

Inequality and Institutions

The Case of Switzerland

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Outline

What we will talk about

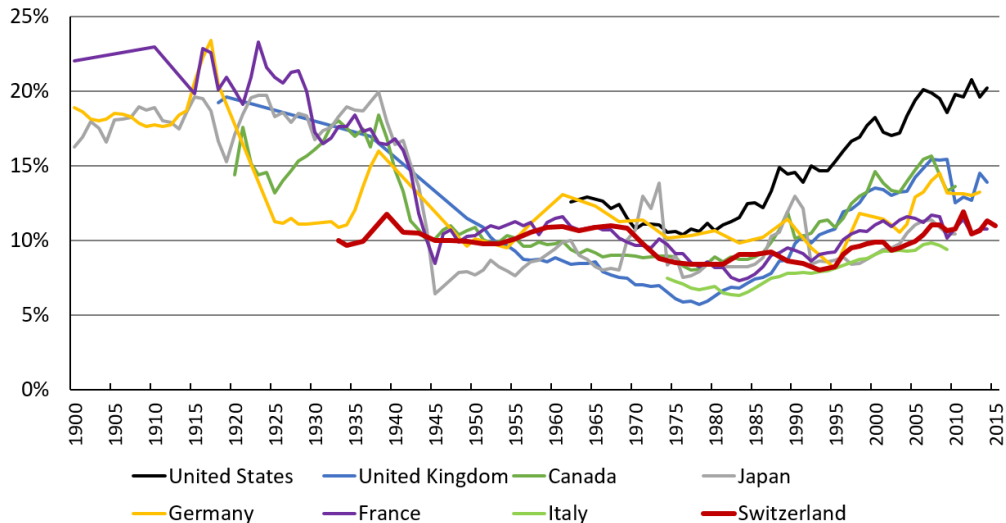
- ▶ What makes Switzerland's income distribution unusual?
- ▶ Why do the institutions of fiscal federalism and direct democracy deserve attention?
- ▶ What are our empirical results regarding their effects on cantonal distributions?
- ▶ Is Switzerland's institutional framework a model for even income distribution?

What we will not talk about

- ▶ Empirical identification strategies
- ▶ Robustness of results

Motivation

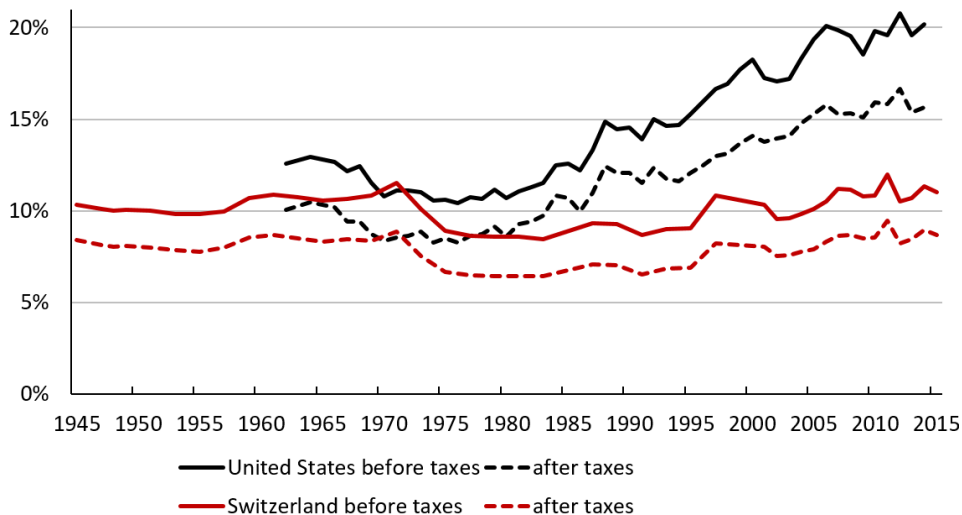
Figure: Top 1 % income shares in the 20th century



Source: World Inequality Database (Jan. 2019)

