

FEDERALISM AND DECENTRALIZATION IN GERMANY

BASIC FEATURES AND PRINCIPLES FOR GERMAN DEVELOPMENT COOPERATION

As a federally owned enterprise, GIZ supports the German Government in achieving its objectives in the field of international cooperation for sustainable development.

Published by:
Deutsche Gesellschaft für
Internationale Zusammenarbeit (GIZ) GmbH

Registered offices
Bonn and Eschborn

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Design/layout:
Diamond media GmbH, Neunkirchen-Seelscheid

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On behalf of
German Federal Ministry for Economic Cooperation and Development (BMZ)
401 – Sectoral and thematic policies, governance, democracy and rule of law
Bonn

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FOREWORD

GIZ is a federal enterprise in the field of international cooperation for sustainable development and international education. It is active in more than 120 countries worldwide, supporting partner countries in implementing political, economic and social transformation processes for a better future. Over the past few years, our partners have increasingly sought a joint dialogue to exchange information on specific German policy experiences– for example decentralisation, fiscal decentralisation, the social-ecological market economy, or the dual system of administrative training.

Partner countries are keen to analyse these “Made in Germany” approaches, compare them with their own reform ideas and to examine which elements, approaches and experiences may be relevant for them. GIZ’s Governance Fund commissioned by the German Federal Ministry for Economic Cooperation and Development (BMZ) addresses this specific demand. Through a network of experts, it makes German experience and knowledge available to partner countries around the world, helping policy makers shape reform initiatives and thus supporting various reform processes. The aim is not to treat the German policy experiences as a mere blueprint, but to use it as a basis for a necessary joint identification of successful and useful elements and an analysis of their relevance for the respective partner country.

As a basis for a dialogue with our partners, the Governance Fund commissioned four studies that illustrate German policy experiences. The studies were discussed and revised in a peer review process by experts with practical policy experience (e.g. former state ministers), with specialists from GIZ and from partner countries.

So far, the following studies have been prepared:

1. “Federalism and Decentralization in Germany – Basic Features and Principles for German Development Cooperation”, carried out by the University of Potsdam: Prof. Dr. Sabine Kuhlmann, Prof. Dr. Ulrike Fleischer and Prof. Dr. Harald Fuhr
2. “Forming Civil Servants – Elements of Success and Ideas for Transfer Based on Germany’s Dual Public Administration Education”, carried out by the German Research Institute for Public Administration: Raphael Marbach, Carolin Steffens, Marius Herr, Prof. Dr. Dr. Jan Ziekow
3. “The Social-Ecological Market Economy in Germany”, carried out by DIW Econ, Prof. Dr. Alexander Kritikos and Dr. Anselm Mattes and commented by Jost de Jager, Schleswig-Holstein’s Former Minister of Economic Affairs
4. “Reform and Future of Financial Equalization in Germany – Benefits for Development Cooperation”, carried out by Dr. Michael Thöne (Executive Board Member of the Institute for Public Economics at the University of Cologne) and Jens Bullerjahn (Former Minister of Finance of Saxony-Anhalt)

A team of distinguished Professors of the Potsdam Center for Policy and Management at University of Potsdam – Julia Fleischer, Harald Fuhr and Sabine Kuhlmann - wrote the comprehensive study on Federalism and Decentralisation in Germany.

The study addresses policy makers from partner countries of German development cooperation as well as the broader professional public interested in decentralisation, reform processes and development policy. Our thanks go to the authors and to stakeholders and colleagues at home and abroad, whose valuable comments contributed to the success of the study.



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1. INTRODUCTION AND OVERVIEW

Since the mid-1980s, a great number of governments around the world have embarked on ambitious decentralization reforms and supported local governments. As an essential part of public sector modernization, initial expectations were high: progressive decentralization was intended to bring about a variety of improvements, particularly in terms of political integration and participation and, above all, the provision of public services (Fuhr 1999, Pollitt 2005; Kuhlmann and Wayenberg 2016; Schwab et al. 2017).

However, after a period of more than 25 years of implementing decentralization policies and “strengthening” local governments, initial enthusiasm has waned. In many cases, decentralization did not result from a carefully designed sequence of reforms, but occurred in politically volatile environments where levels of trust were low, and where policy makers were largely responding in an ad-hoc and unsystematic manner to the emerging demands from citizens, local interest groups and donors (cf. Smoke et al. 2006).

Despite its positive image, decentralization is not easy to carry out. While decentralization has brought about a variety of positive developments around the world, notably in education and school management (Hansen 1997, Faguet and Sánchez 2008), the results of decentralization reforms vary from country to country, and appear to be mixed (Kuhlmann et al. 2014; Kuhlmann and Wayenberg 2016). Policies and institutional arrangements mattered crucially during reforms. When designed and sequenced with care, they allowed over time for better vertical and horizontal accountability and better intergovernmental cooperation. When not, the efforts of policy makers caused a series of new political, fiscal and administrative problems, and even outright failure (Fuhr 2011).

Since the mid-1980s, decentralization has also received considerable attention in bilateral and multilateral development cooperation. In many partner countries with highly centralized administrative systems, policy advice relating to decentralization was often based on practical examples from OECD countries and European, North American or Australian lessons from administrative, fiscal and political decentralization, and the workings of state and local governments.

