

## Reforming Fiscal Federalism in Germany - Learning from International Experiences

In December 2019 the legal basis of the fiscal equalization scheme in Germany will phase out. For the time afterwards a new agreement between the nation level (Federation) and the states (*Länder*) is needed. Last year around 26.4 billion Euro were transferred within the equalization scheme between the Federation and the *Länder*. Despite huge transfers since 1990, the Eastern German *Länder* are still fiscally only half as strong as their western counterparts. Though they made some progress in economic terms their original tax income basis is comparatively weak. Further, they are suffering under the demographic development. But nowadays, also some regions in Western Germany – particularly in North-Rhine Westphalia, Saarland and Rhineland-Palatinate – are pushing for more financial aid from the Federation and the *Länder*. A high number of North-Rhine Westphalian cities, e. g., is highly indebted and not able to invest in public infrastructure anymore.

These developments raise the general question of how to design a fiscally appropriate equalization scheme post 2019 that builds on political consensus. Not surprisingly, the debate about how a future agreement could be shaped has already begun and different political actors are in search for new ideas and adequate arguments to underline their positions. It is anticipated that negotiations about this part of the German fiscal constitution will be quite controversial, hard-bitten and time-consuming.

The federalism reform debate in Germany over the past ten years was characterized by many as having suffered from a gap between high expectations about possible outcomes on the one hand and the limited results of different political processes on the other hand. One reason for this mismatch can be found in the *leitmotifs* which dominated the debate. While one part of the political and academic actors involved is arguing in line with the theory of fiscal federalism for more autonomy of the *Länder* and more competition between them, the opponents are stressing the need to foster solidarity between the federal partners and for the implementation of “comparable living standards” as stipulated in the *Basic Law* (“Grundgesetz”). One of the overarching aspects in all these discussions is the entanglement of the federal negotiation structures which require that the Federation and the *Länder* collaborate on a wide range of policy fields.

Past federal reforms in Germany were always conceptualized incrementally and focused on single pillars of the (fiscal) constitution instead of big-bang-reforms. So, e.g., fiscal issues were almost completely excluded in the 2003 to 2006 negotiations between the Federation and the *Länder* during “Federalism Reform I”. “Federalism Reform II” from 2009 focused mainly on the introduction of a “debt brake” to reduce future public debts. In June 2011 a reform of the local financial system failed in its second attempt since the Federation and the *Länder* could not find a solution to reform the local business tax (“Gewerbesteuer”).

Although the global financial crisis 2008/2009 did not hit Germany as hard as other EU member states, the public debt of the three federal levels is still increasing. Moreover, the federal balance between the three jurisdictional levels was heavily influenced since the Federation in general and the executive branches in particular took over the leading role in crisis management – both in negotiations with the European partners as well as in financial terms. Since the financial crisis is still ongoing it is obvious that a continuous overstretch of federal and parliamentary procedures is jeopardizing the whole federal architecture and particularly the autonomy of the *Länder*.

## **Structure of the Workshop**

**To be held at the *Bundesrat* (Federal Council) on June 19, 2012, in Berlin**

On this background, the Forum of Federations is proposing to discuss some issues pertinent to the current German debate on fiscal federalism from a comparative perspective.

The objectives of the workshop are:

- to share some lessons-learnt from other countries;
- to help generate some new perspectives and ideas for a reform of German federalism;
- to discuss more the general needs and prerequisites for a reform than the details of the current German federal system;
- to discuss off the beaten tracks and beyond conventional paradigms.

The workshop is designed as an open roundtable discussion and by-invitation only (20-25 participants). The workshop will be introduced by an overview presentation including a comment on the current state of German fiscal federalism. Each of the four following panels would consist of a short introductory statement (20min) from a German expert followed by a comment from an international participant (10min) to leave enough room for discussion.

The workshop will be held in German and English (simultaneous translation).

The questions to be discussed at the roundtable can be found in the agenda.