Motivation

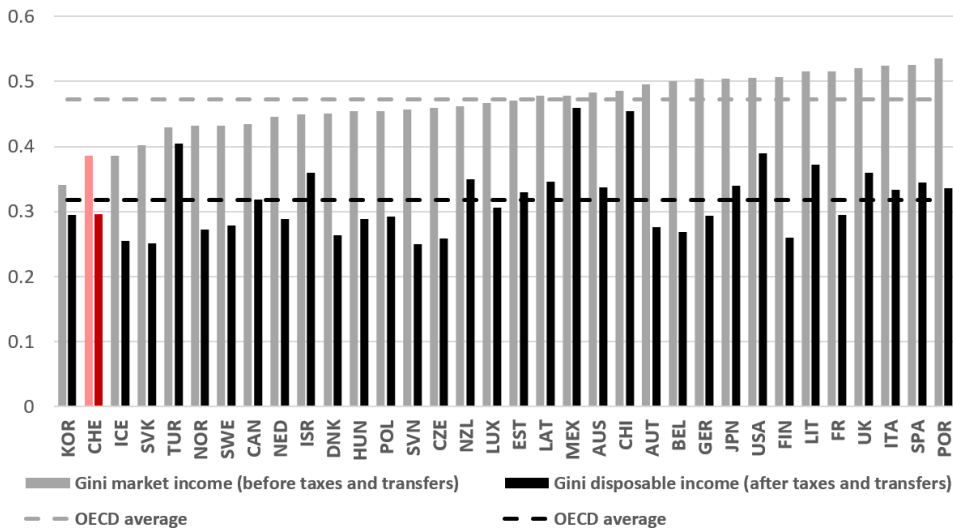
Figure: United States and Switzerland: Top 1% income share before and after taxes