In principle, there is nothing bad about reviewing what has worked in public sector modernization and decentralization in other countries, and seeking to implement good practices. In fact, “learning” from the experience of others can be quite useful in (partially) avoiding some of the critical “mistakes” that are regularly made during the reform process, and making efficient and effective use of public resources. However, instead of carefully reviewing OECD practices and adapting, adjusting and translating them to be useful in other contexts, policy advice has often been rather technocratic, too closely guided by specific OECD practices, and rather insensitive to the political and institutional contexts of partner countries. Political economy analysis and better dialogue among partners about the objectives of reform could have helped, but have rarely been applied.

According to the TORs for this study the following sections will respond to two demands. First, a demand by policy makers and technical staff in partner countries, many of whom seek to know more about and better understand some of the key features of Germany’s decentralized and federalized system, and the workings of its local governments. Second, a demand articulated by German development policy experts regarding the usefulness, applicability and transfer-ability of some of German federalism’s underlying principles and practices for policy advice and for on-going decentralization reforms in partner countries. To illustrate some of these features, we added four boxes on selected lessons from development practice in partner countries (Bolivia, Ukraine, Pakistan and Zambia).

In Section 2 we will briefly review the development of Germany’s decentralized system since the early 19th century. This will help to reach a better understanding of “path dependent” developments that have occurred since 1945, and during and after reunification in 1990. Section 3 will introduce some of the key features, principles and practices of today’s German federalism and its operations at and between three governmental levels. In Section 4 we will review the features of recent reforms in German federalism and the ideas and practices that guided them. Each section will include a summary of key principles and assess the potential implications for German development cooperation and dialogue with policy makers in partner countries. Section 5 will review these lessons again and synthesize the results.

2. HISTORICAL BACKGROUND OF DECENTRALIZATION AND FEDERALISM IN GERMANY

A great number of development experts admire the level of political and administrative decentralization and the presence of strong local governments in European countries, such as in Switzerland, Germany, and Spain, and appreciate the EU's clear commitment to subsidiarity. However, they often tend to overlook the starting conditions those countries once had. While during the 1960s, 1970s and 1980s many developing countries were facing highly centralized political and administrative systems, Germany's situation at the beginning of its rapid industrialization was very different.

Starting in the mid-19th century, Germany's process of rapid economic and social transformation did not suffer from too much centralization. Instead it suffered from too little. After the devastating Napoleonic wars, the German Confederation (Deutscher Bund) consisted of an association of 39 fairly independent German states created by the Congress of Vienna in 1815 to replace the former Holy Roman Empire, which had been dissolved in 1806. Within their boundaries, each of these states had their own rules and regulations, and governments managed their own affairs. At subnational level, particularly in the state of Prussia, the Stein-Hardenberg reforms (from 1807 onwards) laid the foundations for an efficient, effective and participatory local government for many years to come.

However, what may have looked like a perfect world for a secessionist constituted quite a difficult state of affairs for the new Confederation at that time. The German states ensured law and order only within their territories, not amongst them. Inter-state cooperation remained extremely fragile and hindered joint security policies towards European powers. Fragmentation in particular increased the costs of intra-German trade and impeded emerging markets. Understandably, there was little demand in the Confederation for even more decentralized forms of government. Instead, the challenge was to create a borderless market with joint rules, and a national unity government with a more centralized system of administration. Political decision makers favored more centralization with top-down command and control in order to promote what we would regard today as "catch-up development", namely industrialization and societal modernization through investment in education, science and research, but also militarization.

In 1871, the German states were united for the first time under the leadership of Prussia, one of its most developed, and best organized states. Prussia was also the primary driver

behind the German Customs Union, a free trade area created in 1834 that included all German states in 1866. However, trade protection vis-à-vis the external environment, i.e. European economies, was the strategy of these years.

These centralizing trends –with the remarkable technological and industrial development of the German Empire – continued until the outbreak of the First World War (1914-1918). During a short phase of democratization and liberalization in the Weimar Republic of the 1920s, the German states regained more democratic freedoms. However, by 1933 the Nazi dictatorship had removed with brute force all democratic and decentralized structures within a couple of months.

After the Second World War (1939-1945) new shifts occurred. While the occupation forces of the US, France and UK opted for a more decentralized, democratic, market-driven reconstruction of West Germany, the USSR favored a more centralized political system that ensured state-led development and central planning in East Germany. And while the "Federal Republic of Germany" based its economic and social revival quite successfully on its flourishing *Länder* and local governments, the "German Democratic Republic" (GDR) reactivated its economic production and social welfare in a fairly centralized manner with little independence of its subnational entities.

Interestingly, as the GDR began to progressively collapse in late 1989, networks of subnational governments quickly re-emerged, despite their virtual disappearance in the decades before. While monetary policies and financial transfers by the national government were essential throughout the 1990s, a recreation of *Länder* governments and West-East cooperation among those entities was instrumental for rapid "bottom-up" transitions to a market economy and democratic governance. While the fine-tuning of both vertical and horizontal relations among governments, particularly among the wealthiest and the poorer entities of the federation, was left to be decided in a later phase, the national government set about harmonizing development with a series of compensatory instruments and fiscal transfers.