## Agenda

June 19, 2012

8:45 Welcome

9:00-9:30 Introduction: Current and Future Challenges for Fiscal Federalism in Germany

Presentation by Prof. Thomas Lenk (20 min)

Comment by Prof. Dr. Georg Milbradt (15 min)

9:45 – 11:00 Session 1: Leitmotifs and Underlying Values of Fiscal Equalization

Introductory Statement: Prof. Dr. Wolfgang Renzsch, University of Magdeburg (20min)

Comment by: Ramón Galindo, President of the Senate Committee on Municipal Development, and Member of the Committee on State Reform, Mexico (10min)

- Which leitmotifs/general principles do exist in different federations regarding the solidarity between the federal levels?
- Do constitutional statements like the following one exist also in other federations: “The Federation shall have the right to legislate ... if and to the extent **that the establishment of equivalent living conditions** throughout the federal territory throughout or the maintenance of **legal or economic unity** renders federal regulation necessary in the national interest.” (§ 72 of the German Basic Law)?
- Which legal quality do these principles have? Constitutionally binding? Enforceable by the federal partners?
- How are these statements interpreted by the courts, the public and the political elites?
- Which financial mechanisms do exist to achieve the stated solidarity within in the federation?
- How is the political culture of single federations shaped by federal or unitarian ideas?
- Which conflicts are caused by different leitmotifs? How are they solved politically? Which consensus was reached?
- Which possible change of the political leitmotifs took place over the last decades? What were the reasons for it?

10:45-11:15 Coffee Break

11:15 – 12:30 Session 2: Political Crisis Mechanisms – Learning from the GFC

Introductory Statement: Prof. Dr. Lars Feld, University of Freiburg (20min)

Comment by: Dr Vijay Kelkar, Chairman, Forum of Federations (10min)

- Which mechanisms were used or even newly set up to manage the impacts of the global financial and economic crisis in different federations?
- Which sort of “Firewall” was created?
- Which legal quality do these mechanisms have? Constitutional law? Federal law? Enforceable by the federal partners?

- Which measures were taken to protect the autonomy of the constituent units in the course of the crisis management?
- When will they terminate?
- Which long-term costs have to be covered by the different federal levels?
- Which formula was chosen to apportion the costs between the different federal levels for the crisis management?

12:30 – 14:00 Lunch

**14:00 – 15:15 Session3: Debt Rules and Fiscal Equalization**

**Introductory Statement: Prof. Gisela Faerber, University of Speyer (20 Min)**

**Comment by: Roger Wilkins, Secretary to the Attorney-General, Government of Australia (10 Min)**

- What are the rules to manage debt?
- Are there “No-bailout”-rules? Which (financial) aid from central government do constituent units get in a case of high indebtedness?
- How are fiscal equalization schemes constructed? Do horizontal equalization transfers exist? Which experiences were made with vertical block grants? On which basis/formula are these grants calculated? In which way are particular demands of the constituent units addressed?
- To which extent is public borrowing comprised in the calculations of the financial transfers within the equalization scheme?
- Are national governments allowed to use negative sanctions when single federal states are highly indebted? Which role do courts, audit courts and parliaments play in this case?

15:15-15:45 Coffee Break

**15:45 – 17:00 Roundtable Discussion: Designing the Political Process**

**Introductory Statement: Prof. Wolfgang Benz, University of Darmstadt (20 Min)**

**Comment by: Hansjoerg Bloechliger, OECD Fiscal Relations Network (10 Min)**

- Which institutions and procedures are promising to develop a broader and innovative political compromise?
- Which actors should be involved? What should be the role of “independent” actors?
- What should be the role of academic experts? Which possibilities do exist to close the gap between highly theoretical academic approaches and the practical necessities in federal practice?
- In which way should representatives of the municipalities be involved?
- Which experiences were made with the convent format?
- How should the public be involved? Which experiences do exist regarding web-based participation and collaboration tools?