Sources: USA World Inequality Database (Jan. 2019); Switzerland own calculations

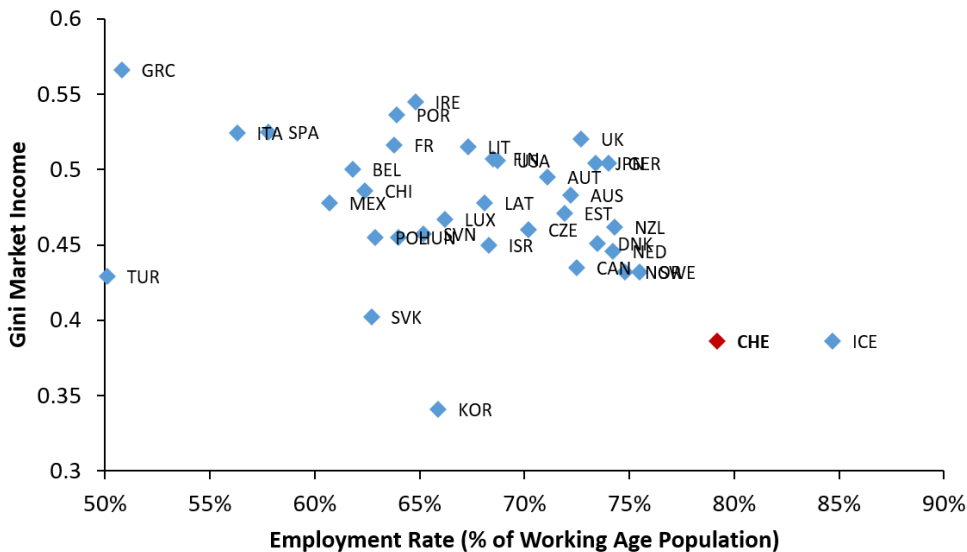
Motivation

Figure: Gini coefficients in market and disposable income OECD 2015



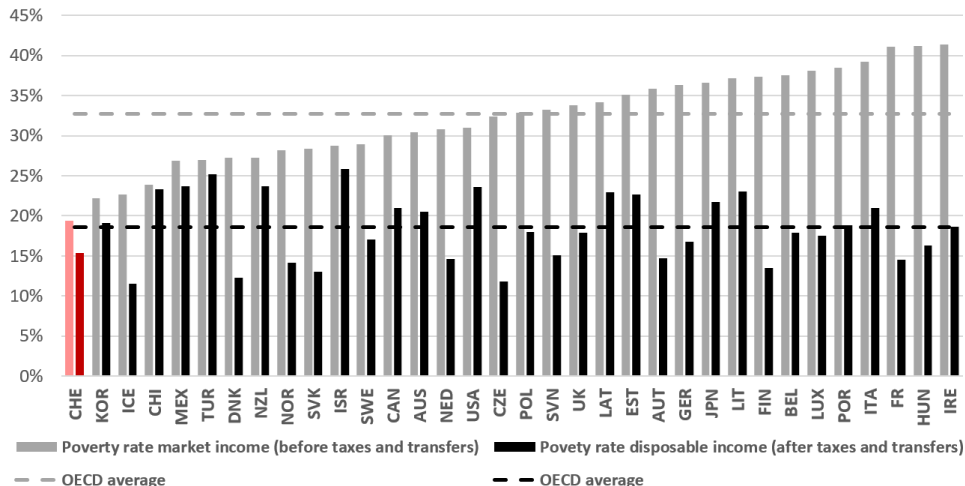
Motivation

Figure: Gini coefficient in market incomes and employment rate OECD 2015



Motivation

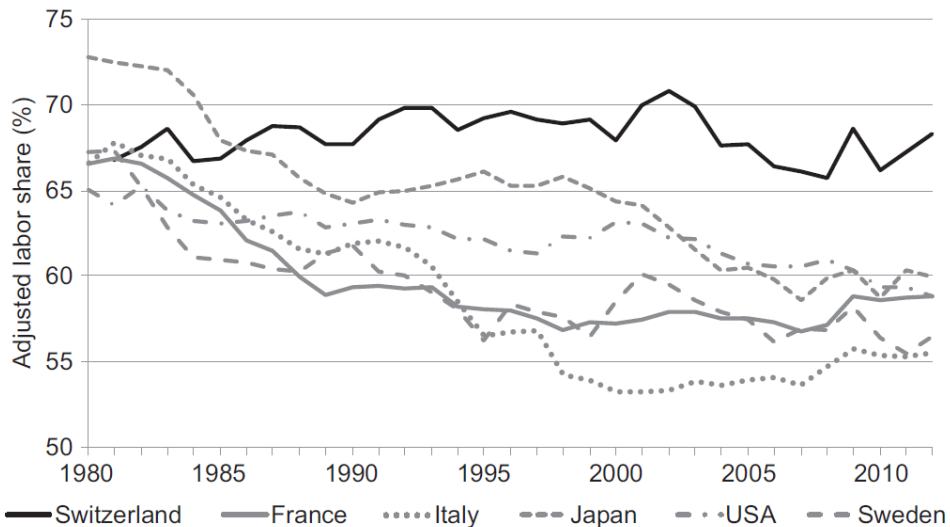
Figure: Poverty rates in market and disposable income OECD 2015 (share of the population with income below 60% of median)



Source: OECD – Income Distribution Database (IDD)

Motivation

Figure: Compensation per employee as a fraction of GDP at market prices per person



Motivation

What explains the unusual income distribution in Switzerland?

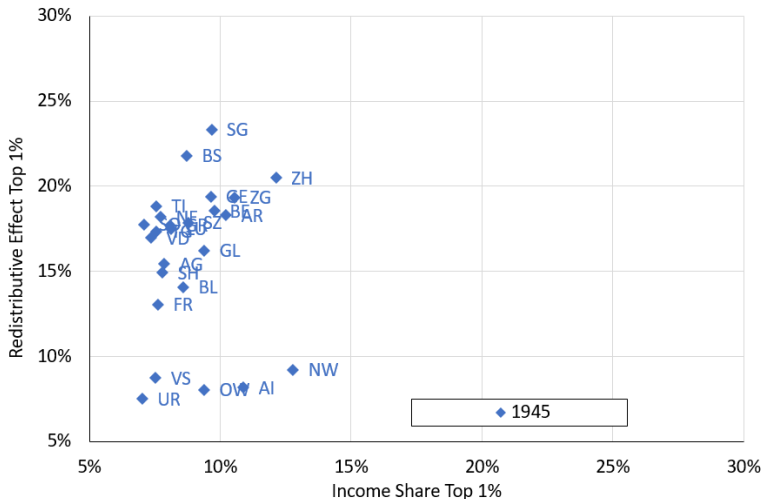
- ▶ Established determinants of the income distribution
 - ▶ Technological change, globalization, migration, population aging or individualism
- ▶ Acemoglu and Robinson (2015) emphasize political and economic institutions
 - ▶ Institutions determine: supply of skills, evolution of technology, regulation of markets (goods, finance, labor), bargaining power, pension system, taxation and redistribution
- ▶ Our focus:
 - ▶ fiscal federalism
 - ▶ direct democracy

