

# **Fiscal Federalism in Germany**

Competitiveness in Europe:  
Confronting Italy and Germany  
Rome, 11 and 12 July 2011

# Fiscal Federalism

How to

- distribute governmental functions to the levels?
- apportion expenditure between the levels?
- share revenue between the levels?

## Basic Law

- Article 30 GG

“The exercise of governmental powers and the discharge of governmental functions is incumbent on the Länder insofar as this Basic Law does not otherwise prescribe or permit.”

# Distribution of Functions

- federation has two kinds of powers:
  - either it has the exclusive power to act
    - Länder can only become active if federal law gives them the permission
  - or it has the concurrent power to act.
    - Länder can operate until the federation takes action
- German federalism is of the cooperative type:
  - scope to act on the level of the Länder diminished

# Expenditure

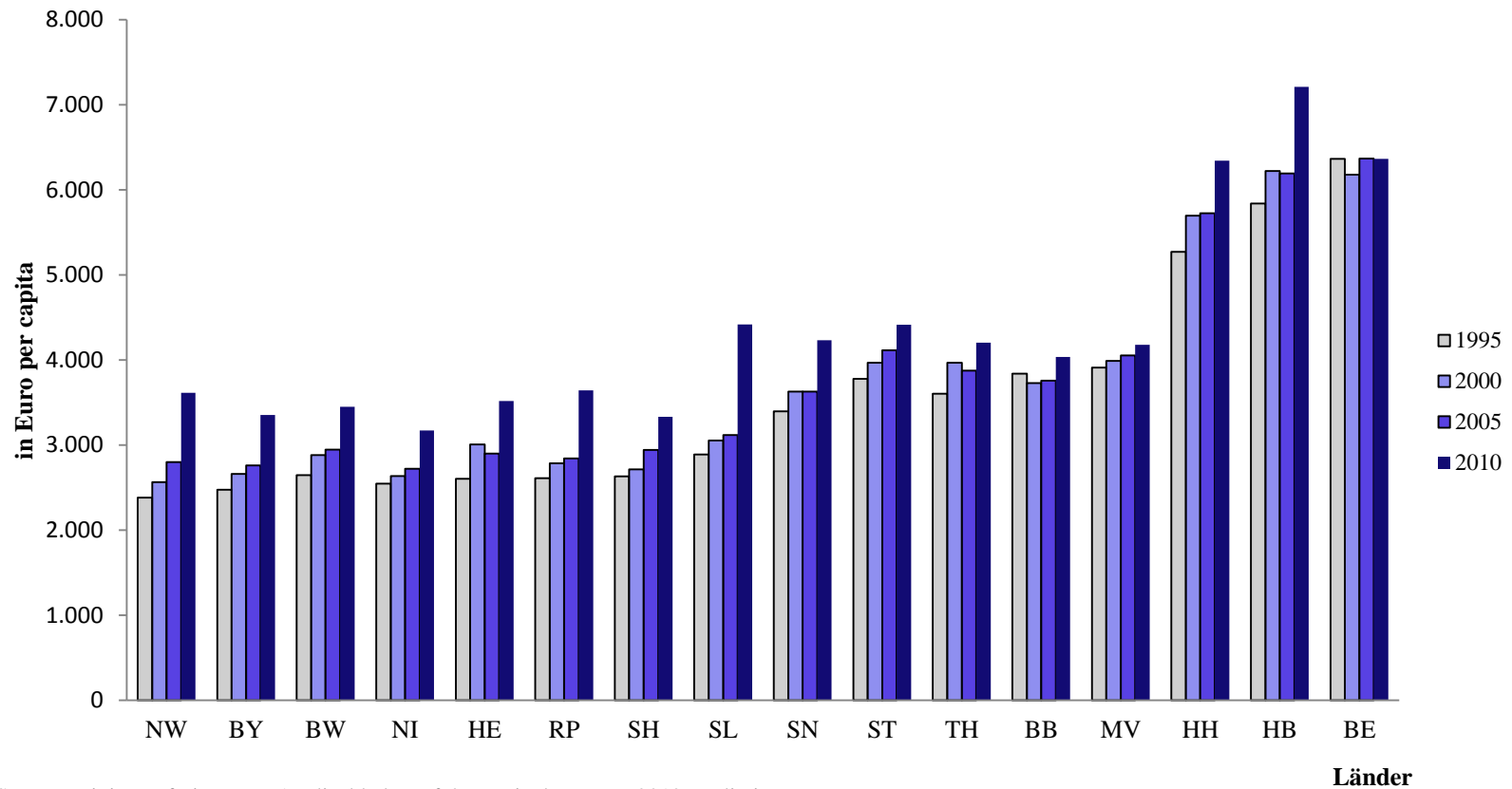
- closely follows functions
  - expenditure that depends on the decision of the Land
  - joint tasks
  - expenditure that is predominated by federal law
- federal laws that affect the states have to pass the Bundestag and the Bundesrat

# Taxation

- federation: power to legislate on taxation
  - federal laws that affect the states have to pass the Bundestag and the Bundesrat
- a Land cannot adjust tax tariffs to its financial needs (since 2007 they can ascertain the tax rate to the real property tax)

# Federation/Länder Financial Relations in Germany

# Expenditure per Capita



Source: Ministry of Finance. - Applicable law of the particular year. - 2010: preliminary.

