



The “mother of all reforms”

German compromise ends standoff on federalism

BY MARGARET HECKEL

September 1, 2006, was the day many German politicians had laboured toward for many years.

On that day, their federal reform — the largest since 1949 — became law. Bavarian Premier Edmund Stoiber dubbed it “the mother of all reforms.”

The guiding principle of the reform was disentanglement of state and federal orders of decision-making. One of its goals had been to make it easier for ordinary people to figure out who was responsible for which law. Since Germany is a federal state, most legislation emanating from the *Bundestag*, the German lower house, had to be accepted also by the *Bundesrat*, the upper house, representing the 16 German states or *Länder*. Very often, the political colours in the *Bundestag* and the *Bundesrat* were not the same and the leaders of the *Länder* governments used the *Bundesrat* as their tool to oppose the federal government. Political stand-offs sometimes replaced collaboration, which led to less than ideal legislation. Even the leaders of the *Länder* at some point had to agree that this system had to be changed. The opportunity for approving sweeping federal reform came when the so-called “grand coalition” of Social Democrats and Christian Democrats stepped into power in autumn 2005: the partners had huge majorities in both chambers of the German legislature.

Länder take on more responsibility

Today, thanks to the reform, the *Bundesrat* has veto power over fewer laws — some say one-third, some say 40 per cent or higher — where it had been an estimated 60 per cent before. In exchange for this, the *Länder* are now solely responsible for education, law enforcement in prisons, the law regulating public demonstrations, paying their bureaucrats and even deciding when to open their shops. There are further changes of course, but these are the most

Margaret Heckel is the political editor of *Welt*, *Welt am Sonntag* and *Berliner Morgenpost*, published by Axel Springer Verlag in Berlin. Before joining Axel Springer Verlag in April 2006, she was political editor of *Financial Times Deutschland* and its Berlin bureau chief.



AP Photo: REUTERS/Manuela Hartling

*Six-year-olds on their first day of school in Berlin. Will all German children start school at the same age now that the *Länder* control education?*

important. The federal level, on the other hand, assumes more responsibility for nature conservation and water regulation.

In addition to Chancellor Merkel and her key coalition colleagues Edmund Stoiber and Kurt Beck, Interior Minister Wolfgang Schäuble also played a major role in the reforms. All in all, the reform loosened the reins on the *Länder* and allowed them a chance to change from a system of basically cooperative federalism to more competitive federalism. The cooperative federalism practised in Germany had proven to be very expensive: whenever the federal government in Berlin and the *Länder* could not agree on what to do, Berlin tried to buy off the other side. A classic example occurred in 1999 when Chancellor Gerhard Schröder and his coalition of Social Democrats and Greens decided to push a new tax reform through parliament. The *Bundesrat* was at that time dominated by the opposition, namely Christian Democrats, who wanted to derail the tax reform. Schröder tried to woo some Christian Democrat leaders of the *Länder* and succeeded — for example, by promising the Mayor of Berlin (the city of Berlin is a *Land* and has seats in the *Bundesrat*) money for his city in exchange for a positive vote for the tax reform. In this way, the reform passed — but the cost to the taxpayer was much higher than it otherwise might have been. The recent so called Hartz legislation for labour market reform is another case in point. Again, some *Länder* agreed only after the Bund put much more money on the table.

Advent of competitive federalism?

However, there are those who fear that the move towards a more competitive federalism will have its downside. The areas about which they are most concerned are education, environment and the payment of local employees and state civil servants, including teachers and police officers. While some of these fears may be valid, others are an expression of unhappiness with competitive systems in general.



German Interior Minister Wolfgang Schäuble

As an example, take pay scales for state and local employees. Police officers of similar rank and age are paid the same in the *Land* of Bavaria in the south of Germany as they are in Schleswig-Holstein in the north. There are differences between eastern and western Germany, but none within eastern Germany itself — say Thuringia or Saxony. In principle, Bavaria could decide to give new police officers a 10 per cent raise, perhaps because there were too many vacancies and safety in Bavarian streets was deemed to be threatened. It would then be quite possible that police staff from Thuringia and even Schleswig-Holstein might move to Bavaria to work there for the higher wage. Of course, this would worry the finance ministers of both Thuringia and Schleswig-Holstein, if they couldn't follow suit and now had vacancies to fill themselves. In market systems, that's the way things work, but for Germany, it is a new experience that hasn't been put to the test — hence the resistance. Meanwhile, unions are ready to argue the other way around: they fear that standards of pay and working conditions will enter a downward competitive spiral once the *Länder* can make such decisions on their own.