Extensive cantonal autonomy provides an ideal setting

- ▶ Heterogeneity in inequality
 - ▶ Considerable cantonal responsibilities in policy fields relevant for the distribution of income (e. g. health, education, social welfare)
- ▶ Heterogeneity in institutions
 - ▶ Cantons granted high degree of autonomy regarding responsibilities and political systems
- ▶ Long-run analysis possible:
 - ▶ Federal tax data yields consistent distributional data on cantonal level
 - ▶ Principles of subsidiarity and direct political participation institutionalized in mid 19th century

Income Inequality (within Cantons)

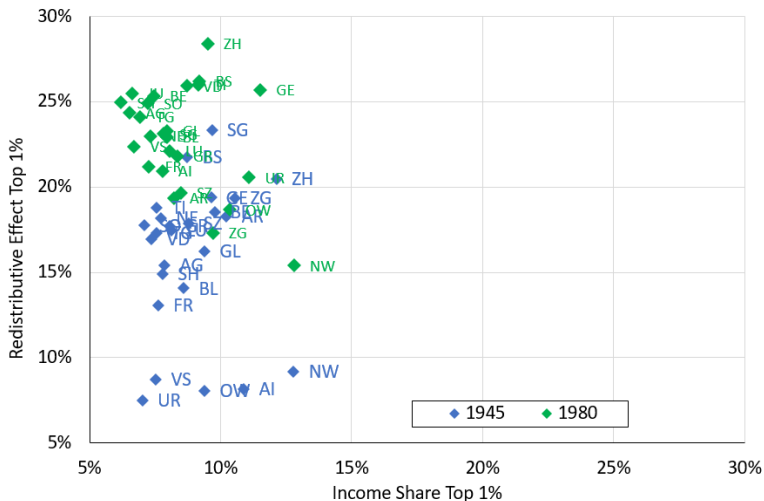
Figure: Top 1 % income share and redistribution via income taxes



Source: Own calculations based on federal tax statistics and cantonal tax burden

Income Inequality (within Cantons)

Figure: Top 1 % income share and redistribution via income taxes



Source: Own calculations based on federal tax statistics and cantonal tax burden

Fiscal Federalism (within Cantons)

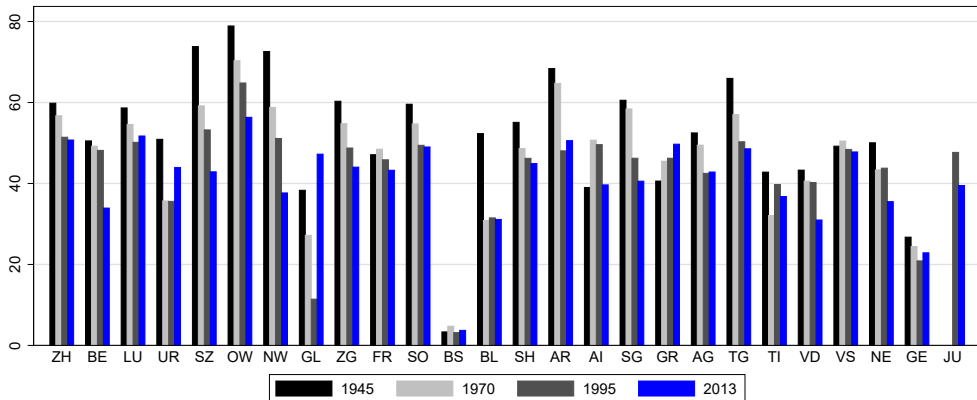
Focus: Fiscal Decentralization

- ▶ Fiscal autonomy of local jurisdictions
- ▶ Variable: Share of municipal on total municipal and cantonal tax revenues
- ▶ Decreasing over time (from 50% in 1945 to 38% in 2013)

In addition, we account for fragmentation, tax competition and federal transfers

Revenue Decentralization (within Cantons)

Figure: Share of municipal on total cantonal and municipal tax revenues (in percent)

