

Local Finances and Municipal Financial Equalisation in Germany

BENEFITS FOR DEVELOPMENT COOPERATION

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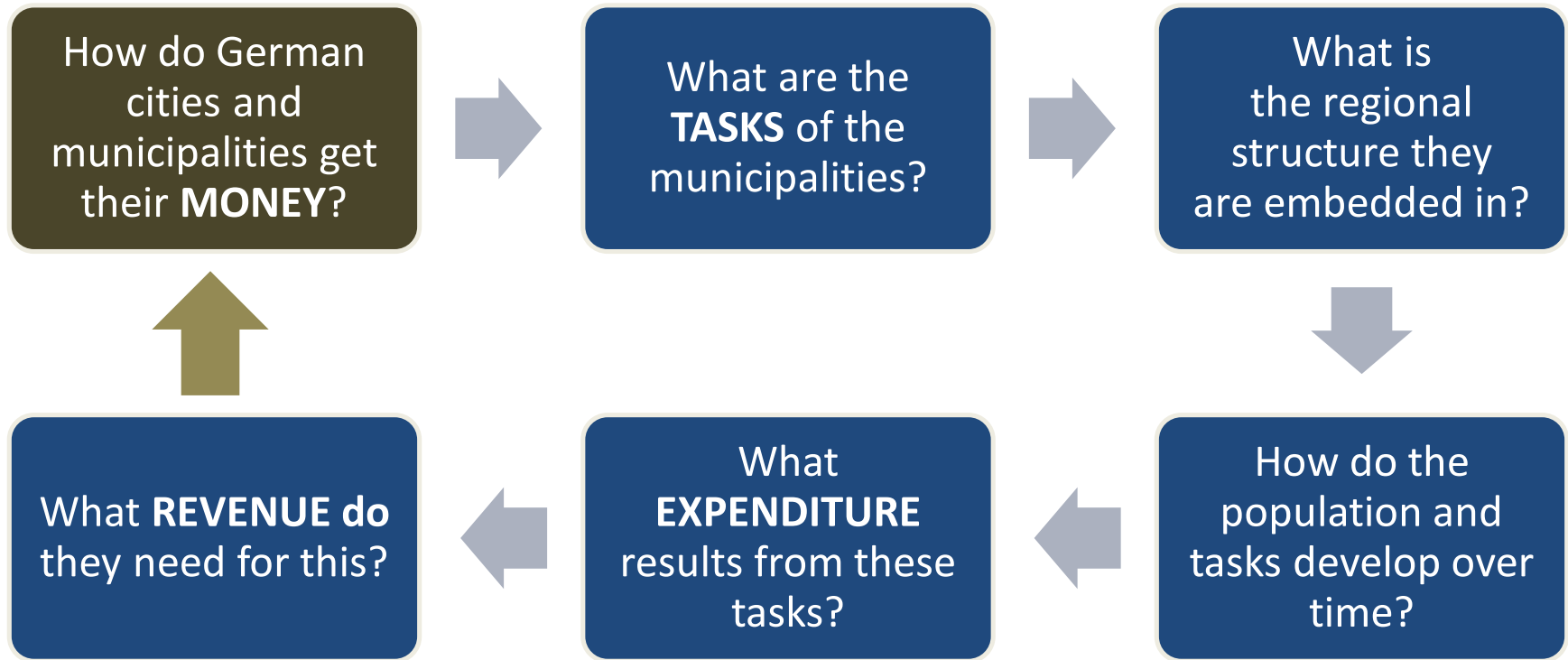
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Introduction: Our way to municipal money



Despite all the complexity and the discussions about tasks, in the end it is often a question of one big and important question in Germany as well: the question of money.

The three levels of Germany

A large and multi-faceted federal state

Intermediate Levels

Regional associations, districts, counties....



1 federation

16 Länder

approx. 12,000 municipalities

Population: 83 million

from 560,000 inhabitants (Bremen)
up to 17.9 million inhabitants (NRW)

from 9 inh. (Hallig Gröde)
up to 3.6 million inh. (Berlin)

Gross Domestic Product (2017)

from € 26,500 per inh. (Mecklenburg-Western Pomerania)
up to € 64,600 per inh. (Hamburg)

Government debt (31.12.2018)