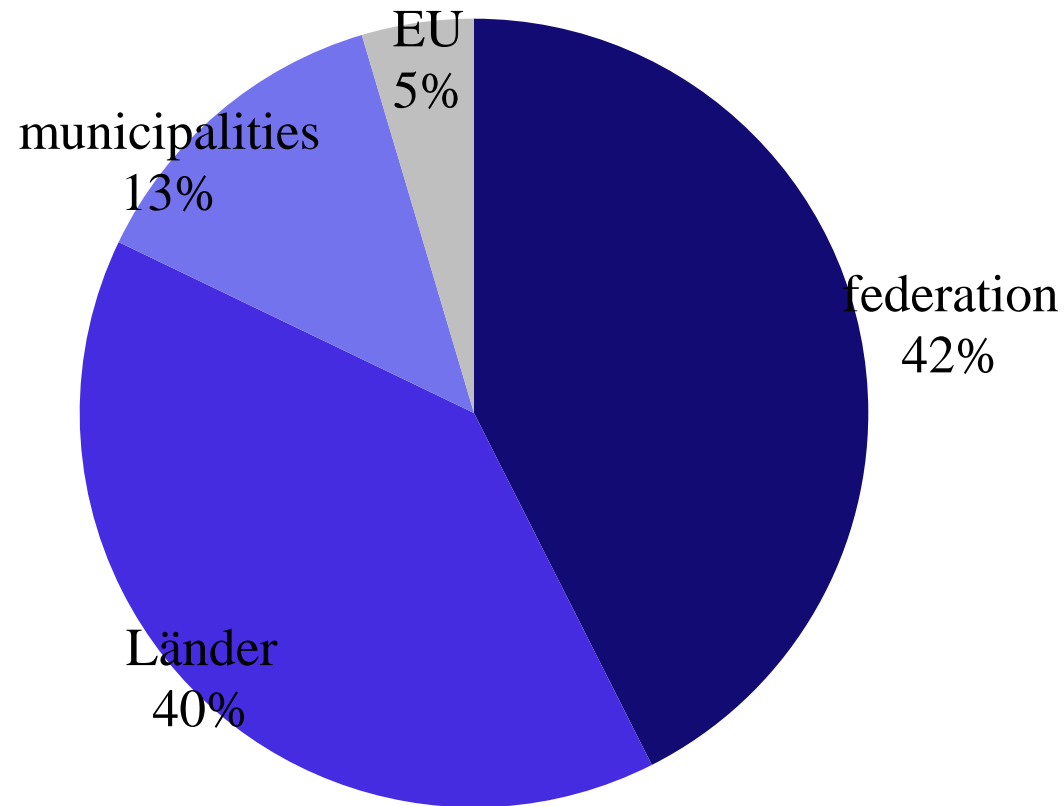


# Structure of Tax Revenue

- in billion Euro -

	1995	2000	2010
Taxes accruing to the federation	92.89	101.13	132.74
<i>as percent of total tax revenue</i>	22.2	22.1	25.4
Taxes accruing to the Länder	18.71	18.44	12.15
<i>as percent of total tax revenue</i>	4.5	4.0	2.3
Taxes accruing to the municipalities	29.31	36.66	47.87
<i>as percent of total tax revenue</i>	7.0	8.0	9.2
Joint Taxes	277.66	301.26	329.27
<i>as percent of total tax revenue</i>	66.3	65.8	63.1
Total tax revenue	418,6	457,49	522,0

# Tax Revenue of Levels

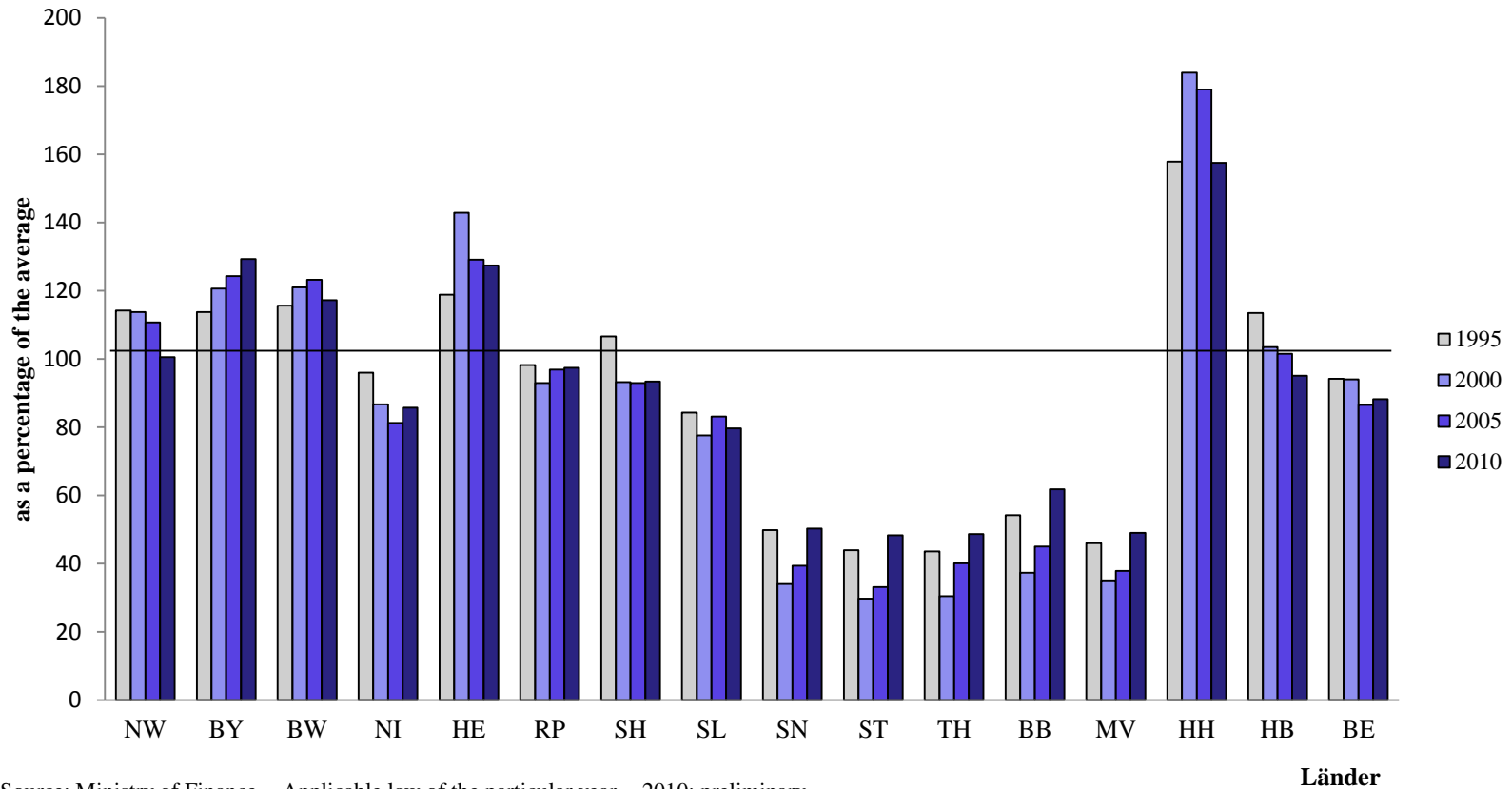


Source: Federal Ministry of Finance, own calculations.



# Tax Revenue per Capita

## - before allotting VAT -



Source: Ministry of Finance. - Applicable law of the particular year. - 2010: preliminary.