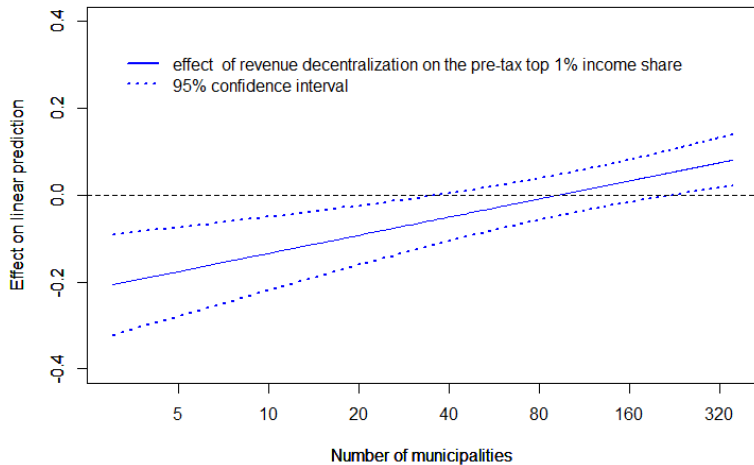


Fiscal federalism: theoretical channels

Fiscal Decentralization

- ▶ Increasing effects on income inequality:
Tiebout income sorting, externalities, regional disparities
- ▶ Decreasing effects on income inequality:
Efficiency of resource allocation (Oates 1972), redistribution preference (Pauly 1973), laboratory federalism (Oates 1999)
- ▶ Interdependence between decentralization and fragmentation

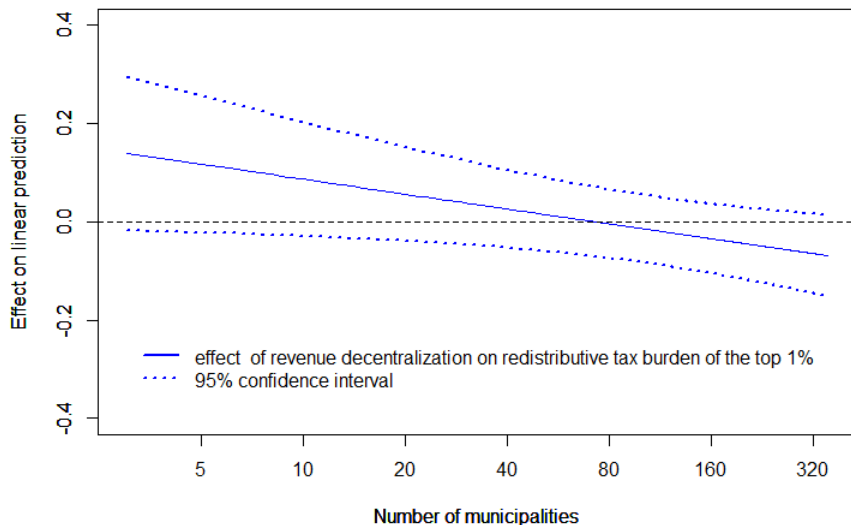
Fiscal federalism: Inequality before taxes



► Inequality after taxes

► Results with alternative measure of fragmentation

Fiscal federalism: Redistribution



Direct democratic institutions (within Cantons)

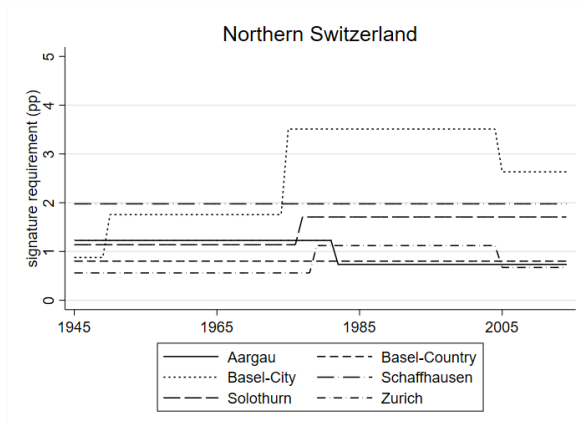
- ▶ Popular Referendum (Veto)
 - ▶ Cantonal Assembly Meeting (Landsgemeinde)
 - ▶ Mandatory Legislative Referendum
 - ▶ Mandatory Budget Referendum
 - ▶ Petition Referendum