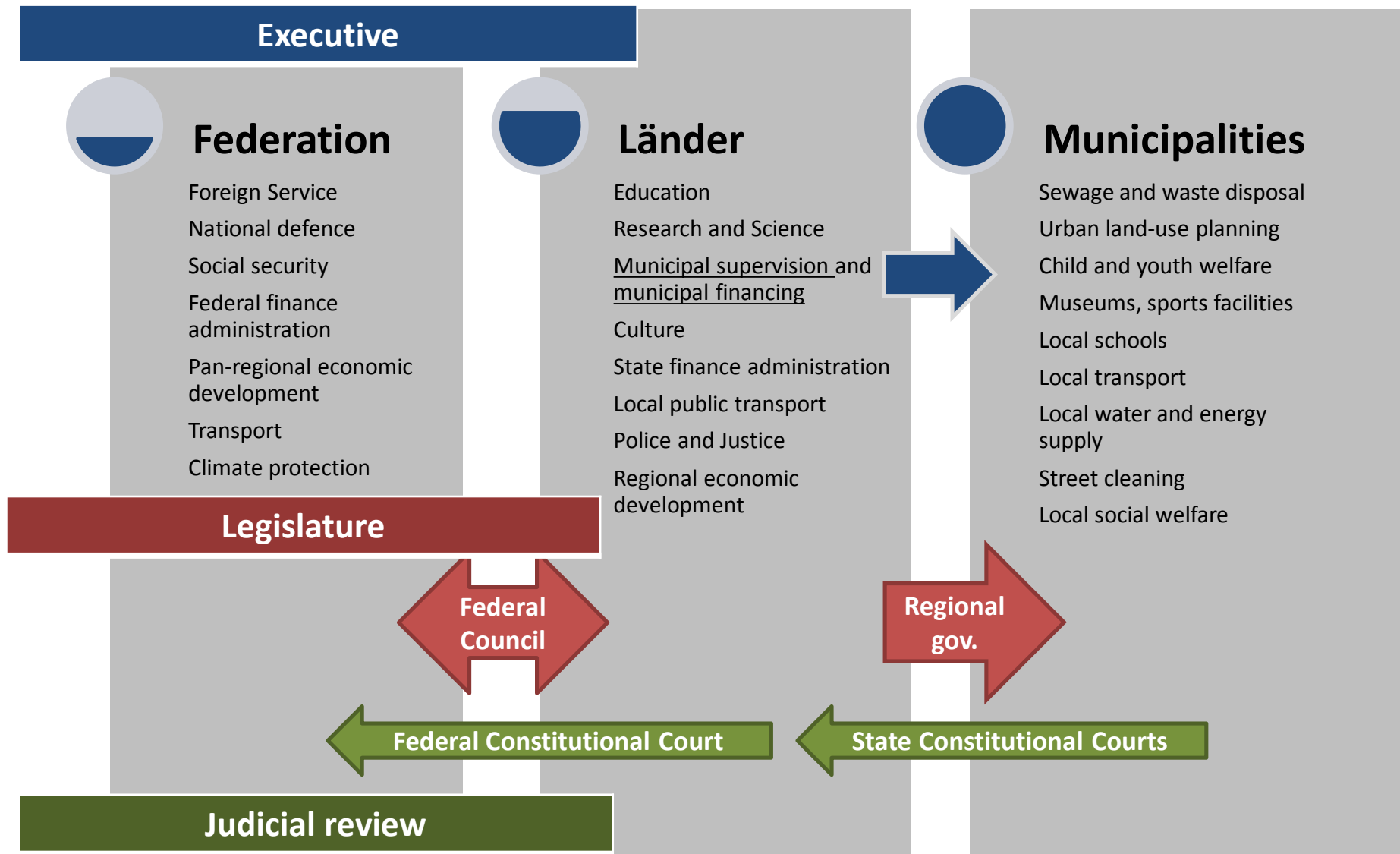
from € 1,040 per inh. (Saxony)
up to € 31,800 per inh. (Bremen)

Municipalities in the German multi-level state

Levels	Tasks	Cooperation	Taxes (proprietary)	Taxes (shared)	Financial equalisation	Transfers
1 European Union	Single market, agriculture, regional policy, currency, etc.		Customs duties, indirect: Own resources			
1 Federal Republic of Germany (Federation)	Foreign affairs, social affairs, defence, environment, energy, economy, transport, etc.		Energy and mineral oil tax, tobacco tax, motor vehicle tax, solidarity surcharge, social security contributions	Corporate income tax, parts of income tax		
16 federal states	Administration, education, research, police, justice etc.		Inheritance tax, real estate transfer tax, minor taxes	Corporate income tax, parts of income tax		
284 districts 107 district-free cities	Social affairs, education, culture, services of general interest, housing, infrastructure, etc.	Indirect	Property tax, trade tax, dog tax, minor taxes			
11 091 municipalities						

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Allocation of tasks between federation - Länder - municipalities



Principles of the municipal system and its finances

Municipalities are assigned to the state level of the Länder. They have the right to regulate all matters of the local community on their own responsibility. The following principles must be observed:

Principle of subsidiarity

- Decisions as decentralized as possible. A higher level only intervenes when uniform regulation is clearly advantageous.