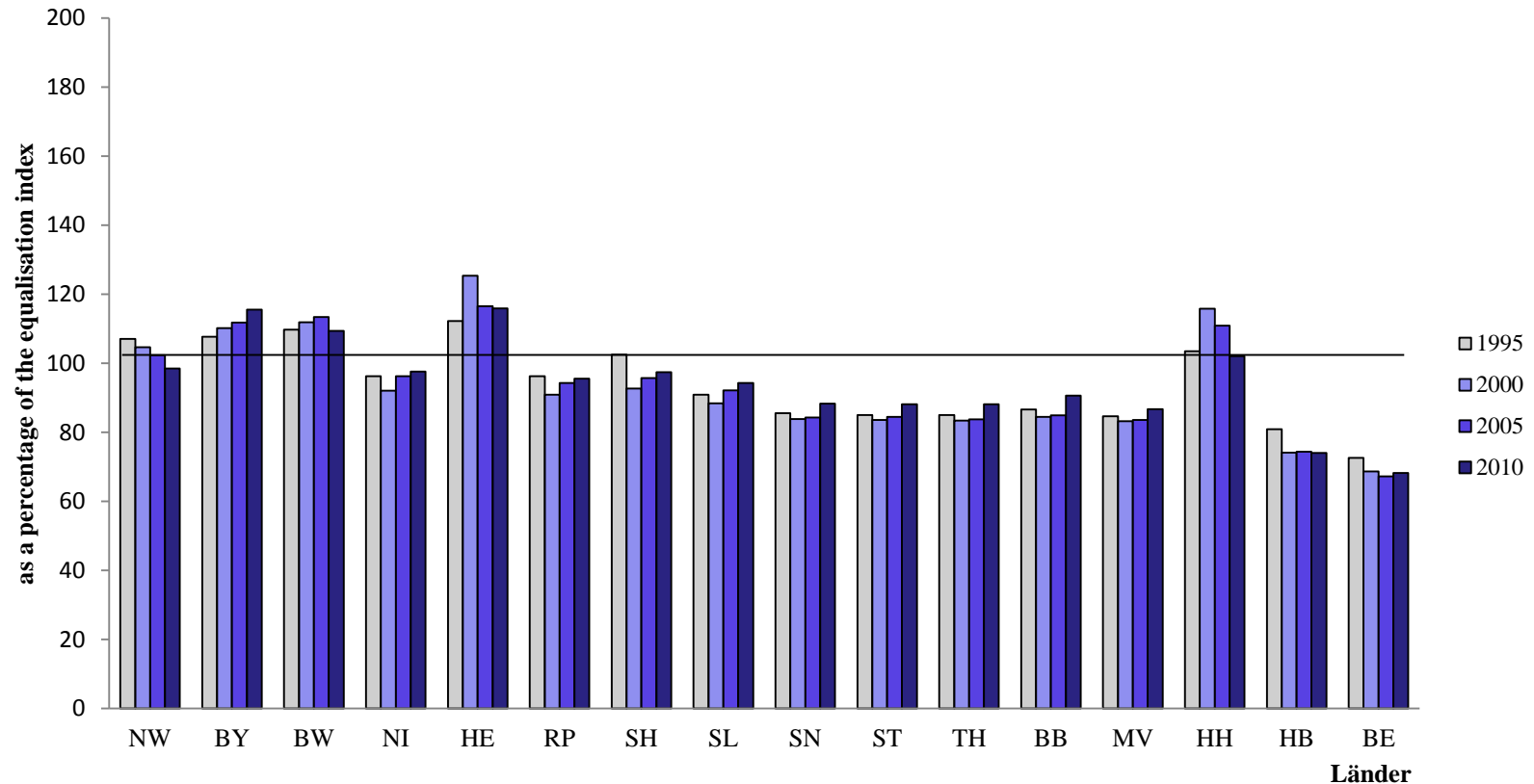
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# Federal Financial Equalisation System

## I. Pre-Stage: Sharing of VAT

- VAT: 9.5% is assigned to the unemployment and the pension system
  - residual VAT is allotted between the federation (53.9%), the Länder (44.1) and the municipalities (approx. 2%)
  - 75% of the share of the Länder is allocated per capita
  - 25% is redistributed to lessen “exceedingly high differences”
- 12.8 billion Euro in 2010 (6% of L-tax rev.)

# Financial capacity after sharing VAT

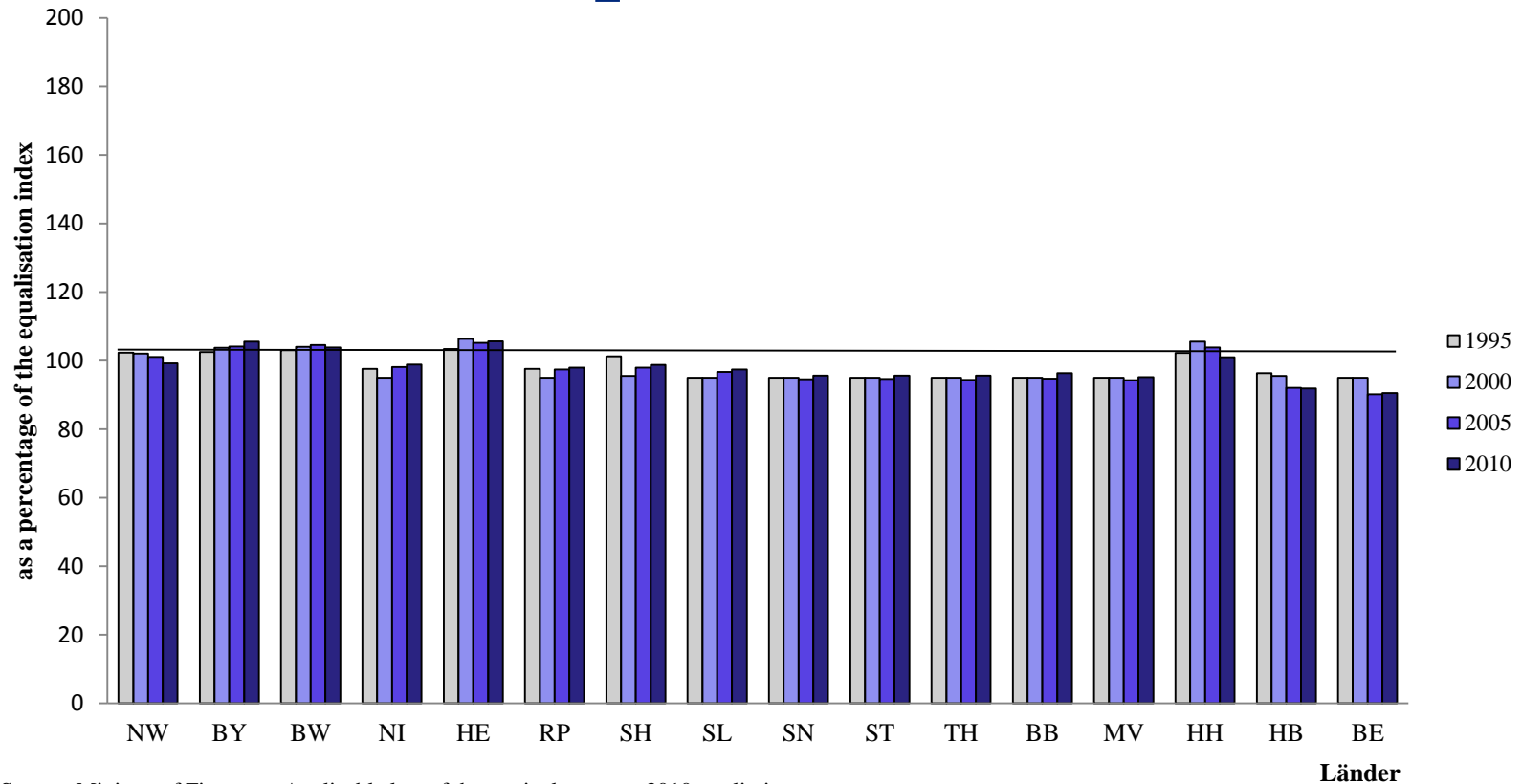


Source: Ministry of Finance. - Applicable law of the particular year. - 2010: preliminary.

