

THE SWISS EXPERIENCE  
WITH REFERENDA AND FEDERALISM

par

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Switzerland lies in the heart of Europe and has always been part of its history. In some respects, Switzerland can be looked at as a future Europe in a nucleus : Its population is composed of many ethnic groups, languages, cultures and religions. 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 in others highly technological services (such as banking) prevail.

Such diversity is bound to lead to problems and conflicts. Without denying these differences (but rather accepting and even, where appropriate, supporting them), the Swiss have developed institutions which effectively regulate these conflicts in the political sphere and to a large extent help to overcome them. These institutions only partly harmonize economic, social and cultural policies. By far more important is that these institutions foster competition between the various interests, but do so within a well-devised basic constitutional design so that competition produces beneficial effects.

These institutional features are basic for Switzerland : the first is the *federal* structure of the country. There exist 23 cantons (some are even divided into half-cantons) and 3019 political communes. These units can to a larger

extent than in any other country, act as independent decision-makers. Most importantly, they have the power to determine their own tax rates with respect to the income of persons and firms, and in addition may use other sorts of public finance. As a result it may be observed that there are communes and cantons situated next to each other with strongly different tax rates and correspondingly different levels of public expenditures and services. The various jurisdictions are therewith able to compete for citizens and firms by providing a mix of taxation and public benefits which is most beneficial for them.

The second fundamental institutional feature of Switzerland 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). Between 1848 and 1990 there were not less than 379 referenda at national level.. This instrument of direct democracy is used much more intensively in Switzerland than in any other country. Up to 1990, there were 45 popular referenda in Australia (since 1906), 21 referenda in France (since 1793) and Italy (since 1929), 15 in Denmark (since 1946), 13 in Ireland (since 1937) and just 2 in Austria (since 1938). The United States do not allow any referenda at the national level. At the sub-national level, in the cantons and communes there have been virtually innumerable popular referenda (on this level, the only serious competitor is the State of California where between 1984 and 1990, the citizens had to decide over 1,089 propositions).

We discuss the relationship between *diversity* and *constitutional order* typical for Switzerland by first focusing on federalism and then on direct democracy. In the final section the two institutional features are evaluated.

## Federalism

Federalism is a crucial institution that serves to establish competition within the political arena<sup>1</sup>. 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

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<sup>1</sup> See also Kenyon, Daphne A. and John Kincaid (eds) (1991). *Competition among States and Local Governments : Efficiency and Equity in American Federalism*. Washington, D.C.: Urban Institute Press, and U.S. Advisory Commission on Intergovernmental Relations (1991). *Interjurisdictional Competition : Good or Bad for the Federal System?* Washington, D.C.: ACIR.

bureaucrats who are self-interested rent-seekers<sup>2</sup> or special interest groups that try to "capture"<sup>3</sup> the relevant decision-makers. Although it is not argued here that politicians and bureaucrats always and exclusively seek to maximize their own utility to the extent of actively exploiting the citizens and taxpayers, taking governments to be completely responsive to the population's wishes is not realistic either. Thus, federal competition serves as a safeguard against decision-makers taking unfair advantage of their discretionary power.

Federal competition may lead to an increase in economic spillovers in some cases. Many economists, therefore, argue that centralized regulation must be introduced to correct market failures arising from economic externalities<sup>4</sup>. A vivid discussion about centralizing and harmonizing is going on in the European Community at the moment. With the creation of a single market and, therewith, the abolishment of barriers to trade, so it is often argued, taxes need to be harmonized and redistribution to be deferred to the Community<sup>5</sup>.

An extensive analysis of the debate about the efficient degree of harmonization and centralization cannot be provided here ; however, we stress that property rights theory<sup>6</sup> and constitutional economics<sup>7</sup> suggest that neither

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<sup>2</sup> See Buchanan, James M., Robert D. Tollison and Gordon Tullock (eds) (1980). *Towards a Theory of the Rent-Seeking Society*. College Station : Texas A & M University Press.