Principle of connectedness

- "He who orders pays." Centralized legislation requires centralized cost assumption.

Principle of equivalence

- Correspondence between the revenue generated and the services provided on the spot

Principle of solidarity

- Redistribution from financially strong to weak municipalities

Equivalence of living conditions

- Justifies centrally organised regional compensation

Loyalty to other members of the federation:

- All for all (as last resort)

Regional planning and municipalities

- **Regional planning:** Determines certain tasks for certain municipalities that others do not have to / must not fulfil.
- **Overall objective:** To achieve equal living conditions in all regions / areas, especially in the area of public services.
- **Responsibilities:** Federation - Länder - planning regions - municipalities
→ From setting the frame down to minute details.



Concept of area categories

- Agglomerations and rural areas



Concept of central places and axes

- Upper, middle and basic centres; development axes



Concept of the regions

- For balanced functional spaces



Concept of large-scale priority areas

- Not in all Länder, e.g. densely populated areas

Currently: Federal and State Commission on the Equivalence of Living Conditions.

Key data for municipal finances 2016-2021

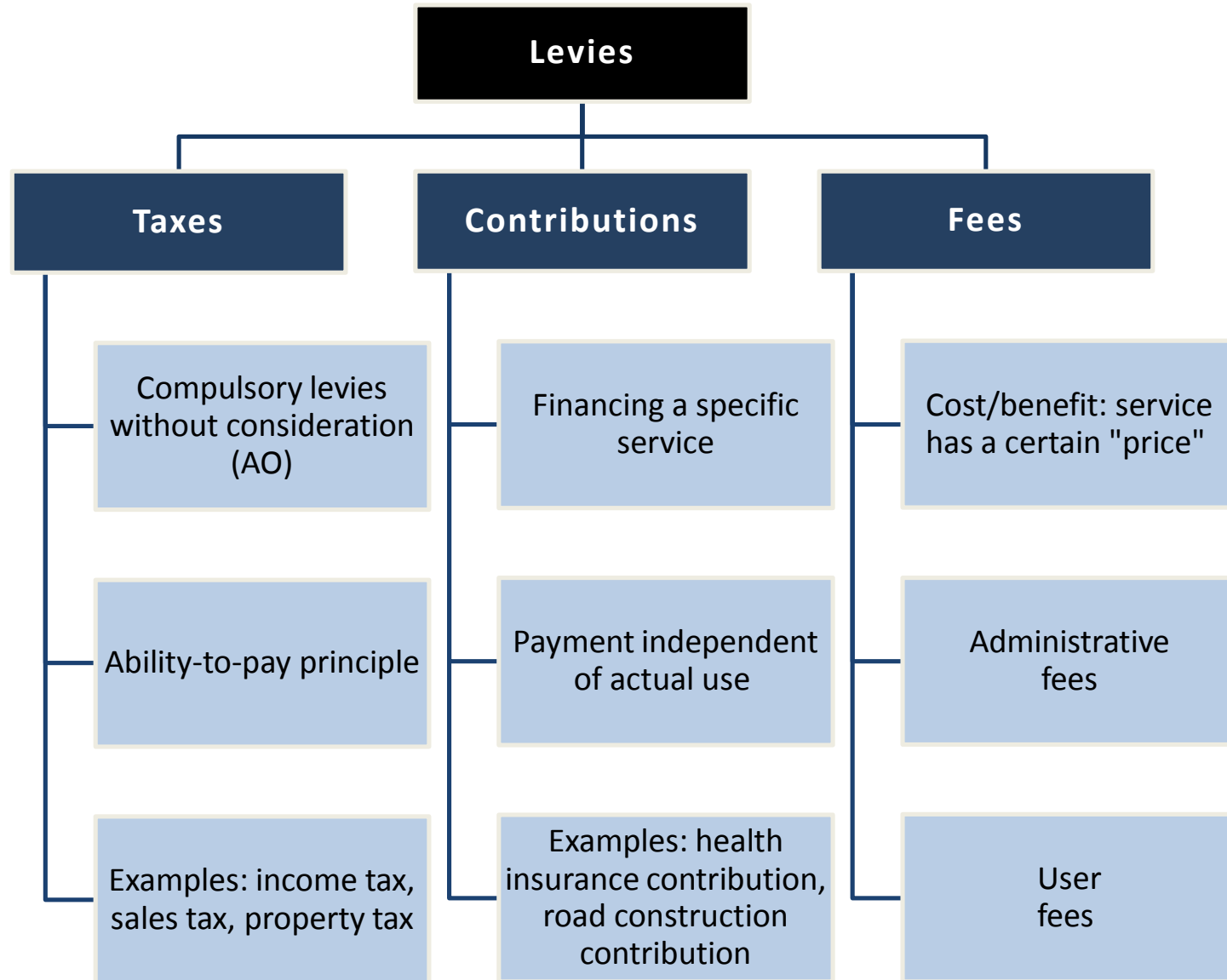
Mrd. Euro

	2016	2017	2018*	2019*	2020*	2021*
Expenditure	230	234	246	258	270	283
