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

“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.

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 statues 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 …”

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.

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.

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).

References ... in German