## II. Inter-State Equalisation

- financial capacity index (real financial power) =  
Land's tax revenue  
+ 64% municipalities' joint tax rev.  
– 64% municipalities' trade tax apportionment
  - equalisation Index (real financial need) =  
average tax revenue per capita of the Länder  
+/- (64% of ...) municipal tax rev. weighted by  
inhabitants of the Land
- 8.3 billion Euro in 2010 (4% of L-tax rev.)

# Financial Capacity After Inter-State Equalisation



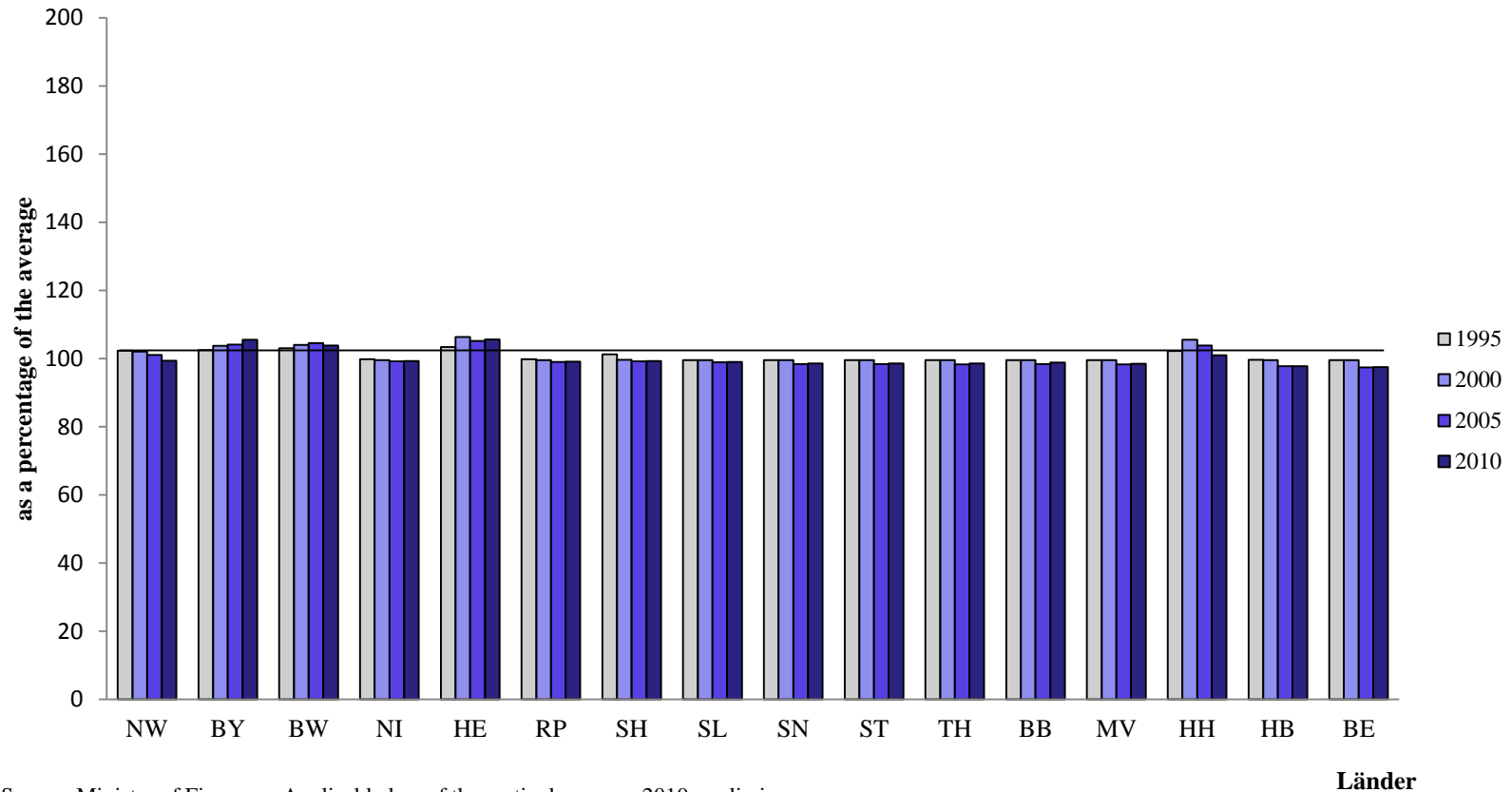
Source: Ministry of Finance. - Applicable law of the particular year. - 2010: preliminary.