<sup>3</sup> See Stigler, George J. (Spring 1971). "The Theory of Economic Regulation". *Bell Journal of Economics and Management Science* 2: 3-21 ; and the survey on the economic theory of regulation in Sam Peltzman, (October 1980). "The Growth of Government". *The Journal of Law & Economics* 23: 209-287. This cooperation of the public sector with parts of the private sector is called "the power of distributional coalitions" by Mancur Olson (1982), *The Rise and Decline of Nations*. New Haven, Conn.: Yale University Press.

<sup>4</sup> For the public-interest view of governments see Musgrave, Richard A. (1959). *The Theory of Public Finance*. New York: McGraw Hill.

<sup>5</sup> Bureau, Dominique and Paul Champsaur (May 1992). "Fiscal Federalism and European Economic Unification". *The American Economic Review, Papers and Proceedings* 82: 88-92; Neven, Damien J. (May 1992). "Regulatory Reform in the European Community". *The American Economic Review, Papers and Proceedings* 82: 98-103; and Schneider, Friedrich (1992). *The Federal and Fiscal Structures of Representative and Direct Democracies as Models for a European Federal Union? Some Thoughts on the Public Choice Approach*. Linz, Austria: University of Linz, Mimeo.

<sup>6</sup> For a recent survey see Barzel, Yoram (1989). *Economic Analysis of Property Rights*. Cambridge, England: Cambridge University Press.

public goods nor income redistribution are sufficient reasons to justify harmonization and centralization.

Surprisingly enough, 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 to a limited extent. However, the potential offered by federalism<sup>8</sup> to establish a vigorous competition between government units has so far not been rationally designed by any country. The principle of "fiscal equivalence"<sup>9</sup> seems to apply only to some extent in the United States, Australia and Switzerland<sup>10</sup>.

Fiscal equivalence means that the size of a political decision making unit should correspond to the spatial effects of the benefits and costs of a publicly supplied good. Each public function (e.g., education, police, fire protection, or, if not privately supplied, refuse collection) could be allocated to a particular political unit whose geographic extension varies according to the particular supply conditions. The Swiss Canton of Thurgau, for instance uses the concept; hence, several hundreds of such multiple functional and overlapping jurisdictions exist, each with corresponding taxes<sup>11</sup>.

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<sup>7</sup> Brennan, Geoffrey and James M. Buchanan (1985). *The Reason of Rules: Constitutional Political Economy*. Cambridge, England: Cambridge University Press; Frey, Bruno S. (1993). *Democratic Economic Policy*. Oxford: Blackwell; Mueller, Dennis (1994). *Constitutional Economics*, forthcoming.

<sup>8</sup> Tiebout, Charles M. (October 1956). "A Pure Theory of Local Expenditure." *Journal of Political Economy* 64: 416-487 and Wallace E. Oates (1992). *Studies in Fiscal Federalism*. Aldershot, England: Edward Elgar.

<sup>9</sup> Olson, Mancur (May 1969). "The Principle of Fiscal Equivalence: The Division of Responsibilities Among Different Levels of Government." *The American Economic Review, Papers and Proceedings* 59: 479-487 and Mancur Olson (May 1986), "Toward a More General Theory of Governmental Structure." *The American Economic Review, Papers and Proceedings* 76: 120-125.

<sup>10</sup> For the Swiss experience with federalism, see Blöchliger, Hansjörg and René L. Frey (1992). "Der Schweizerische Föderalismus: Ein Modell für den Institutionellen Aufbau der Europäischen Union?" (Swiss Federalism: A Model for Institutional Development in the European Union?). *Aussenwirtschaft* 47: 515-548.