Personnel	57	59	62	65	68	71
Material expenditure	49	50	52	55	57	59
Social benefits	59	59	61	64	67	71
Interest	3	3	3	3	3	3
Investments in tangible assets	24	24	26	28	30	32
Other expenditure	38	40	42	43	46	48
Revenues	236	243	254	263	276	288
Taxes	90	96	101	105	112	118
Fees	19	19	20	20	20	21
Ongoing grants Land/Federation	87	88	92	96	100	105
Investment grants Land/Federation	7	7	8	9	11	11
	33	33	33	33	33	33
Balance of financing	6	9	8	5	6	5

* Projektionen.

Quelle: Deutscher Städtetag (2018)

Taxes, contributions, fees

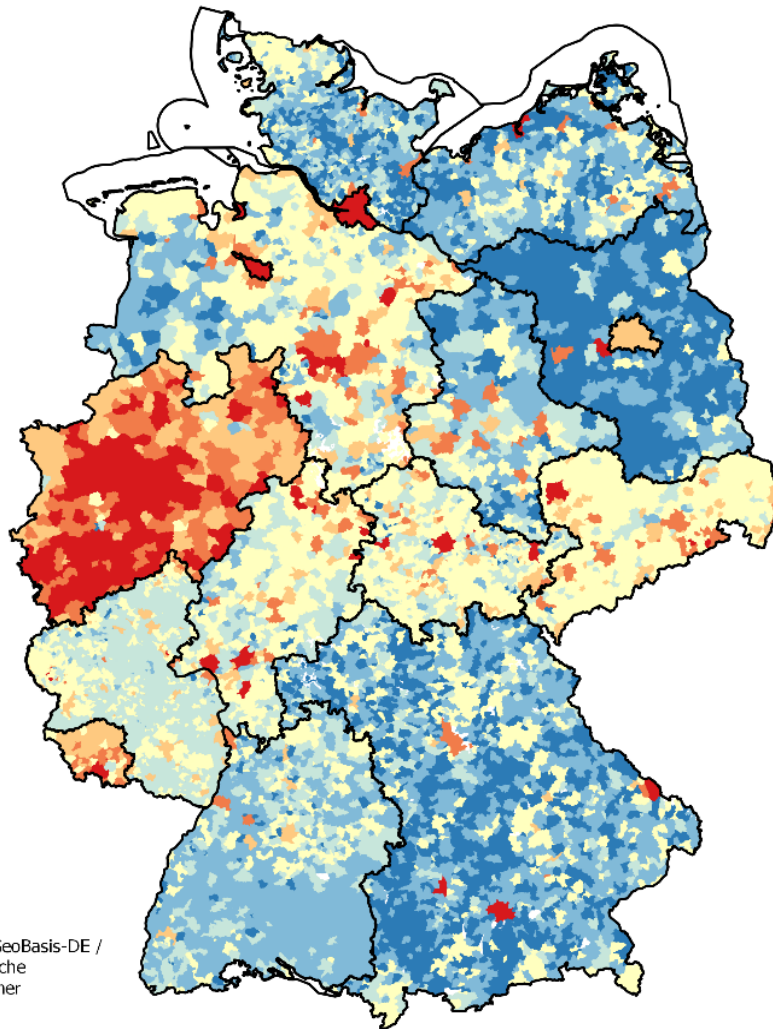


German taxes and their distribution

2018	Federation	Länder	Municipalities
Community taxes			
Wage and income taxes	117 208	117 208	41 182
Sales tax	116 513	110 841	7 484
Corporate income tax + withholding taxes	28 301	28 301	
Federal taxes			
Energy tax	40 882		
Vehicle tax	9 047		
Tobacco tax	14 339		
Electricity tax	6 858		
Insurance tax	13 779		
Solidarity surcharge	18 327		
Other	5 354		
State taxes			
Real estate transfer tax		14 084	
Inheritance tax		6 813	
Beer tax		655	
Other		2 361	
Municipal taxes			
Property tax			14 202
Business tax (pseudo community tax)	2 058	7 020	46 795
Other			1 710
Level totals	372 666	287 283	111 373

Trade tax: Local tax rates (2017)

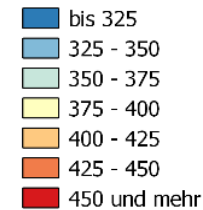
The right to determine the local tax rate on company profits ("business tax") in each municipality has a long tradition, but is economically very controversial because of tax competition.