## III. Supplementary Federal Grants

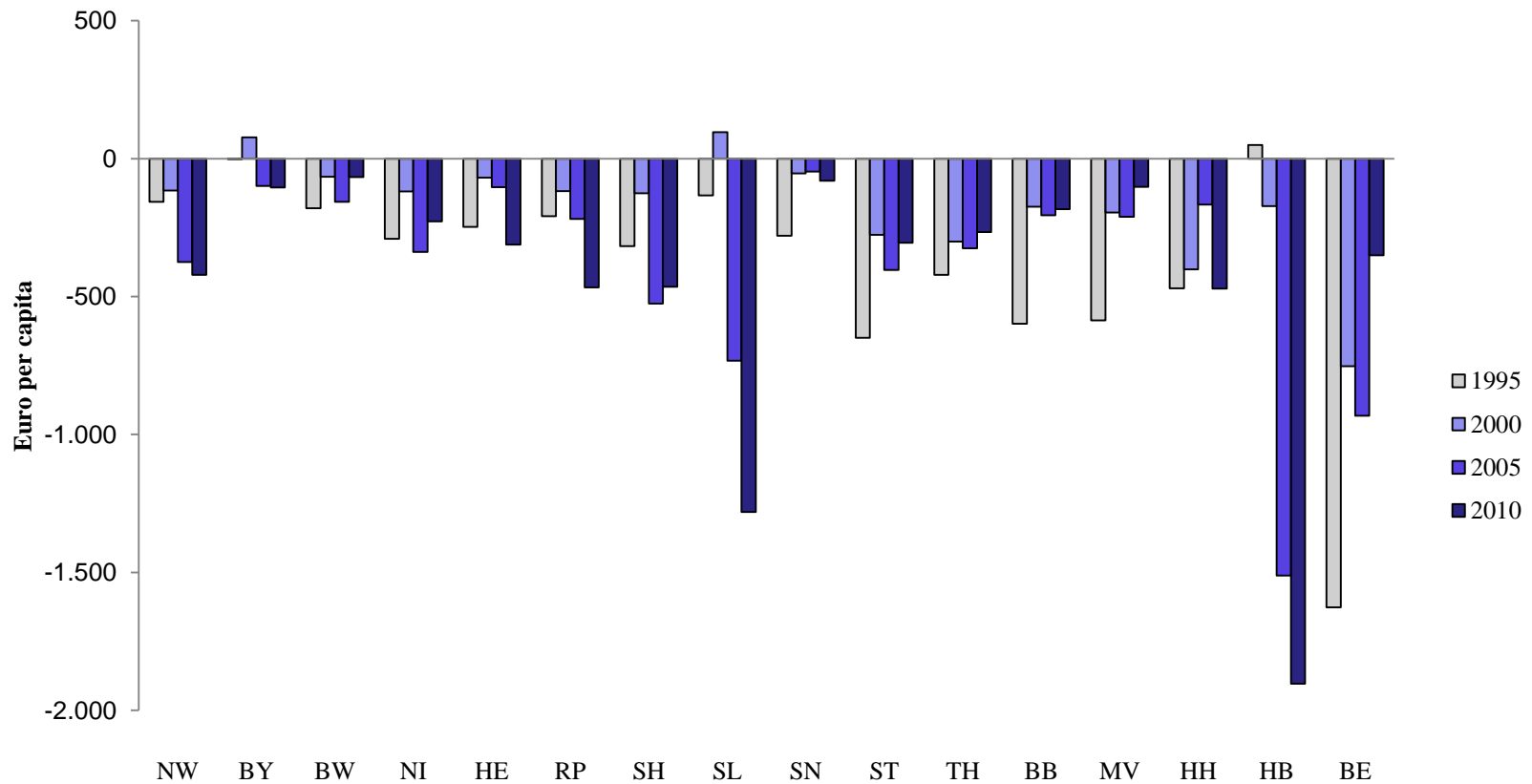
- SFG for shortfalls: 3.1 bill. Euro
  - SFG for administrative costs: 0.5 bill. Euro
  - SFG on German unification: 10.2 bill. Euro
  - SFG for structural unemployment: 1.0 bill. Euro
- 14.8 billion Euro in 2010 (7% of L-tax rev.)

# Financial Capacity After Supplementary Federal Grants



Source: Ministry of Finance. - Applicable law of the particular year. - 2010: preliminary.

# Budget Balances of Länder



Source: Ministry of Finance. - Applicable law of the particular year. - 2010: preliminary.

Länder

# New Challenges: the German Debt Brake

- federation: structural deficit has to be less than 0.35% in 2016
- Länder: structural deficit has to be balanced in 2020
- financial scope of the Länder will decrease

## **New Challenges: End of the Solidarpakt**

- SFG on German unification run out since 2005 on a diminishing return to scale until 2019 (2.1 billion Euro)
- In 2010: 10.2 billion – which raised the financial capacity of the new Länder by 4 ½
- FFES will become more significant for the new Länder

## **New Challenges: Realignment of the FFES**

- Standards Act is limited until 2019
  - currently: four contributing states that are becoming more and more unwilling to pay
  - also because the old Länder will experience demographic changes in the next years (while the new Länder already bear substantial losses)
- negotiations will become rough

## Conclusions

- Shortcomings of the FFES:
    - a benevolent (level of) government does not exist
    - a thorough allocation of functions and powers is a good starting point for balancing financial needs and financial funds in a federation
- Principle of fiscal equivalence should be strengthened

- the higher the degree of disparities the lower the degree of equalisation you can attain without rejection –  
unless the federation engages itself  
→ the willingness of states to pay is restricted





**Thank you!**

# Joint Taxes as a Percentage of Total Tax Revenue in 2010

Joint Taxes	66.3	65.8	63.1
<i>Breakdown:</i>			
wages tax	34,5	29,7	24,5
assessed income tax	1,7	2,8	6,0
non-assessed income tax	2,1	3,0	2,5
interest income deduction/fixed			
withholding tax	1,6	1,6	1,7
corporation tax	2,2	5,4	2,3
value added tax	24,2	23,4	26,1

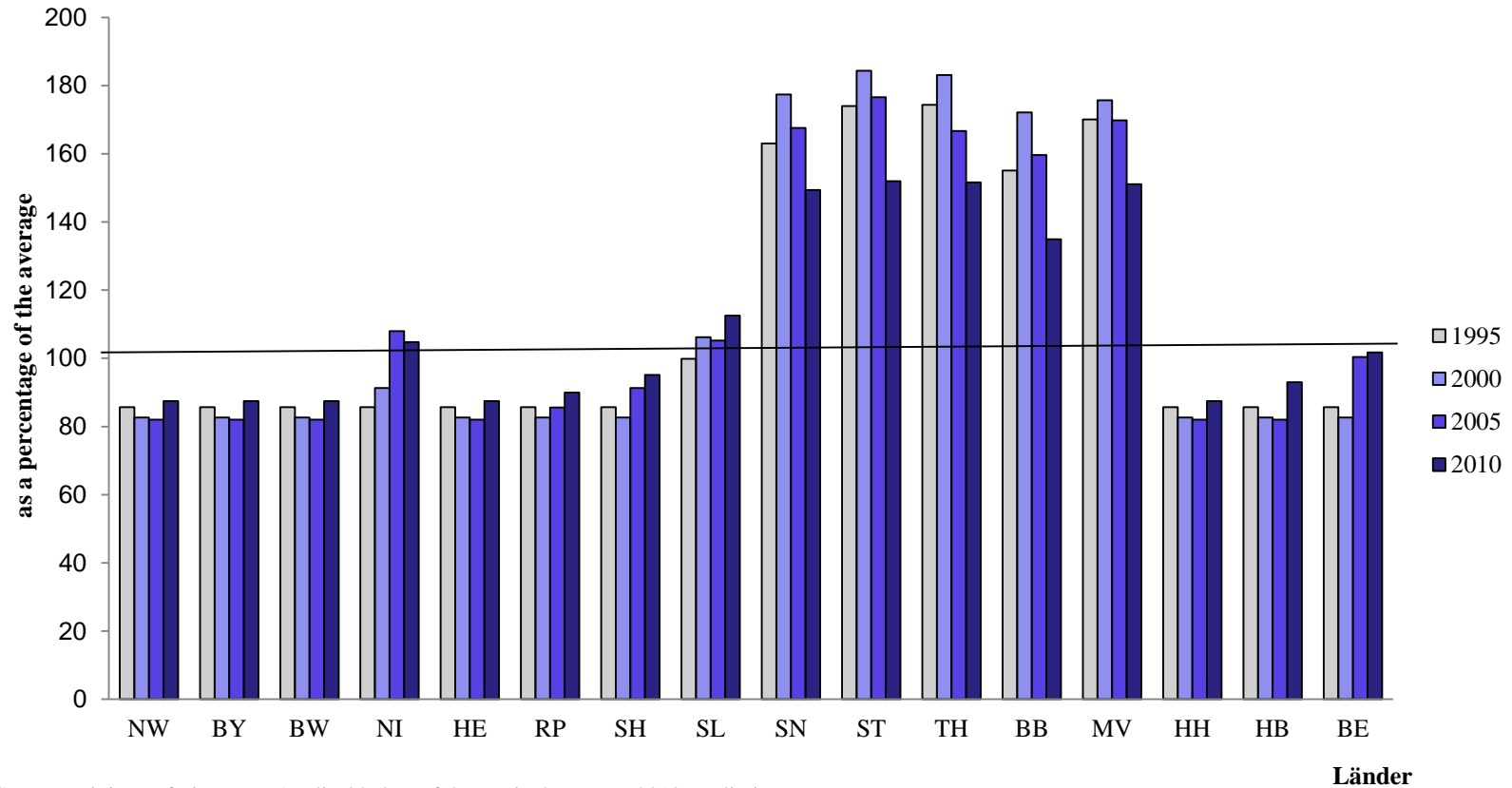
Source: Federal Ministry of Finance, own calculations.