In the area of education, the worry is more that common standards will be given up and replaced by 16 different *Länder* regulations. However, there has been no national curriculum in the past and almost none of the standardized testing common in countries like Great Britain or the United States.

Nonetheless, the *Länder* now have almost complete autonomy concerning their primary, secondary and university systems. Baden-Württemberg, for example, could now decide that all five year olds will attend first grade, whereas neighbouring Bavaria might decide that school should begin only at age seven. The disadvantages are obvious: a family moving from Bavaria to Baden-Württemberg with pre-school children would find itself in trouble. In practice, no sensible education minister of any *Land* would do anything like this. But the potential lines of conflict are there — and they will have to be addressed by complicated negotiation among all 16 education ministers of the *Länder*, including their federal counterpart. And it is clear that such autonomy will have to be followed by more rigorous testing on the national level to make sure that all *Länder* are meeting minimum educational standards. This is, in fact, already happening, prompted also by the shocking figures from the Pisa education study of the Organization for Economic Cooperation and Development

(OECD) — a study that showed Germany as lagging severely behind most industrialized nations in educational achievement.

In the area of the environment, the federal authorities can now work out a national nature conservation law. However, in some aspects the *Länder* can “opt out” or choose not to participate in a federal law. The reason for these strange exemptions stems from the need for compromise: neither *Berlin* nor the *Länder* would give up their rights and so, in some areas, the new federal reform suffers from the same bad compromises that plagued it before. In principle, a big recycling company active in all 16 *Länder* can now hope for common legislation to govern such business in all of Germany. Were things to go wrong, however, the company could also encounter 16 different regulations for their work. Whether common sense will prevail over the individual interests of the *Länder* remains to be seen.

Another area in which the “mother of all reforms” is definitely wanting is finance reform. Finance reform was excluded from the talks because all politicians involved feared that not even the majorities of the grand coalition were big enough for agreement on this extremely controversial subject. There will be talks on finance reform in the future, in a so-called Federal Reform II, but almost no one in Germany is confident that much will be achieved.

The reason for the complicated structure of finance flows between states that has evolved since 1945 is that most taxes, with only a few exceptions, were and still remain under federal legislation. Income tax, for example, is divided among *Berlin* (42.5 per cent), the *Länder* (42.5 per cent) and local communities and cities (15 per cent). Fifty per cent of all corporate tax goes into federal coffers; 50 per

Continued on page 12

Germany at a Glance

Name: Federal Republic of Germany
(*Bundesrepublik Deutschland*)

Capital: Berlin

Constituent units: 16 *Länder*

Central Government:

Head of State: President (*Bundespräsident*)

Elected by: Members of the *Bundestag* and an equal number of members of *Länder* legislatures

Government Leader: Chancellor (*Bundeskanzler* / *Bundeskanzlerin*)

Elected by: *Bundestag*

Lower house: *Bundestag* with 614 members

Elected by: General election with mixed proportional representation

Upper house: *Bundesrat* with 69 members

Elected by: Governments of the *Länder*

German compromise ends standoff on federalism

cent into *Länder* coffers; Germany's value added tax, for example, is also divided among the three layers of the state — and is constantly shifting, too. What makes the system even more complicated is that most taxes are also divided among “wealthy” and “poor” *Länder* — with the wealthier obliged to subsidize the poorer. If the poor ones amass too much debt, they have to be bailed out — as were Bremen and Saarland, for example. Many argue that this system leads to collective irresponsibility because the poor *Länder* know that someone will always foot the bill for their “extravagance.”

Yet on Oct. 19, 2006, a verdict from the German Constitutional Court regarding the city of Berlin stated that the city did not deserve a bail-out. Berlin had amassed roughly 60 billion euros of debt and pleaded in court that it couldn't manage without a contribution from the federal government and the other *Länder*. One of the justices of the court, based in Karlsruhe, took the Berlin slogan, “Poor but sexy” and turned it on its head, saying that perhaps Berlin was sexy because it was not poor. The ruling has effects on the dimension of federal finance reform for the future.

Much remains to be done with federal reform in Germany. In its early years, federalism served the country quite well. As laws got ever more complicated, though, only a few experts knew who was responsible for what and who really had to foot the bill. This situation did not benefit the federal state, as its citizens came to see federalism more as an obstacle than an achievement. It is promising that after so many years, Germany has finally embarked on federal reform. And it would be more promising still if the country could find the courage to embark on federal finance reform as well. 