With a few exceptions, particularly during the Nazi dictatorship from 1933-1945, national governments in Germany could never fully undercut (nor did they intend to do so) the autonomy that state and local governments had possessed over many centuries. Decision makers opted instead for collaborative inter-governmental arrangements with slightly

more or less local self-government, and with slightly more or less competition amongst governments. As we will show in Section 4, historical preconditions have mattered a lot when it came to political and institutional reforms in recent years.

In retrospect, and once the Customs Union was fully established in the 1860s and the German Empire founded in 1871, maintaining high levels of subnational autonomy has probably had a beneficial effect for overall development. It

helped subnational clusters of government officials, bankers, entrepreneurs and workers – for example in the Northwest and Southwest – to develop trusting relationships and to accelerate industrialization in a late-coming nation. It allowed for maintaining diversity and different styles of governance. It also encouraged competitiveness and innovation, particularly through business-friendly local governments and networks of small and medium-sized enterprises.

Key features

- Decentralized government and federalism in post WW2 Germany was built upon three pre-existing features:
 - A long *tradition of independent subnational governments and local self government* (which resulted from a highly fragmented Holy Roman Empire from 962);
 - A strategy of *functional centralization of government and administration* since the mid 19th century as a key measure for catch-up development;
 - Foreign *interventions after the Second World War* – Western occupation powers focused on reconstruction in a decentralized structure in West Germany, particularly to dismantle the highly centralized Nazi state apparatus.
- The Stein–Hardenberg reforms from 1807 onwards encouraged close cooperation between local governments and private businesses, which was instrumental for Germany's catch-up industrialization.
- Within a united Germany, decentralized government has historically preserved diversity, while at the same time encouraging competition, and fostering centers of innovation.
- Germany's reunification and state building in East Germany benefitted from intra-governmental and national assistance programs.

Principles and Transferability:

- *Historical conditions and path dependency* have mattered crucially for the outcomes of decentralization reforms in Germany. Other preconditions in partner countries are likely to result in very different outcomes.
- Functional *centralization* in the 19th century took place while maintaining government capacity at subnational level (except for the years 1933–1945).
- Functional centralization and functional decentralization are not necessarily contradictory strategies. Governments have chosen both to address societal demands and respond to specific challenges. However, making such choices requires steering capacity and political willingness *at all levels*.
- Federalism can be seen as an adaptive and flexible arrangement between levels of government and among governments with three “embedded” principles:
 - *Maintaining autonomy* while adhering to joint rules and restraints
 - *Maintaining diversity* while preserving unity
 - *Maintaining competition* while ensuring cooperation
- Each of these principles – autonomy, diversity and competition – can be taken to extremes. However, governing effectively and legitimately means that policy makers need to identify potential trade-offs and find a balance between these opposing dynamics, and employ them according to emerging societal needs and challenges. Crisis management, for example, may require very different levels of subnational autonomy than those during times of prosperity.

- High levels of *autonomy* of subnational governments (while following joint rules and institutional restraints) can help to move the state closer to citizens and the private sector. Provided there are options for political participation, local autonomy can foster societal innovation and buttress local clusters of development.
- *Diversity*-ensuring decentralization can help to improve national integration; it can also be a source for competition and innovation.
- *Horizontal and vertical competition* amongst members of the federation may foster creativity and innovation; it may also help to ensure mutual accountability.
- *Democratic rights and democratic participation* ensure that diversity does not lead to societal conflict, but instead options for voice of diverse societal groups and subnational units (with protracted processes of decision making as potential negative externalities).
- Cooperative federalism in Germany has required *institutional capacity at all levels of government* (with bureaucratization as a potential negative externality).
- Federalism has also strongly influenced Germany's *style of politics* – requiring the consent of many of its members; it has led to a rather consensus-based democracy (with many veto players, and institutional grid-lock as a potential negative externality).

3. DECENTRALIZATION IN GERMANY: BASIC FEATURES

In the following sections we will first review the current features of decentralized government in Germany and a special variant of federalism, namely “executive federalism” with its specific equality enhancing approach to fiscal federalism. In Subsection 3.2. we will turn to the subnational level and the workings of *Länder* and local governments which, in turn, is based on a long tradition of self-government highlighted in *Section 2*.

3.1 Executive Federalism

Basic principles of executive federalism

suffices. But in view of the constitutional framework, far-reaching majorities are desirable for this kind of financial reform. Otherwise, a compromise reached might be quickly called into question by the outvoted minority by bringing an action before the constitutional court.

Germany is a “unitary federation” (*unitarischer Bundesstaat*) with a strong position of its states (*Länder*), but the constitutionally protected unity of law, economy and living conditions. As a consequence, all three state levels (federal, *Länder*, local) each have their distinct legislative bodies, their own executives, and judicative bodies (see Annex 1). Policy making in Germany follows the principle of an “executive federalism”. In a nutshell, this principle stipulates a functional division of competencies between the federal and the *Länder* level. Whereas the federal level is mainly responsible for policy formulation, the *Länder* level is mostly engaged in policy implementation (see Lehmbuch 2002). This overall notion of a unitary federation under the principle of executive federalism has several

implications. Most importantly, the federal level has no hierarchical control, no legal supervision, and also no financial appropriation over the *Länder* level. Instead, the *Länder* enjoy strong autonomy yet they have limited legislative authority of their own (e.g. police, schools, and culture). As a consequence, the federal executive has only very little direct involvement in implementation and service delivery, and thus does not operate with regional or local offices (exceptions include defense, customs, inland waterways, and the federal police).