# Participation Rates in Revenue of Joint Taxes in 2010

	Federation	Länder	Municipa- lities
wages tax	42.5	42.5	15.0
assessed income tax	42.5	42.5	15.0
final withholding tax	44.0	44.0	12.0
non-assessed taxes on earnings	50.0	50.0	50.0
corporate tax	50.0	50.0	-
VAT <sup>a</sup>	53.9	44.1	approx. 2.0

Source: Federal Ministry of Finance - <sup>a</sup> first of all 9.5% are transmitted to the unemployment resp. Pension security system.

# Länder shares of VAT revenue



Source: Ministry of Finance. - Applicable law of the particular year. - 2010: preliminary.

## Cash tax revenue per capita in the Länder, expressed as a percentage of the average

	NW	BY	BW	NI	HE	RP	SH	SL	SN	ST	TH	BB	MV	HH	HB	BE
1995 <sup>a</sup>	114.2	113.7	115.6	96.0	118.8	98.2	106.6	84.3	49.8	43.9	43.6	54.2	46.0	157.8	113.5	94.2
1996	114.0	116.7	115.9	95.9	129.9	99.1	102.7	82.7	41.1	35.9	34.9	43.6	37.4	169.5	110.9	96.9
1997	113.7	118.9	115.3	93.7	129.1	96.3	104.8	84.9	40.6	35.0	35.3	43.5	38.0	165.1	130.9	97.4
1998	113.8	116.9	119.9	93.0	129.8	94.5	104.3	78.8	41.2	35.8	36.7	43.2	37.8	172.5	95.1	94.9
1999	113.1	117.5	119.5	89.9	138.5	97.4	97.4	76.3	39.5	34.0	35.9	40.9	36.8	173.2	112.2	92.9
2000	113.7	120.6	121.0	86.7	142.8	92.9	93.2	77.6	34.0	29.7	30.5	37.3	35.1	183.9	103.5	94.0
2001	107.4	124.3	124.0	89.4	143.3	95.0	100.4	83.2	34.6	30.1	30.8	39.4	30.2	173.8	103.7	89.2
2002	118.5	123.6	120.6	87.9	133.9	89.4	97.0	76.3	30.2	30.0	30.0	37.0	29.1	169.3	103.4	82.3
2003	106.5	121.7	125.3	90.8	135.1	92.8	103.9	85.5	35.1	30.9	33.6	39.3	32.6	194.3	111.0	86.8
2004	108.1	126.2	124.6	81.4	127.5	98.0	94.9	83.3	38.3	36.2	36.7	43.3	38.0	193.6	108.5	84.4
2005 <sup>b</sup>	110.7	124.3	123.2	81.2	129.1	96.9	92.9	83.1	39.4	33.1	40.1	45.0	37.9	179.0	101.5	86.5
2006	106.6	121.0	120.7	83.4	141.0	93.6	95.0	80.5	42.0	42.9	39.5	47.8	39.2	184.7	103.4	86.7
2007	104.5	121.2	122.0	84.2	144.0	92.3	90.0	82.8	45.9	47.6	42.9	51.9	40.5	168.0	100.3	83.4
2008	104.2	124.6	121.1	82.9	132.3	95.9	87.1	81.9	48.7	47.6	46.7	55.9	44.2	175.1	101.0	81.2
2009	105.5	129.6	114.6	83.5	128.1	98.4	95.0	85.6	46.9	47.0	47.6	62.1	47.6	156.8	100.0	75.9
2010	100.5	129.3	117.2	85.7	127.4	97.4	93.4	79.6	50.3	48.3	48.7	61.8	49.0	157.5	95.1	88.2

<sup>a</sup> Law applicable to 2004. – <sup>b</sup> Law applicable from 2005. – Source: Federal Ministry of Finance.

## Supplementary shares of VAT - in million Euro

	NW	BY	BW	NI	HE	RP	SH	SL	SN	ST	TH	BB	MV	HH	HB	BE
1995 <sup>a</sup>	0	0	0	0	0	0	0	99	2285	1569	1439	1137	998	0	0	0
1996	0	0	0	0	0	0	0	113	2618	1729	1609	1388	1121	0	0	0
1997	0	0	0	0	0	0	0	84	2547	1690	1539	1358	1070	0	0	0
1998	0	0	0	0	0	0	0	170	2731	1801	1628	1500	1165	0	0	0
1999	0	0	0	207	0	0	0	212	2951	1941	1732	1664	1245	0	0	0
2000	0	0	0	542	0	0	0	198	3315	2111	1931	1832	1307	0	0	0
2001	0	0	0	245	0	0	0	111	2971	1888	1740	1603	1283	0	0	111
2002	0	0	0	372	0	119	0	188	3038	1793	1678	1602	1243	0	0	371
2003	0	0	0	108	0	0	0	78	2765	1738	1560	1521	1158	0	0	197
2004	0	0	0	939	0	0	0	102	2572	1557	1454	1390	1037	0	0	288
2005 <sup>b</sup>	0	0	0	1583	0	113	201	186	2787	1785	1509	1512	1143	0	0	475
2006	0	0	0	1552	0	288	153	239	2958	1678	1681	1593	1239	0	0	523
2007	0	0	0	1623	0	384	356	231	3018	1677	1735	1610	1324	0	0	727
2008	0	0	0	1833	0	200	489	252	2978	1734	1674	1537	1289	0	0	870
2009	0	0	0	1565	0	58	157	175	2714	1537	1447	1163	1062	0	0	1001
2010	0	0	0	1358	0	101	213	251	2537	1491	1416	1173	1033	0	36	483

<sup>a</sup> Law applicable to 2004. - <sup>b</sup> Law applicable from 2005. - Source: Federal Ministry of Finance.

