

The federal system in Germany from the perspective of a German federal state

Ladies and Gentlemen,

The European Union and in particular the Eurozone countries are facing enormous challenges: the strengthening of economic growth, the combat of unemployment and the lasting consolidation of public budgets dominate the political agenda.

Germany has made considerable achievements in these areas in recent years. The German economy has grown soundly, increasing by 1.4 % in 2014.

Unemployment has been decreasing for years. With a rate of 5.1 % it is now well below the European average of 10%. Last but not least: The budgets have been balanced since 2012.

Today, we can hardly imagine that just ten years ago, Germany was known as “the sick man of Europe“. My country was considered to be incapable of reform and a considerable part of the blame for this was placed on the existing federal system.

However, the successful economic turnaround happened not in spite of Germany’s strong federal structure, but possibly because of it. It is apparently far better than its reputation. So, what are the strengths of the German form of federalism? What are the weaknesses?

First of all, I want to point out the high degree of stability of our federal system. It is designed in a way that all administrative levels have to work together constructively in almost any far-reaching political decision on structural matters. On the one hand, the positive effect is that the federal, the federal states and local levels are competing for the best ideas. On the other hand, there is much less of a risk that decisions made on the basis of consensus will be changed again because of a new government, ensuring planning reliability and high political stability.

In this respect, the Federal Council of Germany plays a key role. Its powers range from the right to participate in the decision-making process on proposals for new legislation affecting the federal states to rights to propose legislation and the exchange of information. The Federal Council of Germany is made up of members of the various federal state governments and thus ensures that the interests of the federal states are defended in the formation of the political will of the Federation as a whole. Perhaps, the organisation of the Federal Council of Germany can serve as a guide for the constitutional reform and the reform plans for the Italian second chamber, the Senate, which are currently being discussed in Italy. *[Background: Visit of Italian members of Parliament to the Federal Council of Germany in December 2014]*

Secondly, our system is so balanced that no administrative level can dominate the other. This will ensure that there is neither an overly powerful central state nor a proliferation of small states, also known by the term scattered regionalism. In my opinion, both of these extremes are inefficient and have an adverse effect on a country's growth prospects.

And thirdly, Germany's constitution (the Basic Law) guarantees that all administrative levels receive appropriate financial resources to fulfil the tasks allotted to them. The objective of the distribution of tax revenue under the German constitution is that the various levels receive general funds which are not legally tied to a specific purpose.

This is achieved by a system of distribution and redistribution of tax revenue which is complex and of an equalizing nature. That is why the financial equalisation system in Germany is one of the cornerstones of fiscal stability. Thus, the direct responsibility of the federal states manifests itself almost entirely on the expenditure side. As far as the income side is concerned, the federal states have only limited rights. The strong codification is characteristic of the German system. The legal status of the individual local authorities, their rights and obligations, but also their financial resources are largely guaranteed under German constitutional law and thus outside of the sphere of day-to-day politics.

This also makes it clear that the local authorities in principle take responsibility for their own decisions.

In this respect, the judgment of the Federal Constitutional Court in the year 2006 sets a precedent. In dismissing the action of the federal state of Berlin for financial assistance for federal states affected by budget crisis, the Federal Constitutional Court clearly strengthened the “no bail-out” principle and thus the direct responsibility of the federal states under German constitutional law.

In fact, we have had good experience in strengthening the financial resources of the federal states in order to align their financing with their responsibility.

The example of Germany shows that concerns that a federal system is an obstacle to overcoming the crisis, raised in Europe in the wake of the financial and debt crisis, are unfounded.

In this context, in particular, it is also becoming clear that “all that glitters is not gold“. In Germany, too, there is – as in any federal system – a tension between direct responsibility and shared responsibility.

The German system, with its strongly consensual culture, has largely an equalising effect within Germany. With a few exceptions, the same norms and standards apply throughout Germany, for example, in the field of tax and social policy. In my opinion, here already, we would need to be more courageous in pursuing a stronger diversification in a number of issues.

It seems even more difficult to me that the financial equalisation system among the federal states, too, is very much influenced by the idea of equality - some critics say, too much. The financial equalisation system in Germany basically ensures that in the end, each federal state has more or less the same financial resources at its disposal - regardless of its economic success. In principle, the criterion for the distribution of tax revenue is the federal state's population - irrespective of its economic performance or special needs.

The measure for redistribution is the tax revenue. In a complicated procedure, the entire tax revenue is first distributed to the Federation and the various federal states and then there is financial equalisation among the federal states, so that in the end, all federal states will have a more or less average level of funding. The only exceptions are the city-states (Berlin, Hamburg and Bremen) that are granted additional funds to compensate their higher financial requirements as well as the new eastern German federal states, which receive supplementary federal grants (to be gradually phased out by 2019) in order to compensate special needs as a result of the division of Germany.

However, the price for this high level of redistribution and the “equivalent living conditions“ guaranteed by the German constitution is a high level of adjustment amounts for the fiscally strong federal states, in particular, the economically successful southern German federal states Bavaria, Baden-Württemberg and Hessen. Under the horizontal distribution of tax revenue, they had to bear the adjustment amounts of 9 billion Euros in 2015 almost alone and have to pay up to a tenth, sometimes even more, of their tax revenues to the other federal states.

Naturally, this has provoked controversy about the appropriateness of financial adjustment payments. It would be fatal for the German economy, if the few metropolitan areas, determining the dynamics of the economy to a great extent, did not have sufficient access to the financial resources generated by them.

Apart from this general incentivisation issue, I would like to highlight the special status of the three city-states Berlin, Hamburg and Bremen in this context as well. They all receive preferred treatment (such as the specific weighting of population) under the financial equalisation system, while all other territorial federal states are treated equally.

However, no differentiation is made as to whether these federal states have regions with high population densities (with correspondingly above-average financial requirements) which are comparable to the city-states or not.

However, we are also dealing with other issues at the moment:

- In the eastern German federal states, almost 25 years after German reunification, there is still no self-sustaining economic growth,
- dealing with demographic change will put considerable additional strain on public budgets and
- despite all adjustment payments, substantial disparities exist among the various federal states but also within the federal states.

Currently, the Federation and the federal states are trying to find satisfying answers for these challenges. Nevertheless, I am confident that in the end, we will once again be able to find a successful solution, achieving a fair balance between the interests of the Federation and the federal states as well as among the federal states themselves and strengthening Germany as a whole.

Thank you for your attention.