The *Länder* participate in policy making at federal level via the second chamber (the Bundesrat). The German Bundesrat is composed of the *Länder* governments, and thus German citizens cannot vote for these representatives directly via a specific election, but only indirectly via their regular *Länder* elections resulting in distinct compositions of the *Länder* governments acting as Bundesrat members. Moreover, various constitutional and other requirements ensure the participation and veto power of the Bundesrat over policies put forward in the federal parliament (e.g. Scharpf 1989; Leunig 2003; Lhotta 2003). The *Länder* interests in the Bundesrat are further reflected in its distinct composition, which is based on the number of inhabitants in each Land. The Bundesrat often echoes the party competition in the federal parliament, but it is equally relevant to note the regional interests and alliances as well as the overall requirement to collaborate in order to organize policy implementation under the notion of unity across the federation.

These manifold interactions of collaboration can be broadly distinguished between those involving the *Länder* only (horizontal collaboration) and those involving the federal and the *Länder* level (vertical collaboration). These two major forms of collaboration can be formally stipulated by laws, regulations or formal institutional arrangements (formal collaboration), or are adopted over time as routines of good practice (informal collaboration).

Examples of collaboration in German executive federalism:

- Horizontal and formal collaboration:
 - Conference of Prime Ministers
 - Conference of Ministers for Culture
 - Treaties between *Länder* (e.g. media)
- Horizontal and informal collaboration:
 - Working groups and advisory boards
- Vertical and formal collaboration:
 - Bundesrat (second chamber at federal level)
 - Regional economic development
- Vertical and informal collaboration:
 - Permanent representation of the Land in Berlin
 - “Brotherhoods of experts”

These various interactions of collaboration are characterized by different dynamics, ranging from the mechanisms of party competition, competition in areas where this is allowed (see Section 4.2), to cooperation and coordination between *Länder* administrations in order to improve policy implementation and ensure the constitutional guarantee of unity across the federation. Most of these modes of collaboration involve *Länder* executives, and have been criticized for their lack of transparency and participation by *Länder* parliaments. Hence the notion of executive federalism also puts strong emphasis on the executives, and requires reasonable executive capacities on behalf of all actors involved. Simultaneously, and as a consequence of the German notion of executive federalism allocating competencies, the public sector workforce at federal level is comparatively small, while the largest number of public sector employees work at *Länder* level, followed by the local level (see Annex 2)

Box 1: Pakistan: Local Practices Within a Federation

Policy makers in Pakistan often seek orientation for designing their broader policy reforms from experiences and models in Commonwealth member countries, such as Canada and Australia. However, they have been keen to learn more about the lessons from development practices at the German local level, particularly intergovernmental collaboration (“*Gebietskörperschaften*”) and on-the-job training with further education for local civil service staff. Given Pakistan’s strongly politicized second chamber (Senate), where partisan politics heavily dominate agendas, it might be worthwhile to jointly review Germany’s lessons of experience. The purpose of the Bundestag’s institutional design was to limit excessive partisan politics, and ensure “administrative rationality” and pragmatism.

The fiscal equalization scheme

The fiscal relations in the German federation are rather complex (see in more detail Thöne and Bullerjahn 2018), but follow two principles. Firstly, taxes are shared across state levels according to established criteria (vertical division). Secondly, tax revenues are distributed across the *Länder* (horizontal adjustment). Three-quarters of all overall tax revenues are shared between the levels of government, such as VAT and income taxes (personal and corporate income taxes):

- VAT: federal = 52%, *Länder* = 45.5%, local = 2%
- Private income tax: federal = 42.5%, *Länder* = 42.5%, local = 15%
- Corporate income tax: federal = 50%, *Länder* = 50%

Moreover, each governmental level collects some of its taxes separately. The federal level collects customs duties, insurance tax, tobacco tax, and solidarity income tax. The *Länder* collect the inheritance tax and automobile tax, and the local governments collect the taxes on real estate and local businesses.

The redistribution of taxes is generally based on the constitutional objective of the “equivalence of living conditions”. The revenue equalization scheme redistributes tax income between the *Länder* horizontally, including (a) a redistribution of VAT (Umsatzsteuervorwegausgleich), and (b) the financial equalization scheme (*Länderfinanzausgleich*). The

latter redistributes tax income until the financially weaker *Länder* reach 95 per cent of the financial resources of the contributing states. The financial capacity of a Land is assessed by the sum of its receipts (64%) from its local authorities per inhabitant (corrected for three city-states and three sparsely populated *Länder*) and how much it falls below/above the average. In addition, vertical transfers exist between the federal and the local level as supplementary grants of the federal government (Bundesergänzungszuweisungen) to the poor *Länder*, as general supplementary grants for special needs (e.g. the East German *Länder* and Berlin receive money via the Solidarity Pact scheme). The total volume of these horizontal and vertical redistributions was €9.6 billion in 2015. The scheme is regularly contested before the Federal Constitutional Court, and especially those *Länder* providing financial resources on a regular basis question the fairness of the equalization scheme and the incentives and rewards therein (arguing that financially weaker states have an incentive to maintain their weak status in order not to distribute to the equalization).