## Financial Capacity as a percentage of the equalisation index after sharing VAT

	NW	BY	BW	NI	HE	RP	SH	SL	SN	ST	TH	BB	MV	HH	HB	BE
1995 <sup>a</sup>	107.0	107.7	109.7	96.2	112.2	96.2	102.5	90.9	85.5	85.0	85.0	86.6	84.6	103.5	80.9	72.6
1996	106.4	108.6	108.8	95.4	117.2	96.3	99.6	89.8	84.6	84.0	84.0	85.1	83.6	107.9	79.2	72.3
1997	106.4	109.4	108.7	94.4	116.9	95.2	110.3	90.4	84.7	84.4	83.9	85.5	83.6	105.2	86.4	71.4
1998	106.3	108.6	111.3	93.8	117.6	93.4	100.2	90.1	84.7	84.6	84.0	85.6	83.7	109.8	71.8	70.1
1999	105.3	109.1	111.0	92.2	123.0	94.4	96.3	88.9	84.2	84.1	84.2	85.2	83.8	110.3	79.3	69.0
2000	104.6	110.2	111.9	92.0	125.3	90.9	92.7	88.4	83.8	83.6	83.4	84.5	83.2	115.8	74.1	68.7
2001	101.8	112.4	113.2	89.6	125.8	93.2	97.4	88.9	84.5	84.8	84.3	86.3	83.9	109.3	75.0	68.6
2002	106.6	111.3	110.8	92.5	119.5	90.3	95.1	89.0	84.0	84.1	84.1	85.4	83.5	106.4	74.4	67.8
2003	100.9	110.7	113.7	94.0	119.5	92.1	99.3	90.4	85.0	85.5	85.3	86.0	84.5	118.4	77.1	68.0
2004	101.5	112.4	113.3	93.3	116.1	94.4	95.6	90.1	85.3	85.4	85.1	85.6	84.4	116.7	80.4	68.0
2005 <sup>b</sup>	102.3	111.8	113.4	96.2	116.5	94.3	95.7	92.1	84.3	84.5	83.7	84.9	83.6	110.9	74.4	67.2
2006	100.6	110.4	111.7	97.6	122.4	94.0	96.6	92.5	84.8	85.5	84.1	85.6	83.5	115.5	73.7	67.1
2007	100.2	110.5	112.0	97.1	124.2	94.5	96.6	92.6	85.0	85.8	84.7	85.5	83.7	109.0	73.0	68.1
2008	99.8	112.4	112.3	97.3	120.3	94.3	95.9	93.3	85.5	86.2	85.3	87.0	83.5	108.7	72.4	67.2
2009	100.3	114.8	108.3	98.9	117.0	95.0	95.8	94.0	87.4	87.5	87.3	88.4	84.9	101.4	74.3	67.7
2010	98.5	115.5	109.4	97.6	115.9	95.5	97.4	94.3	88.3	88.1	88.1	90.6	86.7	102.0	74.0	68.2

<sup>a</sup> Law applicable to 2004. – <sup>b</sup> Law applicable from 2005. - Source: Federal Ministry of Finance.

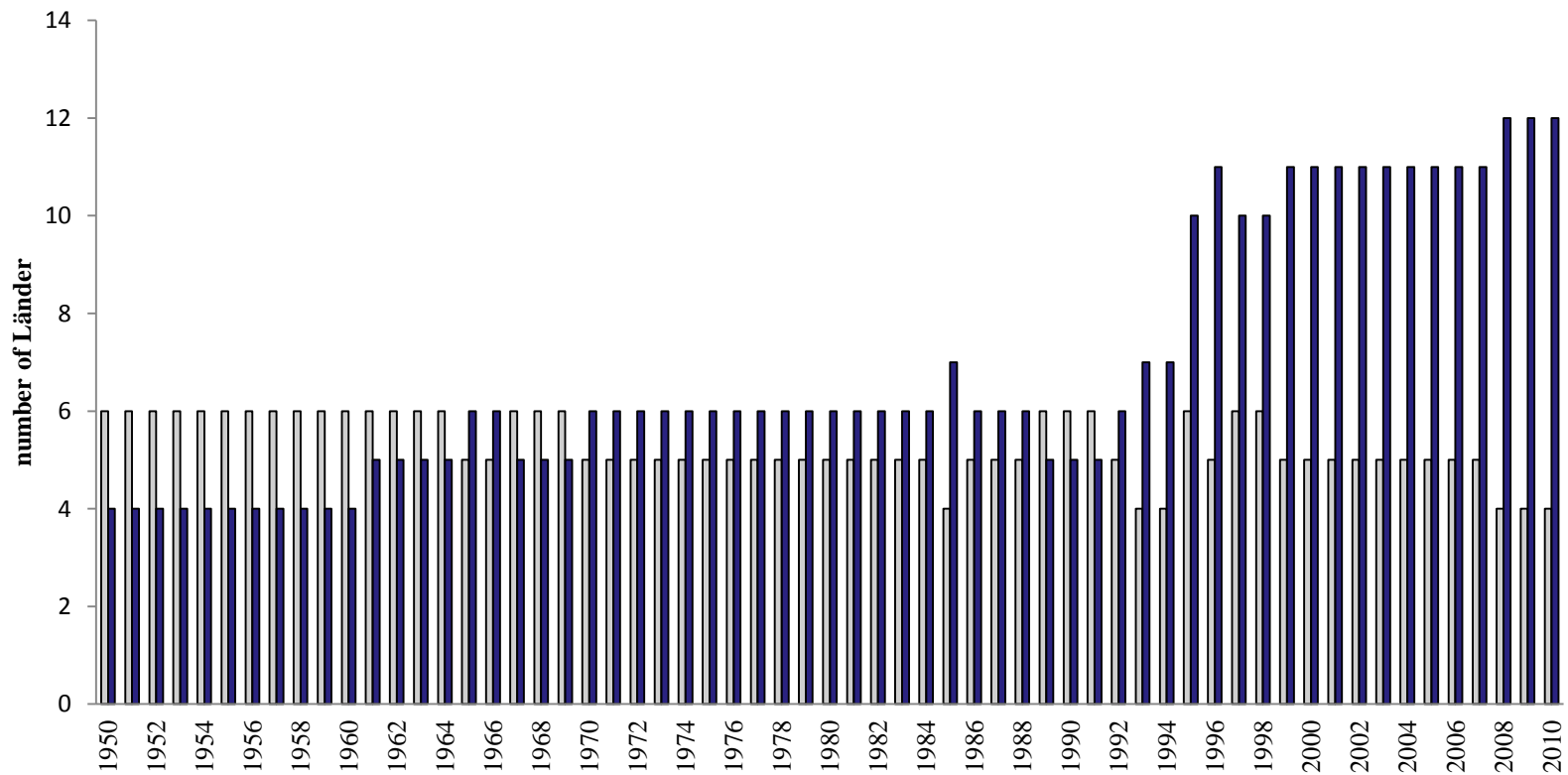
## Financial Capacity as a percentage of the equalisation index after application of inter-state financial equalisation

