PETER MÜLLER
Premier explains Saarland’s innovations as a German state
INTERVIEW BY FELIX KNÜPLING

Germany, the largest federal country in the European Union, became the Federal Republic of Germany in 1949. It has had a tradition of federalism both in the Weimar Republic from 1919 to 1933 and previously in the time of the German Empire, from 1871 to 1919. Germany’s 16 states participate in the federal legislative process through the Bundesrat, Germany’s upper house. All state governments are entitled to a specified number of seats in the Bundesrat based on their population.

In this issue, Federations interviews Peter Müller, Premier of the German state of Saarland. Premier Müller speaks, among other topics, about innovation, autonomy and diversity among Germany’s 16 states*.

Prior to becoming the Premier of Saarland in 1999, he served from 1990 as a member of the state parliament of Saarland. From 1994 through 1999, he was Chairman of the Saarland Christian Democratic Union political caucus as well as Leader of the Opposition. Mr. Müller was recently elected President of the Bundesrat, a post he took up on Nov. 1, 2008.

Premier Müller was interviewed by Felix Knüpling, the Forum’s Director of European Programs.

* Germany has 16 subnational units called Länder ("states" in English).

FEDERATIONS: What does federalism mean to you?

PREMIER MÜLLER: Federalism is an expression of the regional autonomy and cultural diversity of a country. It’s a bulwark against a centralism that discourages innovations and against the counterproductive concentration of power; therefore, it is an important element of a living democracy. It’s easier to focus on the specific situation of a particular region and the needs of its citizens in a federal country. Federalism is an institutionalized driver of innovation, since it promotes creative competition among different political models. However, to prevent this competition from becoming detrimental to the living conditions and future potential of individual regions, we need a fair set of rules and comparable opportunities right from the start. Unfortunately, this is currently not the case in Germany, primarily because of the current structure of financial equalization among the states.

FEDERATIONS: What is Saarland doing that is different or better than its neighbour, Rheinland-Palatinate?

PREMIER MÜLLER: Saarland consistently takes responsibility for how it structures its own programs. If there’s a need to take action, we don’t wait for the other states to do something; we just go ahead and do it – as we did in the case of early childhood education or the increased protection of young children against abuse and neglect. Saarland is also aware of its role as a leader, even if the other states don’t immediately approve. For example, when Saarland was the first state to make the third year of kindergarten free of charge, Rheinland-Palatinate was initially very critical of this decision—then decided to adopt the same measure.

FEDERATIONS: In a recent poll, one quarter of all Germans said they were in favour of eliminating the states.

PREMIER MÜLLER: This survey confirms my opinion that we shouldn’t take the important cornerstones of our basic democratic order for granted, but rather that we should campaign for its acceptance every single day. I’m convinced: if everyone noticed that the alternative to federalism — namely centralization — means less innovation, less citizen involvement and inequitable living conditions, then the minority of those polled would join the majority.

FEDERATIONS: A majority of Saarlanders could see a merger with Rheinland-Palatinate.

PREMIER MÜLLER: After countless personal conversations, and in light of other surveys, it seems highly unlikely to me that a majority of Saarlanders really would like to merge with Rheinland-Palatinate. Aside from the difficult “technicalities”, such as the question of a new state capital, a merger wouldn’t solve any problems. It wouldn’t solve the budget crisis and it would only lead to new problems in areas such as economic and regional policies.

FEDERATIONS: Many of your party colleagues in the CDU often talk about the need for more competitive thinking in support of the solidarity and equalization on which German federalism rests. What do you think?

PREMIER MÜLLER: Thinking competitively is also a basic element of German federalism. However, for constructive competition to develop, there has to be an appropriate set of framework conditions that allow all the states to start from the same point. That’s why, in my opinion, the Commission for the Modernization of Federal-State Financial Relations (Kommission zur Modernisierung der Bund-Länder-Finanzbeziehungen) must find a fully
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If the rights of the... on their responsibilities. All states
need to see a balanced budget. In the
process, various prior financial commit-
ments will have to be taken into account.
Then, and only then, will competition be
possible.

Federations: Because of its budget crisis,
Saarland has gone to the Federal
Constitutional Court seeking increased
support from the federal government. It
and the other states believe that Saarland
can achieve a balanced budget on its
own. What funding efforts would you
introduce for the future?

