called moral hazard. What chance of success do these efforts have?

During the 1980s, the reforms were perceived, first and foremost, as being motivated by the desire of the Confederation and the wealthy cantons to reduce expenditures in order to limit deficits: to untangle is to make accountable, and to make accountable is to discipline. While this causality is certainly plausible on paper, all the more so as most of the cantons have adopted automatic controls that demand a balanced budget, the distribution of interests among the cantons made almost illusory the attainment of these objectives. Decision-making processes, described in the preceding sections, prevent a minority of wealthy cantons from imposing a reform, regardless of how reasonable and economically sound it may be, on a majority of less privileged cantons. The constellation of interests does not favour such a reform.

Budgetary détente in recent years has somewhat altered the situation and the reforms seem more likely to succeed. Through the untangling of responsibilities, combined with
the strengthening of equalization (in respect of revenues, but no longer as regards expenditures), all of the cantons could gain broader autonomy. However, the reduction in vast conditional transfers will be hard to achieve. Why? It might be thought that it is in the interests of all of the cantons to undo the “golden chains” of conditional subsidies. In actual fact, the reduction of conditional subsidies will make the cantonal budgetary process more antagonistic. If various departments now have highly predictable budgets, they will, in the future, have to negotiate the allocation with the cantonal finance minister (Bullinger 2001). Broadly speaking, the cantonal budgetary process would clearly become more political.

Aside from the question of feasibility, we must pose the question of plausibility. As I have noted, horizontal and vertical imbalances are real in Switzerland and criticisms of the system are founded. However, such criticism often centres on economic efficiency reasoning and tends to neglect “political efficiency.” The interaction resulting from these imbalances is itself in balance. In other words, the resulting constraints and limitations serve a function in the Swiss political system, that of the integration and balancing of power.
References