	NW	BY	BW	NI	HE	RP	SH	SL	SN	ST	TH	BB	MV	HH	HB	BE
1995	102.3	102.5	103.0	97.6	103.4	97.6	101.2	95.0	95.0	95.0	95.0	95.0	95.0	102.2	96.3	95.0
1996	102.2	102.8	102.9	97.1	104.1	97.7	99.8	95.0	95.0	95.0	95.0	95.0	95.0	102.8	96.4	95.0
1997	102.3	103.1	103.0	96.5	104.2	97.0	100.5	95.0	95.0	95.0	95.0	95.0	95.0	102.3	96.0	95.0
1998	102.3	103.0	103.5	96.1	104.3	95.9	100.2	95.0	95.0	95.0	95.0	95.0	95.0	103.5	95.8	95.0
1999	102.1	103.3	103.7	95.1	105.6	96.5	97.7	95.0	95.0	95.0	95.0	95.0	95.0	103.7	96.1	95.0
2000	102.0	103.7	104.0	95.0	106.3	95.0	95.5	95.0	95.0	95.0	95.0	95.0	95.0	105.5	95.5	95.0
2001	101.1	104.1	104.2	95.0	106.4	95.8	98.4	95.0	95.0	95.0	95.0	95.0	95.0	104.1	95.8	95.0
2002	102.5	103.7	103.6	95.3	105.1	95.0	97.0	95.0	95.0	95.0	95.0	95.0	95.0	102.4	95.9	95.0
2003	100.8	103.8	104.3	96.2	105.3	95.1	99.6	95.0	95.0	95.0	95.0	95.0	95.0	105.2	95.5	95.0
2004	101.0	104.0	104.1	95.8	104.8	96.5	97.3	95.0	95.0	95.0	95.0	95.0	95.0	105.3	97.6	95.0
2005	101.1	104.1	104.5	98.1	105.2	97.4	97.9	96.7	94.5	94.6	94.4	94.7	94.3	103.8	92.0	90.2
2006	100.3	103.9	104.2	98.8	106.8	97.3	98.3	96.9	94.6	94.8	94.5	94.9	94.3	105.2	91.8	90.2
2007	100.1	103.9	104.4	98.6	107.4	97.5	98.3	96.9	94.7	94.9	94.6	94.8	94.4	103.5	91.7	90.4
2008	99.9	104.5	104.5	98.6	106.5	97.4	98.0	97.1	94.9	95.0	94.8	95.3	94.3	103.5	91.5	90.2
2009	100.1	105.0	103.3	99.4	105.5	97.7	98.0	97.3	95.4	95.4	95.3	95.7	94.7	100.7	92.0	90.3
2010	99.2	105.5	103.8	98.8	105.6	97.9	98.7	97.4	95.6	95.6	95.6	96.3	95.2	101.0	91.9	90.5

<sup>a</sup> Law applicable to 2004. – <sup>b</sup> Law applicable from 2005. - Source: Federal Ministry of Finance.



# Number of Receiving and Contributing Länder in the FFES



Source: Ministry of Finance. - Applicable law of the

□ contributing    ■ receiving

## Financial Capacity as a percentage of the equalisation index after the application of supplementary federal grants

	NW	BY	BW	NI	HE	RP	SH	SL	SN	ST	TH	BB	MV	HH	HB	BE
1995	102.3	102.5	103.0	99.8	103.4	99.8	101.2	99.5	99.5	99.5	99.5	99.5	99.5	102.2	99.6	99.5
1996	102.2	102.8	102.9	99.7	104.1	99.8	100.0	99.5	99.5	99.5	99.5	99.5	99.5	102.8	99.6	99.5
1997	102.3	103.1	103.0	99.6	104.2	99.7	100.5	99.5	99.5	99.5	99.5	99.5	99.5	102.3	99.6	99.5
1998	102.3	103.0	103.5	99.6	104.3	99.6	100.2	99.5	99.5	99.5	99.5	99.5	99.5	103.5	99.6	99.5
1999	102.1	103.3	103.7	99.5	105.6	99.7	99.8	99.5	99.5	99.5	99.5	99.5	99.5	103.7	99.6	99.5
2000	102.0	103.7	104.0	99.5	106.3	99.5	99.6	99.5	99.5	99.5	99.5	99.5	99.5	105.5	99.5	99.5
2001	101.1	104.1	104.2	99.5	106.4	99.6	99.8	99.5	99.5	99.5	99.5	99.5	99.5	104.1	99.6	99.5
2002	102.5	103.7	103.6	99.5	105.1	99.5	99.7	99.5	99.5	99.5	99.5	99.5	99.5	102.4	99.6	99.5
2003	100.8	103.8	104.3	99.6	105.3	99.5	100.0	99.5	99.5	99.5	99.5	99.5	99.5	105.2	99.5	99.5
2004	101.0	104.0	104.1	99.6	104.8	99.6	99.7	99.5	99.5	99.5	99.5	99.5	99.5	105.3	99.8	99.5
2005	101.1	104.1	104.5	99.2	105.2	99.0	99.2	98.9	98.4	98.4	98.3	98.4	98.3	103.8	97.8	97.4
2006	100.3	103.9	104.2	99.3	106.8	99.0	99.2	98.9	98.4	98.5	98.4	98.5	98.3	105.2	97.8	97.4
2007	100.1	103.9	104.4	99.3	107.4	99.0	99.2	98.9	98.4	98.5	98.4	98.5	98.3	103.5	97.7	97.5
2008	99.9	104.5	104.5	99.3	106.5	99.0	99.2	99.0	98.5	98.5	98.4	98.5	98.3	103.5	97.7	97.4
2009	100.1	105.0	103.3	99.5	105.5	99.1	99.2	99.0	98.6	98.6	98.6	98.6	98.4	100.7	97.8	97.4
2010	99.4	105.5	103.8	99.3	105.6	99.1	99.3	99.0	98.6	98.6	98.6	98.8	98.5	101.0	97.8	97.5

<sup>a</sup> Law applicable to 2004. – <sup>b</sup> Law applicable from 2005. - Source: Federal Ministry of Finance.