Key features

- German executive federalism: Functional division of competencies (policy formulation vs. policy implementation/service delivery)
- No hierarchical subordination across the state levels
- Federal government and administration is comparatively small, major bulk of employees is employed by *Länder* and at the local level
- Various arenas of formal and informal collaboration between the *Länder* (horizontal) and between the federal and the *Länder* level (vertical)
- The Bundesrat, as second chamber at federal level, ensures participation of *Länder* governments in policy-making

Principles and Transferability:

- Constitutional principle of unitary federation sets strong limits on competition between the *Länder* and ensures horizontal collaboration
- Different from second chamber (“Senate”) solutions in many federations, there are no direct elections for the Bundesrat. In order to avoid too much politicization, the Bundesrat solution instead focused on *Länder* government representation, administrative continuity and rationality
- Need for sufficient administrative capacity at all state levels
- Criticism regarding the allocation of competences and responsibilities given the various collaboration arenas and arrangements, lack of involvement of *Länder* legislatures

3.2 *Länder* Administration and Local Self-Government

Länder administration

The autonomy of the *Länder* in determining their organizational structure has led to considerable institutional variance among them. For the *Länder* administration, the distinction is usually made between three-tier and two-tier systems (see Kuhlmann and Wollmann 2014). The three-tier administrative structure comprises a central level (highest Land authority, higher Land authority), a meso-level (administrative district authorities, higher single-purpose Land authorities) and lower level (lower Land authorities, county administrations as a lower general purpose Land administration). Other *Länder* have decided to do without meso-level authorities, so that they have two tiers (such as the *Länder* of Saarland, Schleswig-Holstein, Mecklenburg-Western Pomerania, Brandenburg, and Lower Saxony since 2004; see below).

After 1945, most newly established (West German) *Länder* introduced a three-tier-system, including a meso-level: the administrative district (see Annex 5), headed by a president appointed by the Land government, as the intermediate level between the Land government and local authorities. Historically, this institutional scheme goes back to 1806 and 1808, when the then independent states of Bavaria and Prussia had put in place meso-level administrative districts as a key element to modernize their outdated, late medieval administrative structures (whereby some guidance was gleaned from France's post-1789 "invention" of the départements and from the Napoleonic préfet). In the organizational setting of the *Länder*, the meso-level administrative districts as general purpose entities have been assigned two main functions: to bundle and coordinate the sectoral policies issued by central government and the pertinent special purpose administrative units, and to supervise the activities of local authorities.

The meso-level administrative district as a key element of Land administration was put in place in the six West German *Länder* of North-Rhine Westphalia, Lower Saxony, Hesse, Bavaria and Baden-Wuerttemberg (typically the demographically larger *Länder* between 17.8 million and 7.9 million inhabitants), as well as in the three East German *Länder* of Saxony, Saxony-Anhalt and Thuringia (in the latter case, the modified form of central level Land agencies) after reunification. Since 2000, the meso-level district level has come increasingly under reform pressure and has even been abolished in Lower Saxony (see below).

Local self-government

Whereas under the German constitutional tradition and doctrine the local government level is considered to be part of the *Länder*, in legal terms they constitute a third politico-administrative level (see Annex 1). The local government structure is made up of two tiers: the counties as upper level, and the municipalities as lower level. Demographically larger cities have been given the status of 'county free' municipalities. These are generally larger municipalities, which, in combining county and municipal functions, stand organizationally and territorially outside the counties. On the basis of the traditional "dualistic task" model of Germany's local government structure, the *Länder* have adopted the practice of delegating the implementation of legal provisions to the local authorities, preferably to the counties and county-free cities.

The dualistic model was introduced into the German state and local government tradition at the beginning of the 19th century and was actually borrowed from France's post-1789 municipal legislation. Accordingly, the counties and municipalities concerned carry out a "duality" of tasks. On the one hand, they discharge tasks which are based on and derive from the "general competence" clause, an essential of local self-government as guaranteed in article 28 of the Federal Constitution and by the *Länder* constitutions. Accordingly, the municipalities and the counties (to a somewhat lesser degree) have the right "to regulate all matters relevant for the local community under their own responsibility within the limits set by the laws". Typical examples are urban planning, social and cultural activities and the like. On the other hand, the local authorities carry out tasks that are delegated to them by the Land. These delegated functions relate to the maintenance of public order and safety, such as the issuance of driving licenses, environmental protection, etc. The wide range of self-government and delegated functions of the local authorities makes up 70 to 80 per cent of all legal provisions (federal, Land and EU) applied and implemented by the local authorities.

It is worth noting that the local executive in Germany acts as a politically accountable local politician, rather than as 'agent of the State', even in the conduct of delegated business. This aspect probably holds true all the more since the beginning of the 1990s, when the direct election of the mayor (and, in part, county chief executives) was introduced in all *Länder* (see Heinelt et al. 2018).

Box 2: Ukraine: Focus on Local Autonomy and Self-government

Given its socialist past and administrative centralization, Ukraine's policy makers today are mostly interested in strengthening local autonomy and self-government vis-à-vis national level politics and policies. Intermediate levels of government, however, have not yet been fully considered in current debates. But how far can local autonomy go, how much autonomy is feasible? What is the minimum size a local government should have in order to operate effectively and efficiently, and who can supervise (later on) the multitude of localities and ensure accountability? How can we train local employees? All these are highly important questions and topics, for which policy makers in Ukraine can heavily draw on German and European experiences relating to the performance of self-governing bodies, and their limitations.