- ▶ Voter Initiative (Agenda Setting)
 - ▶ Cantonal Assembly Meeting (Landsgemeinde)
 - ▶ Legislative Voter Initiative
 - ▶ Constitutional Voter Initiative

Access to direct democratic rights can be measured by the cost to initiate a ballot (i.e. signature requirement)

Voter initiative I (within Cantons)

Figure: Signature requirement for an initiative (in pp of the electorate in 2014)



▶ Central Switzerland

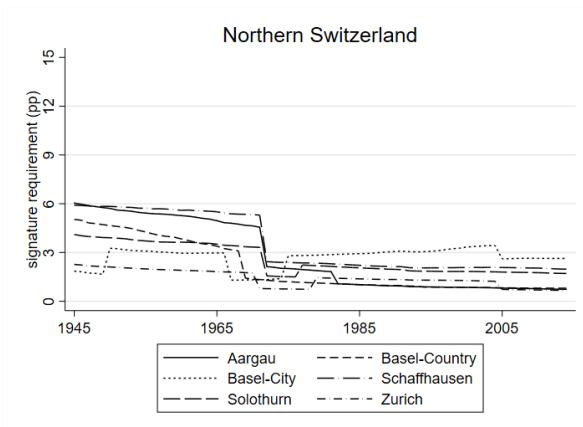
▶ Western Switzerland

▶ Eastern Switzerland

Source: Fischer (2005), Trechsel & Serdült (1999) and own inquiries of of cantonal constitutions

Voter initiative II (within Cantons)

Figure: Signature requirement for a referendum (in pp of the electorate)



▶ Central Switzerland

▶ Western Switzerland

▶ Eastern Switzerland

Source: Fischer (2005), Trechsel & Serdült (1999) and own inquiries of cantonal constitutions

Direct vs. Representative Democracy

Theory:

- ▶ Perfect representative democracy (Downs, 1957): Direct democratic institutions have no effect
- ▶ Political economy literature identifies a series of frictions
 - ▶ the fiscal commons problem, interest groups, logrolling, bundling of issues in candidate elections, influence of the bureaucracy
- ▶ Direct democracy counteracts the democratic principal-agent problem

Channels:

- ▶ Direct: Successful initiatives/referenda
- ▶ Indirect: Strategic concessions by the government (Gerber, 1996)

Few empirical studies regarding Distribution

- ▶ Stadelmann et al. (2015)

Results

Table: Effect of direct democracy on income shares of different income classes (1945 to 2014)

	Top 25-10%	Top 10-5%	Top 5-1%	Top 1-0.5%	Top 0.5-0.1%	Top 0.1-0.01%	Top 0.01%
Income Share (sample average)	20.4%	9.5%	11.5%	2.6%	3.6%	2.2%	1.3%
Effect Initiative (-1 pp sign. requ.)	0.09	0.07	-0.03	-0.05	-0.08	-0.09	-0.21
Effect Referendum (-1 pp sign. requ.)	-0.25	-0.05	0.02	0.02	0.05	0.05	0.07

- ▶ Voter initiative seems to induce policy shifts that
 - ▶ decrease top incomes
 - ▶ benefit the upper middle class
- ▶ Popular referendum implies an opposing impact relative to the voter initiative

Conclusions

Secular trends affect Switzerland as many other industrial countries

- ▶ technological change, globalization, migration, population aging or individualism

However, Switzerland exhibits a unusual pattern of inequality

- ▶ Long-run stability in top income shares
- ▶ Low market income inequality
- ▶ Low redistribution

Possibly explained by institutional framework

- ▶ both fiscal federalism and direct democracy seem to promote policies that lead to a more even distribution, especially of market incomes
- ▶ thereby diminishing demand for redistribution