<sup>11</sup> Casella, Alessandra and Bruno S. Frey (April 1992). "Federalism and Clubs: Towards an Economic Theory of Overlapping Political Jurisdictions." *The European Economic Review*

This decentralization of decision making enables the citizens to "vote with their feet."<sup>12</sup> If they are dissatisfied with the publicly supplied good and the corresponding cost, they can leave the jurisdiction searching for a different jurisdiction where their preferences are better fulfilled. This possibility of "exit"<sup>13</sup> tends to undermine regional or functional cartels by politicians.

## Referenda

Popular referenda have proven to be very successful in Switzerland for fighting restraints on competition in the political market. We will elaborate on two aspects: monopolies (or cartels) and information problems.

## Referenda Against Politicians' Cartels

Rent-seeking theory argues that representatives have a common interest in forming a cartel to protect and possibly extend political rents.<sup>14</sup> Referenda and initiatives are means to break the politicians' coalition against the voters. Initiatives require a certain number of signatures and force a referendum on a given issue. They are a particularly important institution because they take the agenda-setting monopoly away from the politicians and enable outsiders 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<sup>15</sup>, the group determining which propositions are voted on

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36: 639-646.

<sup>12</sup> Tiebout, "A Pure Theory of Local Expenditure"; James M. Buchanan (February 1965), "An Economic Theory of Clubs". *Economica* 32: 1-14; and Albert O. Hirschman (1970). *Exit, Voice and Loyalty*. Cambridge, Mass.: Harvard University Press.

<sup>13</sup> Hirschman. *Exit, Voice and Loyalty*.

<sup>14</sup> The literature on rent-seeking was developed by Gordon Tullock (June 1967), "The Welfare Costs of Tariff, Monopolies and Theft", *Western Economic Journal* 5: 224-232; James M. Buchanan, Robert D. Tollison and Gordon Tullock, *Towards a Theory of the Rent-Seeking Society*; and surveyed by Robert D. Tollison (1982), "Rent Seeking: A Survey" *Kyklos* 25: 575-602.

<sup>15</sup> Denzau, Arthur T. (1985). "Constitutional Change and Agenda Control", *Public Choice, Carnegie Papers on Political Economy* 47: 183-217. In general see Dennis C. Mueller (1989). *Public Choice II*. Cambridge: Cambridge University Press.

and in what order has a considerable advantage, because it decides to a large extent which issues will be discussed when, and which ones will be left out.

Referenda, obligatory or optional, enable the voters to state their preferences to the politicians more effectively than in a representative democracy. In a representative system, deviating preferences, with respect to specific issues, can only be expressed by informal protests, which are difficult to organize 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.

A recent referendum made it clear that the political elite's interests do not always correspond with voters' preferences. In September 1992, the citizens of Switzerland 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<sup>16</sup>. Many more telling pieces from democratic history in Switzerland could be adduced here<sup>17</sup>. Particularly interesting cases are two referenda on Switzerland joining international organizations or agreements: the United Nations in 1986 and the European Economic Area in 1992.

Both proposals were rejected by the citizens, even though the political elite strongly supported them. These referenda were universally supported by all major political parties ; all pressure groups, including both employers and trade unions ; a huge majority of the members of Parliament ; and the executive branch. However, the popular referendum on Switzerland joining the United Nations resulted in a rejection by 76 percent of the voters ; on 6 December 1992, 50.3 percent of the population and a majority of the cantons (sixteen out

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<sup>16</sup> Empirical evidence for the extent of rent appropriations by the German politicians is provided by Hans H. von Arnim, (1991). *Die Partei, der Abgeordnete und das Geld (The Party, The Representative and Money)*. Mainz, Germany: v. Hase & Koehler.

<sup>17</sup> For more examples see Charles B. Blanker (Spring 1993). "A Public Choice View of Swiss Liberty". *Publius* 23: 83-95.

of twenty-three) voted against Switzerland becoming part of the European Economic Area. This clear rejection by the federal units induced a broad public discussion of the merits of the federal system in Switzerland where not only the majority of the population but also of the cantons is required to adopt a proposal.