Germany's local government has traditionally been characterized by a multi-functional model. This territory-based model of local multi-functionality is further strengthened by the traditional feature of German local government being strongly engaged in the local economy and providing public services, either by local government units and personnel (in house), or through municipal companies (city works; Wollmann 2016). In the engagement of local authorities in the provision of public services, the institutional variant of the city works still prevails, under which the various services (energy, water, waste, and traffic) are 'bundled', and has come to be considered a German peculiarity in the European context. By contrast, in the area of social services, the principle of subsidiarity is traditionally predominant, and so the provision of social services is largely undertaken by private, independent and/or non-profit organizations. This has led to a de facto monopoly of large charities with pronounced corporate-like networks (cf. Henriksen et al., 2016, 223 et seq.).

As to the territorial structure at the local government level, the *Länder* have exhibited wide differences in the exercise of their individual legislative power in determining the local-level territorial structure (see Annex 3). Except for some early territorial reform moves undertaken in Prussia in the 1920s, the territorial structure of municipalities and counties that existed until World War II reached far back into the nineteenth century. After 1945, the old Federal Republic consisted of 24,381 municipalities with an average of 2,000 inhabitants, 425 counties and 135 (single-tier) county-free cities, combining both municipal and county tasks.

In the late 1960s and early 1970s, local government reforms were introduced and implemented in all the *Länder* of the (old) Federal Republic (for details see also Chapter 4, Section 4.2). Two of the *Länder* (North Rhine-Westphalia and Hesse) can be assigned to the Northern European type of territorial reforms, since large-scale amalgamations were effected, resulting (in the case of North Rhine-Westphalia) in 396 unitary municipalities with an average of 45,000 inhabitants. In most *Länder*, 'softer' territorial reform strategies more closely related to the Southern European territorial type, were pursued. In the Land of Rhineland-Palatinate, for instance, the scale of amalgamation was minimal as it largely retained 2,306 municipalities, averaging some 1,700 inhabitants.

The legal regulation of the internal 'Constitution' of local government (i.e., the rights and responsibilities assigned to the different bodies and actors) falls, in the German constitutional tradition, to the individual legislative competence of each Land. Ever since the reforms of the municipal charters in the 1990s, there has been a considerable convergence towards the South German model of municipal charter. The direct election of the mayor, which prior to the 1990s had only been in place in Bavaria and Baden-Württemberg, has since been introduced in all of the other German *Länder* – and began with the Land of Hesse in 1990. This shift has also been connected to the all-new possibility of recalling a mayor by way of referendum. Heads of county administrations are now directly elected too (except in Schleswig-Holstein and Baden-Württemberg). Moreover, the 'twin peaks' (dual leadership) model has been abolished in those *Länder* that formerly had the North German model of municipal charter and in its stead an 'executive mayor' has been installed. The dual distribution of powers in both the chief administrative executive and the council is currently in place nationwide.

In addition to direct elections of the mayor and the recalls, the possibility to hold legally binding local referenda (based on popular citizen initiatives) was added to the municipal charters, even though procedural hurdles and regulations vary greatly from Land to Land (Vetter et al. 2016). Overall, the frequency of decisions made by local referenda in Germany is still quite low.

Key features

- High institutional variety at the subnational level
- Länder administration organized as three-tier or two-tier systems, with the meso-tier (districts) increasingly under reform pressure
- Local Governments constitutionally part of the Länder; functionally a third level of the German politico-administrative system.
- No powers at the federal level regarding legislation of local government issues.
- Länder governments responsible for legal regulation of the 'Constitution' territorial sizes and functional responsibilities of "their" local governments
- Constitutionally enshrined "general competence principle" for municipalities
- Direct election (and recall) of mayors and (in some Länder) county chief executives and legally binding local referenda (advance of direct democracy)

Principles and Transferability:

- Principle of subsidiarity and local self-government as a possible principle of order – but historical situation in partner countries (?)
- Local self government is firmly embedded (and part of) rule-driven intergovernmental relations
- Need for sufficient implementation capacity at subnational levels and by all regional authorities
- Particularly interesting for resource rich partner countries is the "tax-benefit link" at local level: citizens pay for local services and thus have a strong leverage in local participation (and representation)
- System-stabilizing and legitimizing effect
- Mobilization of local activity (e.g. entrepreneurship) and citizen participation
- However, local governments require supervision and auditing "from above"

4. RECENT REFORMS OF GERMAN FEDERALISM AND THE LOCAL GOVERNMENT SYSTEM

Although there have been major reforms and adjustments in West Germany's federalism, such as the Territorial and Functional Reform in the 1960s and the Finance Reform of 1969, the major challenge to German federalism was triggered by German unification in 1990. Given the high differences in per capita income between the Eastern and Western *Länder*, the old principles of fiscal federalism and fiscal equalization became outdated and needed a serious overhaul (see Thöne and Bullerjahn 2018: III). They also increased the role of the federal government in managing transfers and kick-starting investment in the "New *Länder*". In Subsection 4.1 we will review the key features of the reforms that took place during the 2000s, and in Subsection 4.2 we will discuss the reforms and institutional adjustments that started in subnational governments during the same period.