Premier Müller: During a sitting of the
Commission for the Modernization of
Federal-State Financial Relations a few
weeks ago, it was confirmed, as part of an
analysis of the state budgets of Bremen,
Saarland and Schleswig-Holstein, that
Saarland has the lowest structural expen-
ditures of all the states. To date, we’ve
severely restricted our spending and, in
future, we’ll benefit from the structural
savings measures that we introduced
years ago. The amount and rate of
increase are well below those of the
national average. We’ve already consist-
tently cut costs. What’s more, I don’t see
the potential for any further reductions.
The call by some commissioners for addi-
tional and more serious reductions to
achieve a balanced budget without any
funding help would only mean that com-
parable living conditions throughout the
federal republic could no longer be guar-
anteed and that the quality of life enjoyed
in a particular state would greatly suffer.

Federations: In general, what results do
you expect to see from the Commission,
of which you are a member?

Premier Müller: We have a clearly defined
goal: to stop the move to debtor nation
that Germany began during the major
financial reform of the late 1960s. To do
this, the new indebtedness must be
turned as far back as possible to zero. If
we can codify and actually maintain this
on a continuing basis, then we’ve
achieved the first success. Because of
their structural differences, various states
are currently not in a position to respect
the current limits on borrowing, nor will
they be in a position in future to comply
with even stricter limits. The funding
assistance proposed by the co-chairmen
of the Commission represents a first step
that, along with other tools, will allow all
states to approve tighter controls on new
indebtedness. In a second step, once a
structurally balanced budget is achieved,
it will be possible to focus on debt
reduction.

Federations: In your opinion, can the
Commission reach a long-term, sustain-
able solution when politically sensitive
issues, such as financial equalization
among the states or restructuring, are
ignored?

Premier Müller: Yes. We shouldn’t set
the bar too high with respect to the
demands made on the Commission.
Just a few years ago, we were going
through the greatest public financial
crisis in the history of the Federal
Republic of Germany. Every year,
Germany fails to meet the requirements
of the European Stability and Growth
Pact. Therefore, if we succeed in agree-
ing on a strict new-indebtedness rule in
conjunction with funding assistance,
this would be a major achievement and
a prerequisite for discussions to be held
in a few years, as part of Federalism
Reform III, on reforming financial
equalization and on working together to
reduce old debts.

Federations: Does the call for tax relief
made, in fact, by your party, threaten the
Commission’s chances for success?

Premier Müller: Our overriding goal is the
funding of government budgets, bearing
in mind our responsibility towards future
generations. The earliest the federal
budget will not need to incur new debts
will be 2011, which is why extensive tax-
reduction models can no longer be
implemented during this legislative
period. Therefore, I consider it simply
irresponsible to promise people signifi-
cant tax cuts for as early as next year. Tax
relief is essential, but only through a step-
by-step process implemented over time
and that doesn’t call into question bud-
getary restructuring. I’m confident that
the Commission, when it meets for the
last time in mid-October, will decide on a
conclusive, total package that will take us
on the road away from being a debtor
nation.

Federations: The Swiss cantons or
Canadian provinces have a lot more
authority when it comes to tax revenues
than the German states. Would you like
to see more decentralized responsibility
in this area?

Premier Müller: Greater fiscal autonomy
basically needs to be looked at from two
perspectives. On the one hand, it would
offer the states the possibility, on the
revenue side, to make the new debt
restrictions more manageable and to
gain more room to manoeuvre. On the
other hand, the risk of a competition that
may, by its very nature, lead to a decline,
always exists, with long-term, negative
implications for all the states. Therefore,
greater fiscal autonomy could only be
justified if the initial conditions were the
same for all the states and it could only exist
in a narrowly defined context to avoid
tax rates from drifting further apart,
with the corresponding economic and
political ramifications.

Federations: The federal states are
involved in the decision-making process
at the European level. When it comes to
matters that directly impact their areas of
responsibility, such as education and
culture, they sit at the negotiating table in
Brussels. What importance does any
development at the European level have
for federalism in Germany?

Premier Müller: If the rights of the
German states to participate in European
policy-making stipulated in the Basic
Law and in European provisions are con-
sistently respected, then European
integration will have no negative impact
on the states of Germany. In this respect,
it is important that the Treaty of Lisbon
be implemented, despite its rejection by
Irish voters, because it reinforces the
principle of subsidiarity. I also believe
that Europe promotes German federal-
ism, since it facilitates co-operation
between municipalities and states across
national boundaries. In this way,
European development offers many pos-
sibilities for each region to realize its
potential. We must always take advan-
tage of these opportunities.
**Federations:** What are the major questions relating to German federalism that will have to be answered in the next 10 to 20 years?