Quellen: Geobasisdaten © GeoBasis-DE /
BKG 2018; Hebesätze Deutsche
Industrie- und Handelskammer

Local tax rate

Collection rate points (2017)



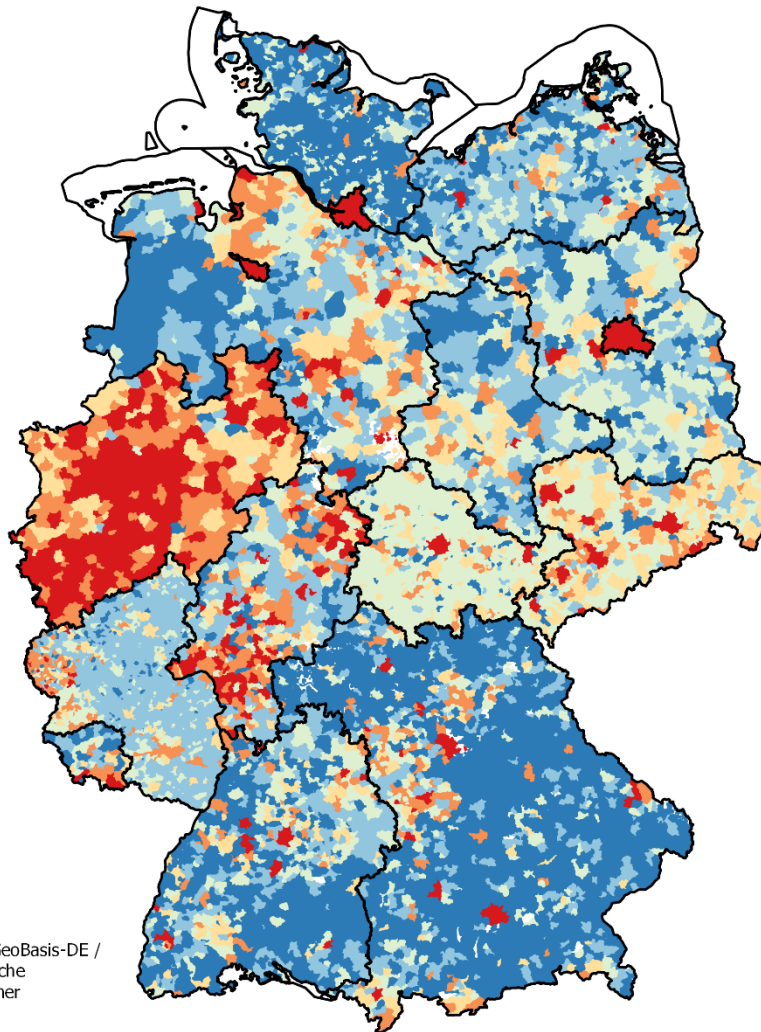
□ Ländergrenzen Länder borders

The map shows how strongly the state finances also affect the collection rates:

- Strong municipalities do not need high rates (BY, BW)
- Economically weak municipalities do not allow high rates (MV, BB, ST...)
- Underfunding of municipalities forces high rates (NW)

Land Property tax: Local tax rates (2017)

The right to determine the amount of local land and property tax in each municipality has a long tradition and, unlike business tax, is not economically controversial.



Local tax rate tax B

Collection rate points (2017)



Länder borders

The map shows how strongly the state finances also affect the collection rates:

- Strong municipalities do not need high rates (BY, BW)
- Economically weak municipalities do not allow high rates (MV, BB, ST...)
- Underfunding of municipalities forces high rates (NW)
- Financial equalization laws of the Länder have additional influence (hetero- / homogeneous)

Quellen: Geobasisdaten © GeoBasis-DE /
BKG 2018; Hebesätze Deutsche
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Vertical municipal financial equalisations

- Only a few municipalities finance themselves solely from levies – i.e. are "**abundant**".
- By far the majority of municipalities are integrated **into the tax-revenue scheme of their federal state ("tax association")**. The funds flow into the municipal financial equalisation schemes (KFA).
- The KFA are designed as **vertical financial equalisation tools with horizontal effect**.
- Models of **vertical resource allocation**:

Pure association quota model

- Fixed percentage of federal states' tax revenues
- Baden-Württemberg, Bavaria, Lower Saxony, NRW, Saarland

Association quota model with symmetry requirement

- Symmetrical state and municipal finances (revenue/expenditure)
- Brandenburg, Schleswig-Holstein

Uniformity principle

- Relative uniformity of state and municipal revenues
- Mecklenburg-Western Pomerania, Saxony

Stabilisation model

- Association model with economic compensation
- Rhineland-Palatinate

Demand model

- Municipal financial requirements on a cost basis
- Saxony Anhalt, Thuringia, Hesse

Structure of municipal financial equalisation schemes

Allocations to municipalities		
Within the financial equalisation system (association volume)		Outside the financial equalisation volume
Key allocations	Earmarked allocations	Reimbursement for administration of orders and other allocations from the Land
	Demand-based allocations	Forwarded reimbursements from federation or EU

Requirements

- **Subsidiarity:** Exploiting your own revenue potential first.
- **Appropriate determination of needs:** Appropriate standards for determining financial needs and financial strength.
- **No levelling out:** financial strength sequence not to be changed by equalization.
- **Transparency requirement:** In order to ensure acceptance of the results of equalization, it must be as comprehensible as possible for the municipalities.