These two examples of the citizens voting differently than the public officials in power are no exceptions : in 39 percent of the 250 obligatory and optional referenda held in Switzerland between 1948 and 1990, 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 39 percent of all cases where referenda were held.

Econometric cross-section studies for Switzerland<sup>18</sup>, moreover, reveal that political decisions with respect to publicly supplied goods correspond better with the voters' preferences when the institutions of direct political participation are more extensively developed. Because it is the individual taxpayers and not the elected officials per se 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.

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<sup>19</sup>. 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. It has been econometrically shown that the more direct democratic institutions are, the less tax cheating takes place. Compared to the mean of all

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<sup>18</sup> Pommerehne, Werner W. (April 1978). "Institutional Approaches to Public Expenditure: Empirical Evidence from Swiss Municipalities". *Journal of Public Economics* 9: 255-280; Werner W. Pommerehne (May 1990). "The Empirical Relevance of Comparative Institutional Analysis". *European Economic Review* 34: 458-469; Gebhard Kirchgässner and Werner W. Pommerehne (1990). "Evolution of Public Finance as a Function of Federal Structure: A Comparison Between Switzerland and the Federal Republic of Germany" (Paper presented at the 46th congress of the International Institute of Public Finance, IIPF, Brussels, Belgium); and Bernard Steunenbergh (1992). "Referendum, Initiative, and Veto Power : Budgetary Decision Making in Local Government". *Kyklos* 45: 501-529.

<sup>19</sup> Pommerehne, Werner W. and Bruno S. Frey (June 1992). "The Effects of Tax Administration on Tax Morale" (Paper presented at the Conference on Tax Administration and Tax Evasion of the International Seminar in Public Economics; ISPE, at Escorial, Spain).

cantons, almost 8 percent (that is, about Sfr. 1.600 per taxpayer per year) less income was concealed in 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, the mean income undeclared exceeded the mean for all cantons by roughly Sfr. 1.500.

The price of land has also been used as an indicator for individuals' demand to live in a certain community<sup>20</sup>. The findings support the notion that the more developed the direct participation options in a jurisdiction, the more people are attracted to it (i.e., the higher the willingness to pay and thus the price of land).

Referenda do, however, not only serve to break up the politicians' coalitions by destroying their monopoly on agenda-setting, but they also induce more competition in yet another respect : they provide information and stimulate communication.

### Referenda Against Information Asymmetries

In economic research on politics, the process which takes place before casting the vote has so far been almost completely neglected. Economics is the science of choice, a choice between known alternatives. These alternatives, however, have been shaped and defined by a process of verbal exchange<sup>21</sup>. This discourse among the citizens puts new issues on individuals' agendas, raises their perception, and communicates the arguments in the media. It 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

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<sup>20</sup> Santerre, Rexford E. (1986). "Representative Versus Direct Democracy: A Tiebout Test of Relative Performance". *Public Choice* 48: 55-63.

<sup>21</sup> For the relevance of communication in democracies, see John S. Dryzek (1990). *Discursive Democracy: Politics, Policy, and Political Science*. Cambridge, England: Cambridge University Press. Discourse, or discussion is the central element in the philosophy developed by Jürgen Habermas. See his most recent presentation in : *Faktizität und Geltung*. Frankfurt: Suhrkamp 1992. Somewhat surprisingly, he completely overlooks that the discussions preceding popular referenda are an excellent practical application of an 'ideal discourse'.

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. As was pointed out for the European Community (EC), the more removed the agents are from the principals, the easier it is to pass the buck to someone else<sup>22</sup>. Thus, the very indirect system of the EC (now EU) makes it easy for national politicians to blame the commission for any decision that may endanger their reelection. This means, however, that the EU can make even more decisions that do not represent the will of the people than is the case within the national arena.

