



VIEWPOINT:

Ten proposals for financial reform in Germany

Since 1949, the division of powers in Germany has shifted toward the federal government: the author argues for rebalancing these powers.

THEME III: THE ASSIGNMENT OF RESPONSIBILITIES AND FISCAL FEDERALISM

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"Whoever pays the piper calls the tune!" In a federal state, like the Federal Republic of Germany, the type and scope of federal, *Land* and municipal government activities depend on their financial resources and their powers in financial matters. As Udo Margedant and Werner Heun have shown, their activities are further limited by European legislation (see *references*).

As a solution to the problems faced by the *Länder* and the municipalities, I am advancing these 10 theses:

1. Admit that the jurisdictions of *Länder* and federal government are intertwined. The Constitution of the Federal Republic of Germany, the Basic Law of 1949, has been in effect for more than 50 years and during that time, the decision-making jurisdictions of the federal, *Land* and municipal governments have become highly intertwined. This is contrary to the basic concept of federalism and local autonomy. Many reforms in the regime and in practical policies have had the effect of transferring tasks and powers to the central government. In addition, the Federal Council or upper house, in which the *Land* governments are represented, has played an ever-greater legislative role. As Ursula Männle has shown, the result has been an erosion of the powers of the *Länder* parliaments (see *references*).
2. Distentangle the jurisdictions. A discussion has therefore arisen over how to disentangle and decentralize legal and legislative

powers (subsidiarity principle - see *box*). This is true, as well, of the financial regime and, in particular, the equalization payments between the federal government and the *Länder* and also among the *Länder*.

3. End the disconnect between power and responsibility. There is a great disconnect now between legislative powers and financial responsibility. The connectivity principle entrenched in the constitution – whoever creates and carries out a program must also pay for it – often does not apply to a large extent. There is more and more federal legislation that the *Länder* have to implement on their own and pay for. Federal legislation transfers programs to cities and municipalities, without any firm commitments on the part of the

federal government to contribute to the financing of them. As Wolfgang Renzsch has argued, there is an urgent need to reunite legislative authority and financial responsibility (see *references*) and to introduce a binding co-funding rate for the federal government when it creates cash benefits, for instance in social services.

4. Increase powers for the *Länder*. The leeway of the *Länder* to do as they see fit is too limited, especially by federal framework statutes and joint federal-*Land* programs (the construction of universities, economic development, etc.). Shared funding leads to high administrative costs, delays and inflexibility. Joint federal-*Land* programs should be eliminated.

Solidarity, subsidiarity, and connectivity

German social policy is based in large part on three key principles: subsidiarity, solidarity and connectivity.

"The solidarity principle can be derived from the welfare state principle. It means that members of a certain group, who are affected by similar risks, have to give each other mutual support ...

"The subsidiarity principle however contains the condition that certain groups of persons are to receive assistance from the outside only if their reasonable self-help is exhausted ... "

- *Lehrbuch der Sozialpolitik*, Heinz Lampert, Berlin: Springer, 1998, 5th edition

"The connectivity principle means that any legislature that transfers cost-incurring tasks to the cities, municipalities and districts, must also provide for their financing (Whoever orders must pay the bill)."

- Christian Democratic Party website, "Community politics", <http://www.cdu.de/politik-a-z/kommunal/kap57.htm>

5. End distortions to competition. Federal financial assistance distorts competition among the *Länder*. The federal financial assistance to prevent macro-economic disturbances and encourage economic growth should be eliminated. Equalization payments are so complicated that only experts now can understand them. They are also unfair because they disadvantage politically and economically successful *Länder*.
6. Give taxation powers to the *Länder*. A precondition of strong federalism is that the *Länder* have their own taxation powers. The *Länder* must not become dependent on the federal government. The *Länder* should have full authority to set regionally-applicable taxes (property taxes, motor vehicle taxes, inheritance taxes).
7. Give income tax powers to the *Länder*. Autonomy for the *Länder* in tax matters should be increased in regard to income tax and corporate tax as well.

Three orders of government in Germany

Bund: the federation – the federal government of the Federal Republic of Germany. Its powers were set out in the Basic Law of 1949 (*Grundgesetz*). The origins of the federation go back to the German Empire founded in 1871: there were 25 states in that federation, of which Prussia was by far the most powerful. Both Nazi Germany and the Communist German Democratic Republic (1949-1990) abolished the *Länder*, but the Federal Republic of Germany reinstated them. The so-called “eternity clause” in Article 79.3 of the *Grundgesetz* specifies that the federal system as such must never be abolished.

Land: one of 16 sub-national units in the Federal Republic of Germany. There were 11 *Länder* before the unification of Germany. Only three of them have exact historical antecedents – Hamburg, Bremen, and Bayern (Bavaria). The *Länder* have certain rights specified in the constitution, and possess residual rights for those rights not assigned to the federal government or listed as “concurrent rights”. The exclusive rights of the *Länder* are those of administration plus all those relating to police and public order, culture, the media and education.

Stadt, Gemeinde: city, municipality: the municipal order of government. In addition to the three city-states of Berlin, Hamburg and Bremen (which comprise three of the 16 *Länder*), there 13,682 cities and municipalities in Germany. They have differing powers: there are 112 *Kreisfreie Städte* or “cities without districts” that have the same powers as districts (*Kreisen*).

8. Autonomy for municipalities. The demand for autonomy in tax matters should also apply to cities and municipalities. In local

equalization payments, unearmarked transfers are preferable to transfers for specific purposes.

References ... in German

- Udo Margedant, “Grundzüge der deutschen Finanzordnung,” in *Föderalismusreform: die deutsche Finanzordnung auf dem Prüfstand, Zukunftsforum Politik* Nr. 44, published by the Konrad-Adenauer-Stiftung (St. Augustin, 2002), p. 7 – 18
- Werner Heun, Allocation of Tasks and Regimes of Public Finance Responsibilities between the Federal and other Levels of Government, General Report, in: Eibe Riedel (ed.), *Aufgabenverteilung und Finanzregime im Verhältnis zwischen dem Zentralstaat und seinen Untereinheiten, Schriften der Gesellschaft für Rechtsvergleichung*, vol. 195 (Baden-Baden, 2001), p. 17 – 33.
- Ursula Männle, “Thesen zur Reform der Finanzverfassung,” in *Zukunftsforum Politik* No. 44 (footnote 1), p. 19, 20.
- Wolfgang Rensch, Finanzausgleich und die Modernisierung des Bundesstaates. *Perspektiven nach dem Urteil des Bundesverfassungsgerichts* (Friedrich-Ebert-Stiftung: Bonn, 2000), p. 1 – 18.
- Kurt Döring, “Ein bisschen Wettbewerb” in *Frankfurter Allgemeine Zeitung* v. 14, May 2002, p. 10.

9. Enforce disentanglement, connectivity, transparency, subsidiarity. The watchwords for the reform of the financial regime are disentanglement, connectivity, transparency and subsidiarity (see box). There should be greater responsibility, competition should be facilitated, and decisions should be more easily monitored.
10. Renounce “federalism of equality”. We need to renounce the federalism of equality and redistribution and move to competitive federalism. This is not inconsistent with either equivalent living conditions within the federal state or the solidarity principle (see box). ☺