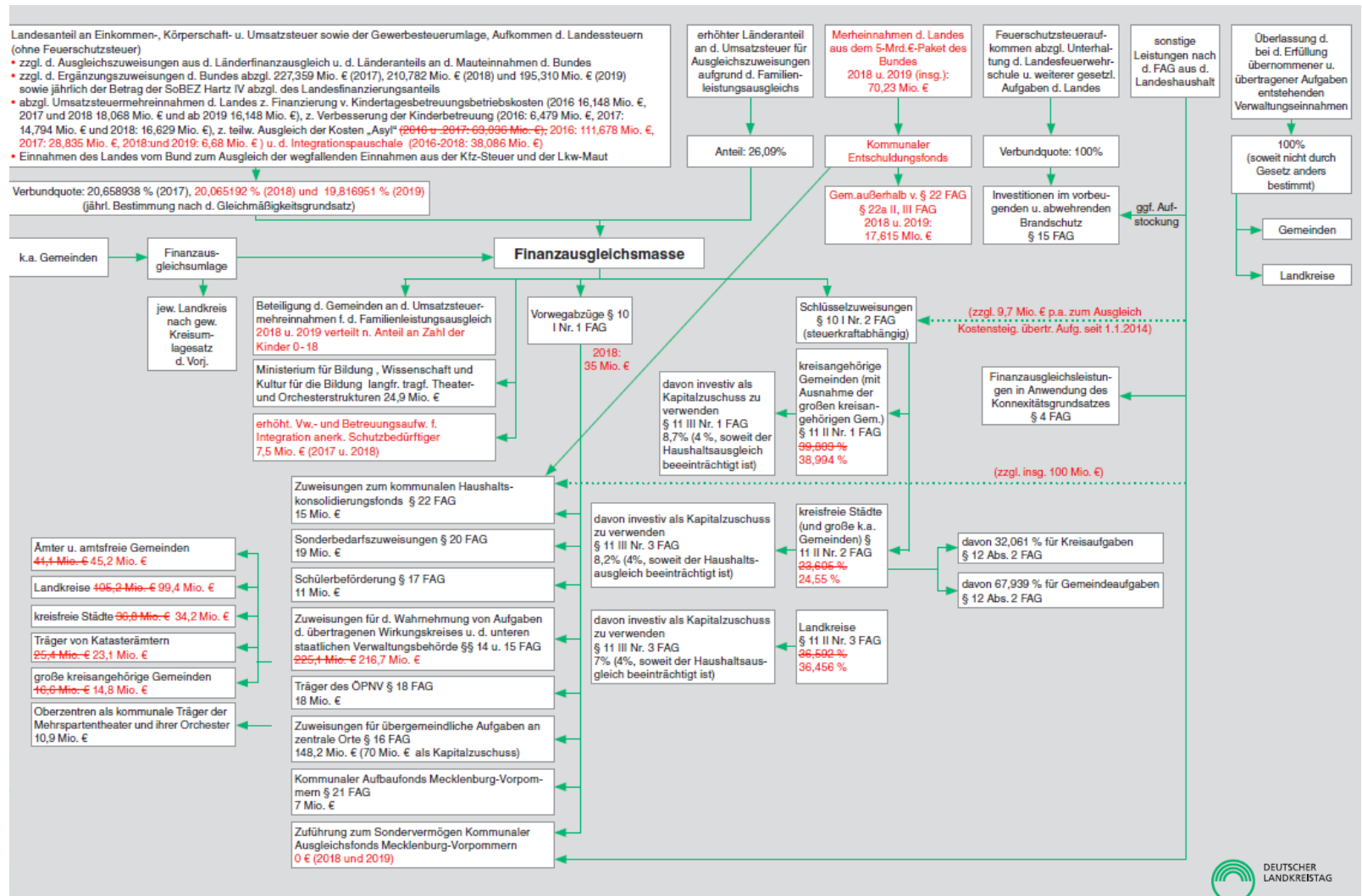
Local financial equalisation in a narrow sense

- Flat-rate **financial requirements** > flat-rate **fiscal capacity** -> key allocations
- Financial requirements are calculated on the basis of independent **indicators**.