**Premier Müller:** Intergenerational equity, in my mind, is the topic that will influence the discussion on the future of German federalism over the next few years. We need to ensure that we don’t negatively impact the chances of future generations by leaving behind major debts and an outdated infrastructure. This will mean consolidating our budgets without neglecting important investments in the future. Given the fact that major future investments—whether they’re in the areas of education, childcare, health and long-term care or transportation infrastructure—are all definitely the responsibility of the states, intergenerational equity will be more relevant at the state level than at the federal level. We need to be ready to take up this challenge.

**India VAT [FROM PAGE 27]**

government and the states would share the revenue, and whether different states could set varying tax rates. A second question was who would collect the new tax—the central government or states? India had observed how a VAT was introduced relatively effectively in Canada. It took negative lessons from the experience of Brazil in how not to introduce a VAT, since in Brazil the federal government and states each impose different VATs.

Next came the question of how to implement a GST (Goods and Services Tax) by combining the existing Service Tax with VAT. The key question, before implementation of a GST system became universal in India this year, was the state of the existing VAT, which is neither uniform nor comprehensive—goals long sought by economists, businesses and most politicians.

**Debate over tax rates**

Each federation’s VAT has three essential aspects to it: the tax base (the value of the taxed item), the tax rate and the mechanism for collection.

There are three lists of powers in India’s federal constitution: the Union list, or powers of the central government; the state list, or powers of states; and the concurrent list, or powers shared by states and the centre.

India’s constitution gives taxation power to the central government for levying customs duties on imports and exports and excise duty on manufactured goods, in addition to the power to tax services.

India’s list of state-government powers includes the power to tax the sale of goods. The states implemented a state VAT with four rates: zero for commodities (unprocessed and natural products) and those with social implications; one per cent for gold, silver, ornaments and bulk-auctioned tea; four per cent for raw materials, medicines and drugs, capital goods and nearly 300 other categories; and 12.5 per cent on remaining items, which are usually manufactured goods. The list has varied over time.

Although the central government’s eventual objective is to have a uniform rate, many locally important goods were presented as special cases deserving lower rates.

Gradually, more exceptions began to appear. The latest came in March 2007 when the state of West Bengal announced reduced duties on industrial components and items such as kerosene. Some economists support this practice in the name of fiscal federalism, but others call it “fiscal mayhem.”

‘Complicated bookkeeping’

The state VAT is applied up to and including the retail stage though. Sometimes retailers absorb the VAT, especially when they are clearing stock.

For merchants, keeping the necessary financial records for the VAT is complicated. For one thing, an input-tax credit is given only for materials or labour purchased in the same state. A further frustration is that no credit is given for payment of the central sales tax that has not yet been merged into the VAT. This is an inter-state sales tax imposed by the state in which the goods are sold. This tax was four per cent in 2005, is now two per cent and is to be reduced to zero by 2010. However, the loss to the states, especially major exporting states, will possibly be offset by the central government.

Thus the successful merger of India’s sales and manufacturing taxes into a VAT and CENVAT is only the first step. Many economists and governments have their eye on something bigger. Their ultimate goal is to create a more encompassing tax to extend the VAT to services, as well as goods. This is called the goods and services tax or GST.

Giving states the right to charge a services tax would be a crucial step in this regard. Discussions are underway between the central government and the states on a GST. A committee analyzing political and economic relations between governments may recommend sweeping changes in the federal structure. These discussions have taken place behind closed doors, but media reports speculate that both states and the central government will have their own GST, which will be called the dual GST.

The unanswered administrative question is: “Who will collect a tax on a single combined base—the central government or the states?” It may be very difficult to get the states and the central government to agree on an answer.

In the end, there could be one of three possible solutions:
- a single nation-wide GST collected by the central government
- a single GST collected by the states—possibly with different rates in each state
- a “dual GST” composed of a state GST and a central government GST

If India were to give up on establishing a single national GST, then the existing CENVAT could be merged with service tax at the state level. The current VAT could be improved by allowing an inter-state input credit, establishing just one or two tax rates rather than the four existing ones. No serious attempt has been made by current governments at the state and central levels to move in this direction.

At the national level, the central budget for 2008-2009, announced in February 2008, was the last effective budget of the current government and another budget will be presented after the next national election. Thus, analysts do not expect that there is much of a chance of a comprehensive GST even by April 2010.