4.1 Reforms of the German Federal System

The institutional structure of the German federal system links decentralization with the interdependency between central and local tasks. The German federal system involves a high number of actors with different veto powers, often expressing concurring interests across actors at different state levels, but also at the same level (*Länder*, local level). Moreover, Germany has a relatively stable party system supporting strong party competition present at all state levels. As a consequence, the German federal system is capable of supporting information exchange, solving conflicts of interest, formulating standards and achieving stability for public service delivery. However, it also lacks transparency and is characterized by ambiguous accountability relations and ineffective task delivery. As a result of this German federal system, political decisions regularly express the lowest common denominator because other actors may otherwise veto them or take a rather long time to reach consensus, yet they are also particularly stable and long lasting once compromise has been reached. However, in cases of failure to compromise, so-called "joint-decision traps" (Scharpf et al. 1976, Scharpf 1999) emerge that deadlock actors and thus delay policy solutions (see also Grimm 2001).

Box 3: Zambia: Consensus-based Approach to Decentralization

In Zambia, partners are particularly interested in the collaborative and coordinating aspects of Germany's federalist system and the country's overall gradualist and consensus-based approach to policy reforms, as illustrated in the workings of the German "Föderalismuskommission", for example. As a consequence, the German project team spent time working alongside a "Decentralization Policy Implementation Committee", and became involved in various institutional arrangements that brought together key stakeholders in Zambia's ongoing decentralization process. Such measures as these have contributed not only to making the different interest and concerns regarding decentralization more transparent for policy makers, technical staff and the general public, but have also allowed for a more effective negotiation process amongst partners and fostered consensus building.

As a response, reforming German federalism appeared more regularly on the policy agenda (e.g. Czada 1999; Benz 2003). To make substantial changes to the federal system possible, constitutional changes rearranging competencies across the state levels are necessary. Therefore, if reforms of German federalism address constitutional principles, they require two-thirds of votes in the Bundestag and the Bundesrat. Over the past few decades, regular debates on reforming the federal system have occurred, most notably its fiscal dimension. More importantly, two larger reforms were carried out in the 2000s (e.g. Benz 2003; Fischer/Große-Hüttemann 2003).

In October 2003, a reform commission was appointed by the Bundestag to examine how legislative responsibilities could be split between the federal and state levels, examining which responsibilities should be jointly addressed by the federal and state levels, and how bi-level funding structures should be designed, yet avoiding concrete financial issues. In July 2006, a final vote reorganized the law-making competencies between the federal and the *Länder* level in order to reduce the number of "consent bills". The *Länder* were given the right to regulate administrative procedures and create

authorities themselves. Framework powers involving both the federal and *Länder* level were abolished in favor of transforming them into sole powers of the federal or the state level, for example passports and registry to the federal level, and civil service regulations to the *Länder* level. The latter especially became a recurrent issue thereafter, with *Länder* trying to set up some competition with future *Länder* civil servants in areas such as education.

Box 4: Bolivia: Fiscal Concerns, the “Fiskalpakt”, and Mediation

In Bolivia, partners were highly interested in the workings of Germany’s “Fiskal-pakt” plus the “debt brake” with subnational governments, and the operations of the intergovernmental “Vermittlungsausschuss” (“Mediation Committee”). Similar to the Zambian experience, partners gave value to German “process-oriented” inputs, particularly those relating to mechanisms that allow to reach consensus and agreements amongst national and subnational governments, some of which maintain deeply-rooted differences in political positions. Policy makers in Bolivia were particularly interested in the arrangements and tools that have allowed German policy makers at both national and subnational levels to jointly reach credible commitments on public expenditures targets, fiscal control, and overall fiscal stability.

Just one year later, another reform commission started its work, focusing on approaches for restructuring and increasing fiscal autonomy and consolidating policy-related services and their impacts on the federal-state financial relationship, also critically analyzing responsibilities, setting standards, cutting red-tape and improving efficiency.

One of the key measures the reform commission advised was to adopt a “debt brake” for all *Länder* and to reorder the financial equalization scheme. The vote in June 2009 stipulated such a debt brake and the creation of a Stability Council to discuss the fiscal and economic indicators between the federal and *Länder* level. Moreover, the federal level gained responsibilities in IT infrastructures, and benchmarking across federal and state level was allowed and entrenched in the German constitution (Kuhlmann and Bogumil 2018).

Key features

- Reforms of the federal system require broad consensus across the two federal legislative chambers (involving the Bundesrat with representatives of the *Länder* governments)
- Federalism reform is rather complex and cumbersome, yet has become more regular over recent decades
- Federalism reform of the early 2000s aimed to disentangle responsibilities; its successor focused on financial and fiscal governance

Principles and Transferability:

- Federal systems need regular analysis of problems that block their well-functioning and make appropriate adjustments, if need be
- Federal system reforms should build upon a broad consensus involving all key actors

4.2 Reforms at the Subnational Level

Decentralization and functional reforms

Since the early 2000s, most of the *Länder* have embarked on comprehensive organizational and functional reforms, which are commonly labeled “functional reforms”, or broadly “administrative structure reforms” (see Ebinger and Richter 2016). The *Länder* were eager to simplify and ‘trim’ what has come to be increasingly criticized as an “over-institutionalization” of the subnational administrative and organizational structure. Furthermore, under increasing budgetary pressure, the *Länder* sought to cut public spending by organizational and functional reforms coupled with a reduction of public personnel. In most *Länder* the ‘functional reform’ hinged on transferring functions and tasks from units of Land administration to the local authorities, particularly to the counties and to the “county-free cities”. It should be added that in the “old” (West German) *Länder*, where extensive local level territorial reforms were carried out in the 1960s and 1970s (see above), the new wave of functional reforms somewhat builds on these past territorial reforms, while functional reforms in the “new” *Länder* have been undertaken hand-in-hand with territorial reforms. Basically, three models of functional reforms can be distinguished.