Friedrich Hayek called the market a discovering mechanism<sup>23</sup>. 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. In economic terms, it could be said that communication changes the production function to fulfil individuals' preferences.

The Swiss experience shows that people's demand for discussion varies, depending on the importance of the issue in question. Some referenda motivate intensive and farreaching discussions that lead to a high rate of voter participation (e.g., the proposal to join the European Economic Area witnessed a participation rate of 79 percent, though the average turnout between 1985 and 1992 was only 42 percent). Referenda considered to be of little importance by the voters engender little discussion and low participation (as low as 25 percent).

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. The 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.

Switzerland again provides a suitable example. In 1989, a popular initiative demanded that the Swiss army be completely dismantled. To many

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<sup>22</sup> Vaubel, Roland (1986). "A Public Choice Approach to International Organisation". *Public Choice* 51: 39-57.

<sup>23</sup> Hayek, Friedrich A. (ed.) (1978). "Competition as Discovery Procedure". *New Studies in Philosophy, Politics, Economics and the History of Ideas*. London: Routledge & Kegan Paul.



Swiss, this was considered an attack against one of the most essential, almost sacred institutions of the country. The *classe politique* 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 percent).

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, by then, had been mandatory for all Swiss men — had been rejected in several referenda before, the last time in 1984 with a rejection rate of 64 percent. 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.

### Criticism of 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 in the sense that 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<sup>24</sup>. This task, they argue, should be left to an elite.

Following the individualistic view and taking individuals' preferences as the normative base for evaluation, such a charge is unacceptable. Compatibility with the citizens' preferences is valued higher than any possible technocratic brilliance. The voters, moreover, need not have detailed knowledge on the issues,

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<sup>24</sup> Direct and representative democracies are compared by Cronin, Thomas E. (1989). *Direct Democracy: The Politics of Initiative, Referendum and Recall*. Cambridge, Mass.: Harvard University Press; and David B. Magleby (1984). *Direct Legislation: Voting on Ballot Propositions in the United States*. Baltimore, Md.: John Hopkins University Press. The Swiss system is e.g. criticized in Hans Peter Hertig (1984). "Volksabstimmungen" (Referenda). *Handbuch des politischen Systems der Schweiz*. ed. by Ulrich Kloti, Bern, Switzerland: Haupt 2: 247-277.

but rather on the main questions at stake. These, however, are not of a technical nature but involve basic decisions (i.e., 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<sup>25</sup>.

This argument only holds, of course, if voters are given the opportunity to make their choices seriously. As has been pointed out for 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."<sup>26</sup>

Such obviously ineffective institutions, however, 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 in a representative democracy. It is, furthermore, not clear why the citizens are trusted to be able 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 elite, for a parliament, and a bureaucracy in a democracy. They are indispensable to provide information, work out the details, and assess the consequences of the various political issues at hand. This technical expertise of the representatives 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. This can be witnessed by 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.

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<sup>25</sup> Enzensberger, Hans Magnus, "Erbarmen mit den Politikern" (To have Mercy with Politicians). *Frankfurter Allgemeine Zeitung* (Frankfurt General Newspaper), 9 November 1992, p. 18.

<sup>26</sup> "Government in California: Buckling Under the Strain", *The Economist*, 13 February 1993, pp. 19-22.

Critics also point out that well organized interest groups might utilize direct democratic procedures for their own benefits. It cannot be denied that financially potent parties and pressure groups are better able to start initiatives and to engage in referendum propaganda than poor and non-organized interests. Again, there is no sense in having the impossible aspiration creating a totally egalitarian democracy where every citizen is a citizen-legislator<sup>27</sup>. Of course, there remain disparities in individuals' and groups' capacities to influence the direction of government. It is always true that rich and well organized groups wield more power.

