

**Abstract:**

We examine the impact of Swiss fiscal equalization transfers following a reform in 2008 on the fiscal sustainability of cantonal governments between 2008 and 2020. Using a dynamic fixed-effects fiscal reaction model, we find that in response to a 1 percentage point increase in the debt-to-GDP ratio in the preceding year, cantonal governments increase their total primary surplus-to-GDP ratio on average by 0.12 percentage points. Once we exclude transfers from the resource equalization system from the primary surplus-to-GDP ratio, however, the response is 40 percent smaller indicating a dependency of cantonal fiscal sustainability on such transfers. The difference is driven by the fiscal power of the cantons as measured by the resource index, which determines transfers in the equalization system. Our findings indicate potential moral hazard created by the resource equalization system.