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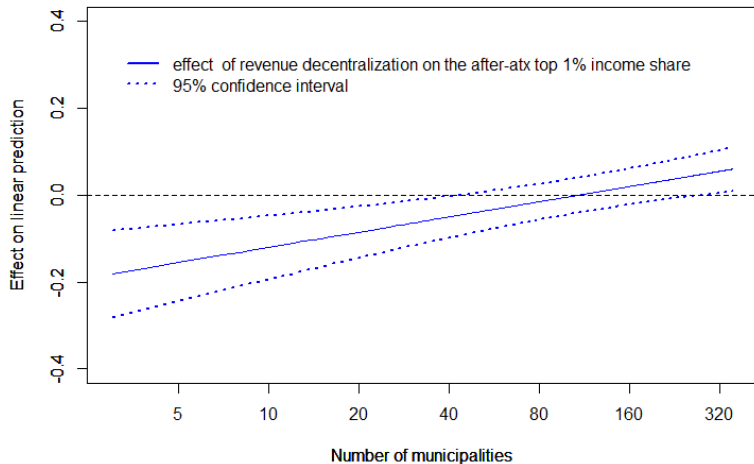
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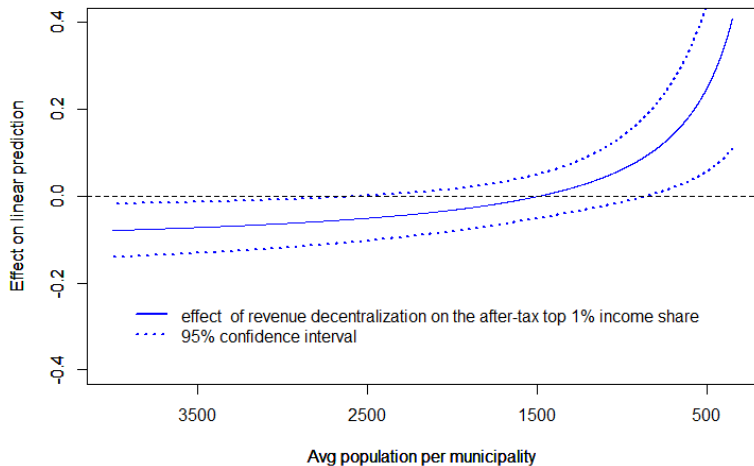
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Appendix - fiscal federalism: Inequality after taxes



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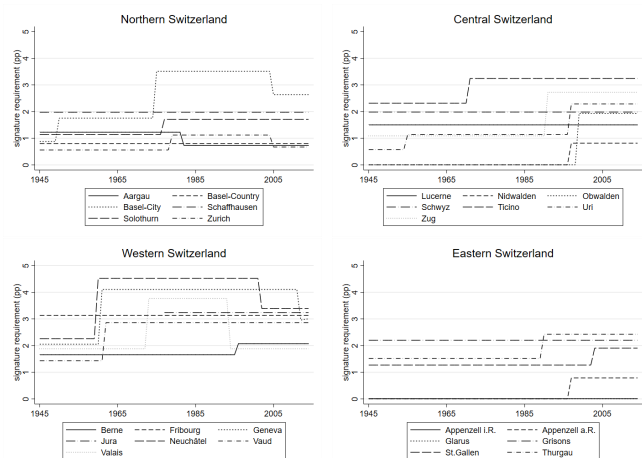
Appendix - fiscal federalism: Inequality after taxes



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Appendix - voter initiative I (within Cantons)

Figure: Signature requirement for an initiative (in pp of the electorate in 2014)

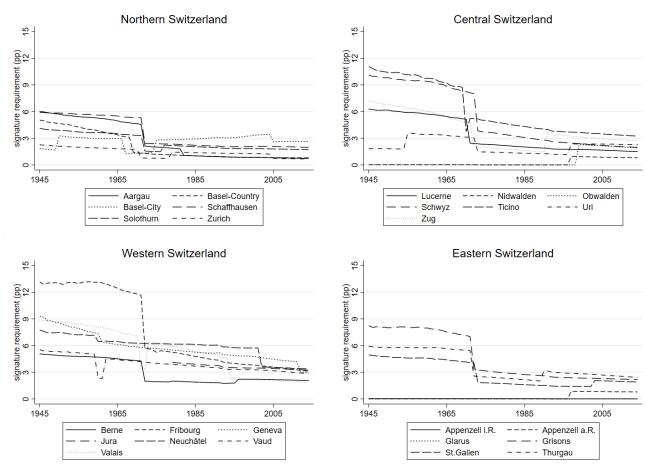


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Source: Fischer (2005), Trechsel & Serdült (1999) and own inquiries of of cantonal constitutions

Appendix - voter initiative II (within Cantons)

Figure: Signature requirement for a referendum (in pp of the electorate)



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Source: Fischer (2005), Trechsel & Serdült (1999) and own inquiries of cantonal constitutions