The important question, however, is not if there are any disparities, but under which institutional arrangements or rules, organizational and financial advantages play a more important role. We argue that lobbying is more successful, the less democratic a system is, because even with no elections, as in dictatorships, interest groups do have channels of influence. For the European Union, it is argued that pressure groups are able to exert more power than in the former nation-states exactly because the EU is less democratic than its member states<sup>28</sup>. 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.

## Evaluation

Federalism is not an alternative to referenda but rather a prerequisite for the effective working of a direct democracy. In small communities, the information costs of voters when deciding on issues or judging representatives' performance are much lower than in a large jurisdiction. The more fiscal equivalence is guaranteed, the better the benefits of publicly supplied goods can be acknowledged and the corresponding costs be attributed to the relevant political programs or actors. Thus, while federalism provides for cheaper information, referenda enable citizens to use this knowledge effectively in the

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<sup>27</sup> The argument for a unitary democracy is presented in Mansbridge, Jane J. (1989). *Beyond Adversary Democracy*. New York: Basic Books.

<sup>28</sup> Bohnet, Iris (1991). "Interessenvertretung in der EG: Die Landwirtschaft". (Interest Representation in the Economic Community: Agriculture). Zürich: University of Zürich, Mimeo; Svein S. Andersen and Kjell A. Eliassen (September 1991). "European Community Lobbying." *European Journal of Political Research* 20: 173-187; and William S. Peirce (1991). "After 1992: The European Community and the Redistribution of Rents." *Kyklos* 44: 521-536.

political process.

The interdependence of federalism and referenda also works the other way around: Referenda improve the working of federalism. Besides the possibility of voting with their feet, citizens may also vote directly. This represents a double incentive for politicians to take their citizens' preferences into account; otherwise, they may lose their tax base to another jurisdiction or may be forced by referenda and initiatives to meet the demands of the voters.

Direct democracy and federalism are effective mechanisms to provide competition in the political arena. At the same time, they produce incentives for politicians to take the citizens' preferences into account. We do not argue, however, that referenda and federalism are the only institutions to prevent politicians from pursuing their own goals at taxpayers' expense. All democracies have recognized the potential danger lying in cartels among politicians and have therefore created institutions to prevent their appearance. Many constitutions know the division of executive, legislative, and judicial powers; the establishment of two houses of parliament; and electoral competition between parties.

Further constitutional devices are rules prohibiting the excessive appropriation of rents by politicians, the most stringent ones being against corruption. Courts of accounts are supposed to control politicians' and administrators' behaviour. In at least some respects, however, these institutions tend to widen the gap between what the decision-makers provide and what the population wishes.

Instead of relying on direct democratic institutions, individuals may also express their dissatisfaction in other ways. Governments can be forced to respond to citizens' wishes by various forms of protest, ranging from complaints by individuals to violent uprisings by the masses. If taxpayers do not have any ability to exit to another jurisdiction (as in the former communist countries), or if this kind of exit is relatively more expensive, they may prefer an internal exit to the shadow economy. In both cases, the rulers lose part of their power because the tax base and the area in which their regulations are followed shrink accordingly.

The "Swiss experience", nevertheless, suggests that all these institutions do not provide a sufficient safeguard against politicians' rent-seeking because they do not effectively fight political market failures. Initiatives and referenda, however, break the politicians' coalition by destroying their monopoly on agenda-setting and decision-making. Furthermore, they induce a discussion on

relevant issues and thus provide information for all citizens at a very low cost. The informational advantage of the *classe politique* shrinks.

By providing the exit option, federal competition undermines political externalities in the form of politicians' or pressure groups' rent-seeking. Fiscal federalism enables the citizens to judge the politicians' performance and compare it with differing jurisdictions. The federal subunits of Switzerland, the cantons, represent a good example of the interdependent working of federalism and direct democracy.

Even though this article refers to the "Swiss case", we suggest that the results are of general relevance, especially for a *future Europe*. Referenda and federalism provide better means of fulfilling individual preferences than any other constitutional device designed for breaking up politicians' cartels.

