



Germany: model budgets for the former GDR Länder

This year, the country that introduced the 'golden rule'¹ and also a 'debt brake' (Schuldenbremse) in 2011, has passed a milestone which is as important as it is symbolic: for the first time all the five 'new Länder' and the City of Berlin together ended the financial year with a budgetary surplus. That surplus will mainly be used for debt repayment.

The 'Länderfinanzausgleich' (financial compensation mechanism), which has been in existence since 1950 and is enshrined in Article 107² of the Basic Law, operates at two levels: a vertical level between the Länder and the Bund (the Federation) and a horizontal level between all sixteen Länder. Although the first level is fairly well accepted, the second level remains highly controversial, even though it is based on the principle of solidarity. For example, it has given rise to the ideas of 'Geber- und Nehmerländer' (donor and recipient States), and has even prolonged the existence of situations which some of them have ultimately been no longer willing to accept, to the point that they have lodged a complaint with the Constitutional Court³.

The incorporation into the system in 1995 of the five 'new Länder' (Brandenburg, Mecklenburg-Western Pomerania, Saxony, Saxony-Anhalt and Thuringia) and East Berlin, which made up the former GDR, inevitably resulted in a reshuffling of the cards in this federal redistribution system. The disastrous economic situation on the other side of the former Iron Curtain meant that Germany had to make an unprecedented effort to try to harmonise the situation in the Eastern and Western parts of the country. The 'Aufbau Ost' (reconstruction of the East) programme, funded by 'Solidarpakte' (solidarity pacts) I and II demanded very large contributions from the Western Länder.

Good results that cannot fail to have repercussions

Twenty five years after the fall of the Berlin Wall, the wheel seems to have come full circle. On 23 April of this year, the Federal Ministry of Finance, which publishes an annual report on the budgetary situation in the Länder, announced that the five new Länder and the City of Berlin, together with Schleswig-Holstein, have joined Bavaria in the ranks of the States showing a surplus⁴. On the contrary, the situation was reversed in the Länder that have long been classed as 'rich', such as Baden-Württemberg or Hessen.

At first sight, it would be tempting to explain the reversal of this trend by the equalisation achieved by the financial compensation mechanism and to consider how long it would have taken to eradicate the disparities between the two parts of the country. However, the situation is more complex: even if they have proportionally benefited over this period from a larger volume of federal subsidies and European funds, the new Länder, which were under extreme pressure, have implemented extremely rigorous budgets. It is worth noting, for example, that personnel costs in those States account for only 24 %, whereas in the West they are as high as 38 %⁵. Added to this, there is the historical

¹ See *Responsive Public Management* N° 41, January 2012.

² 'Every citizen in Germany must be able to enjoy the same standard of living, regardless of the fiscal revenues of the Land in which he/she lives.'

³ <http://www.dw.de/länderfinanzausgleich-solidarität-am-ende/a-16638734>.

⁴ <http://www.spiegel.de/wirtschaft/soziales/finanzen-der-laender-bayern-hat-den-groessten-haushaltsueberschuss-a-951541.html>.

⁵ <http://de.statista.com/statistik/daten/studie/207069/umfrage/wirtschafts-und-strukturdatenvergleich-von-ost-und-westdeutschland/>.

and cultural dimension: the governments in the East, which experienced the bankruptcy of the GDR, seem less reluctant to rein in expenditure and the local population shows more tolerance for strict budgetary measures.

Of the EUR 8.28 billion paid in 2013 (as 'horizontal' compensation) by four⁶ of the sixteen Länder, half was paid by Bavaria⁷. Three quarters of that sum went to the East. The City of Berlin alone received 3.32 billion⁸. Following the new budgetary figures, the list of donor Länder will automatically be amended. Saxony, for example, which has achieved the best budgetary surplus in the East at EUR 822 million, will therefore have to make a proportional contribution to the savings made. Even if, for the moment, there is reason to be satisfied with the results achieved (today half the Länder are running a surplus), the need to rethink the compensation mechanism or even abolish it, is once again on the agenda.

Putting an end to the East/West divide

No one disputes that inequalities due to differences in size, population, forms of economic activity and therefore fiscal revenues between the Länder need to be reduced. Criticism is focussed on the calculation methods used to operate the system and the conditions under which the sums paid into the compensation fund are redistributed. Several politicians, including Markus Söder⁹, the Bavarian Minister of Finance, have expressed regret for the 'lack of incentives for budgetary rigour.'

Apart from the different points of view in the donor and recipient Länder, which are naturally opposed, the new situation, if it continues over the next few years, should probably help to reduce the tensions which have grown up over the past twenty years between the two parts of the country. As Manfred Stolpe, the former Minister-President of Brandenburg, pointed out: 'There was a very long period during which the Western Länder suspected us of living above our means. Of spending money on non-essentials. I remember being criticised on many occasions because we had too many crèches. In the meantime, the Federation has changed direction and we have become an example to be followed.'

Possible future solutions for the system

A new model governing budgetary relations between the Federation and the Länder will have to be adopted by 2019 at the latest, because Solidarity Pact II and the current financial compensation mechanism will come to an end by then. When the coalition agreement was signed last November, the three parties in power agreed to set up a commission¹⁰ consisting not only of representatives of the Federation and the Länder, but also of representatives of the municipalities. That commission is due to present its proposals for reforming the compensation mechanism and the solidarity surcharge at the beginning of 2016.

At present, various solutions have been suggested, including:

- the creation of a compensation fund in which the East/West solidarity criterion would be abolished, but which would take account of economically disadvantaged areas in the country as a whole;
- granting the Land Berlin special status¹¹, with higher subsidies from the Federation in order to compensate for its position as the capital city and the additional costs this entails;
- greater acknowledgment of the special situation of the three City-States (Berlin, Bremen and Hamburg¹²), which are heavily indebted as a result of low fiscal revenues owing to the large number of people who work there but live in the neighbouring Land.

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⁶ Baden-Württemberg, Bavaria, Hessen and Hamburg.

⁷ <http://www.faz.net/aktuell/politik/inland/bund-laender-finanzbeziehungen-bayern-traegt-die-haelfte-des-laenderfinanzausgleichs-12673631.html>.

⁸ <http://www.tagesspiegel.de/berlin/klage-gegen-laenderfinanzausgleich-wie-berlin-auf-kosten-der-anderen-lebt/7989028.html>.

⁹ <http://www.finanzen.net/nachricht/aktien/Soeder-Laenderfinanzausgleich-und-Solidarpakt-koppeln-3287348>.

¹⁰ http://www.focus.de/politik/deutschland/bundestagswahl-2013/der-koalitionsvertrag-im-wortlaut-3-solide-finanzen_id_3437526.html.

¹¹ <http://www.cesifo-group.de/de/ifoHome/infoservice/News/2014/02/news-20140214-ifo-Dresden-berichtet-Berlin.html>.

¹² The three merger plans (Berlin with Brandenburg, Bremen with Lower Saxony and Hamburg with Schleswig-Holstein) failed at the public consultation stage.