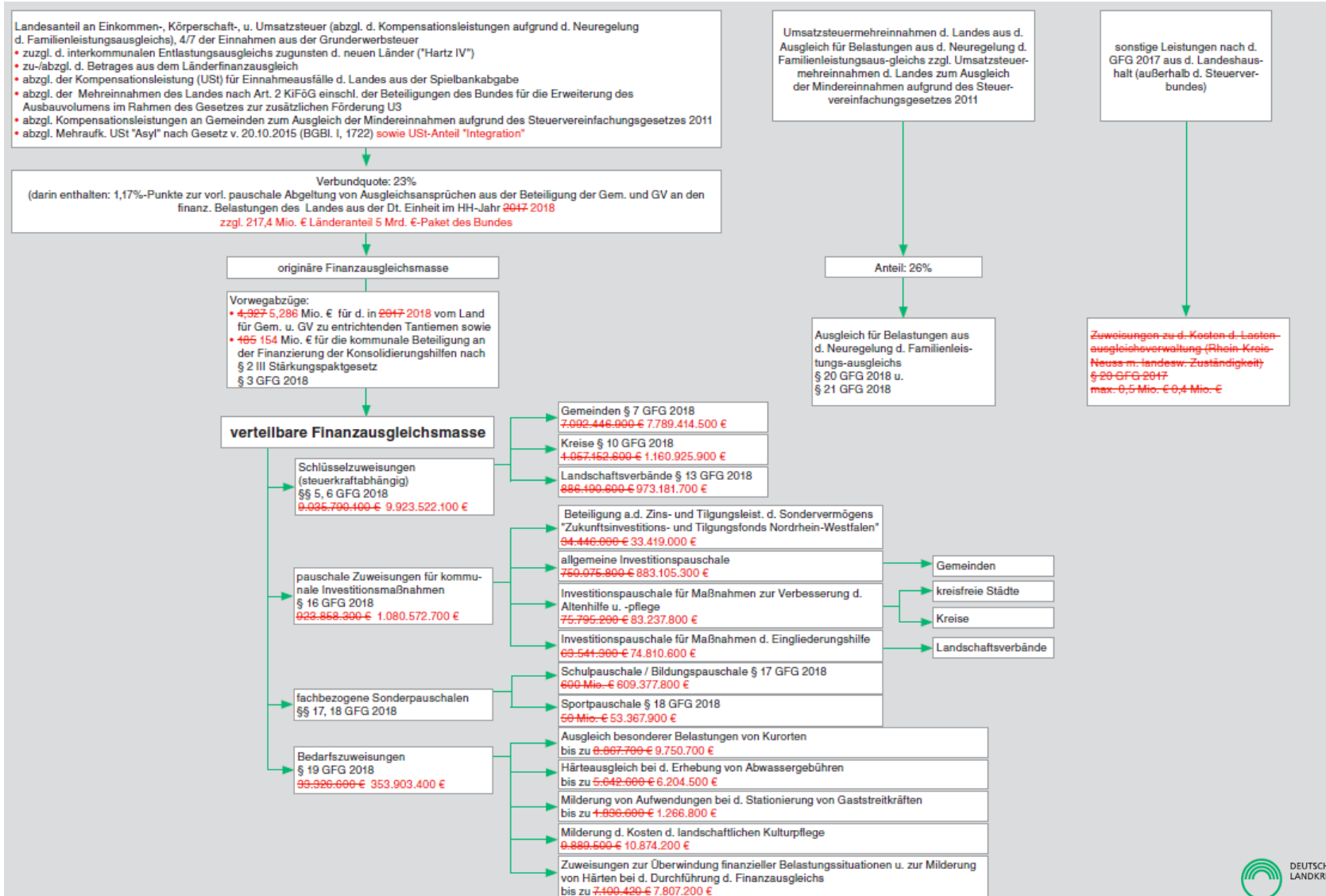
Often:

- **Main approach:** number of inhabitants x size of town ("inhabitant scaling")
- **Secondary approaches:** Surface area, pupils, centrality, social charges ... ¹⁵

Examples of different financial equalisation systems: Mecklenburg-Western Pomerania

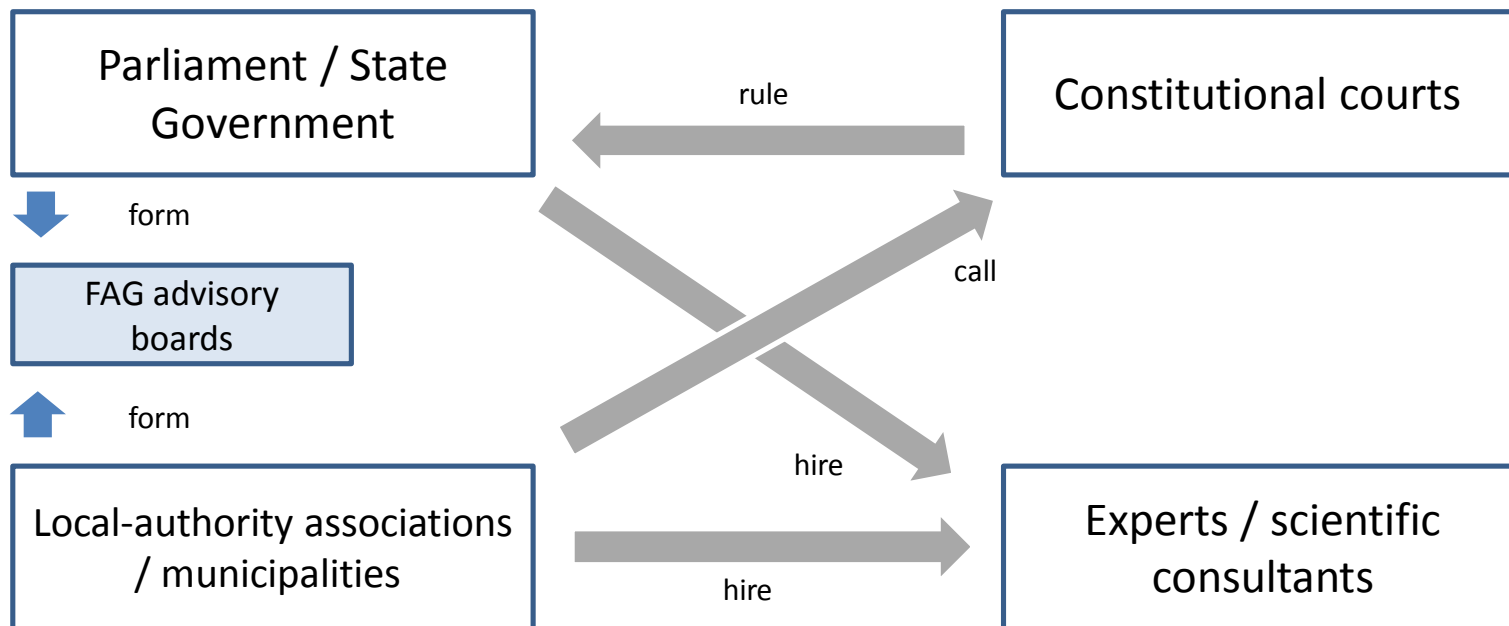


Examples of different financial equalisation systems: North Rhine-Westfalia



Review and evaluation

- Municipal finances in Germany are a **constant point of contention between the** municipalities and the Länder; now also involving the federation.
- The **numerous interests** and the **complexity of** the 13 different municipal fiscal equalisation scheme create a **network of actors and instruments**, also in the review and evaluation of fiscal equalisation laws and their financial resources.



Success factors 1 and 2: Goals and integrated laws

What has proven its worth? Everyone must be able to support the federal narrative. And federal finances should be handled in one place.

1 . Equal living conditions: Semi-specific targets...

- ... as narrative strengthen the integrative power of a equalisation scheme, because they help to bridge latent contradictions between equalisation and autonomy.
- It offers means of identification to all sides, but creates a corridor of commitment. This creates an understanding the boundaries between autonomy on the one hand and equalisation on the other hand.

2. integrated legislation for municipal finances... ..

- ensures that the overall effects of adjustments are always taken into account . All central financing issues are regulated in a (respective) Financial Equalisation Act.

Success factors 3 and 4:

Data standards and central balancing

What has proven its worth? With common data standards, everyone is talking about the same thing. Even if it goes against the principle of transparency, a little horizontal balancing by the central state makes it much easier for everyone to reach a consensus.

3. Common data and accounting standards...

- ...significantly reduce the number of potentially contentious issues in negotiations, because you do not have to discuss facts, but can trust them.

4. Compensation by the central (state) level...

- ...creates the political conditions for an indirect balance between financially strong and financially weak partners in difficult starting conditions.

Success factors 5 and 6:

Uniform taxation and subsidiarity

What has proven its worth? Uniform taxes reduce conflicts. Subsidiarity must be lived.

5. Homogeneous taxes...

- ...facilitate the recording of financial strength, which is decisive for financial equalisation, enormously. Everyone automatically knows both amount and composition of everyone else's revenue.
- There still is intermunicipal tax competition though, which should be constantly recalibrated (which is not always achieved).

6. Municipalities as spaces to live - living and work - recognised

- Subsidiarity must be lived.
- Powerful municipalities and actors in local politics are needed -> Not always easy as based on voluntary work

We have raised many questions and answered
some of them (...partly).

Now we come to your comments and questions!

Continue the dialogue:

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