(1) The Land of Baden-Württemberg represents the case of a large-scale administrative decentralization of state tasks to the local level while retaining the existing territorial order of local governments and the three-tier structure of Land administration (see above). The complete dissolution of 350 of the total 450 existing single-purpose administrative authorities of the Land administration was the core element of that reform. The tasks and the personnel of these single-purpose state units have instead been transferred to 35 counties and nine county-free cities as well as to the four administrative district (Land) authorities. As the Land’s transfer payments are being reduced by 3 per cent every year, the Land government expected a so-called efficiency gain of about 20 per cent over the subsequent five to seven years. The achievement of this ‘gain’ has been imposed on the local authorities.

(2) By contrast, an example of administrative de-concentration (without territorial consolidation) can be observed in Lower Saxony where the (four) meso-level administrative district authorities were abolished, thus shifting from a three-tier to a two-tier model of Land administration. At the same time, a significant de-concentration of administrative functions from these (abolished) meso-level entities also took place. Only about 10 per cent of state functions have been decentralized to the local governments, whereas the functional scope of the single-purpose state unit has been noticeably expanded instead of strengthening the local government levels.

(3) Finally, reference is made to the case of the (East German) Land of Mecklenburg-Vorpommern. As the new Land was established after German reunification in 1990, no meso-level administrative districts have been introduced, preferring the two-tier structure of Land administration instead. Based on the County Reform Act of 2011, six quasi-regional counties (with 160,000 to 280,000 inhabitants) were created by amalgamating 12 existing counties. At the same time, the transfer of further state tasks to these quasi-regional counties, including upper-level coordination and bundling tasks, was envisaged. This case represents a combination of a large-scale county reform and further decentralization of state tasks within a two-tier model of Land administration.

Territorial reforms

The territorial reform strategies pursued in Germany can be assigned in part to the ‘Northern European’ model and in part to the ‘Southern European’ one (see Kuhlmann and Wollmann 2014; Schwab et al. 2017). The reason for this variance between the *Länder* lies in the constitutionally entrenched power of each of them to decide their “own” territorial reform policy that reflects the different settlement structures and varying party-political constellations. A radical territorial reform strategy has been chosen by the *Länder* of North Rhine-Westphalia and Hesse (according to the Northern European reform model). Their territorial reform hinged on the creation of territorially and demographically enlarged municipalities by amalgamating all existing municipalities to form new territorially and functionally integrated municipalities. In both *Länder*, the number of municipalities was drastically reduced by over 80 per cent.

By contrast, in the majority of the *Länder*, mostly the more rural and less densely populated areas, ‘mixed’ (hybrid) territorial reform strategies have been pursued with significant variance among them. The hybrid nature shows in two components. For one, these strategies also aim at reducing the number and enlarging the existing municipalities through amalgamation, and in the last resort, by way of binding legislation. However, unlike the afore-mentioned radical reform version, the hybrid strategy seeks a softer approach: either by amalgamating only part of them (for instance, in the case of the Land of Bavaria, reducing the number of municipalities by 71 per cent and raising their average size to some 8,000 inhabitants), or by way of very small-scale or practically no amalgamation (for instance, in the Land of Rheinland-Palatinate that has left its municipalities largely unchanged averaging 1,700 inhabitants). Insofar as the *Länder* have embarked upon amalgamation schemes, which result in the continuing existence of small-sized municipalities, they have also legally introduced inter-municipal formations, which essentially have the task of supporting the former in carrying out their functions.

The proportion of municipalities that are members of an inter-municipal formation varies between the *Länder*, reflecting the different impetus of amalgamation. Whereas in the Land of Rheinland-Palatinate it is as high as 98.2 per cent, it stands at 47.8 per cent in the Land of Bavaria.

After 1990 and following German reunification, the (newly established) East German Land governments also turned to territorial reforms at their local government level as an important step towards restoring efficient local government structures. The amalgamation of counties resulted in an overall reduction of their number from 189 to 87, leading to an average population size of over 100,000 inhabitants (see Annex 4). Since the mid-2000s, the territorial rescaling of the East German municipalities has finally been tackled,

too. The first East German Land to enter this territorial reform path was the Land of Brandenburg. As of January 1, 2005, the number of municipalities had been reduced by 72 per cent. The Land of Saxony-Anhalt followed suit and, as of 1 January 2011, had cut the number of municipalities through amalgamations by 79 per cent to reach an average population size of 10,900 inhabitants. Lastly, in the Land of Thuringia in 2016, an ambitious attempt at comprehensive territorial and functional reform, which aimed at reducing the number of counties from 17 to 8, as well as effecting extended amalgamation of the municipalities, accompanied by practically abolishing the existing inter-municipal bodies, recently failed due to political conflicts and resistance. The same applies to a recent reform attempt of the government of the Land Brandenburg.

Key features

- No single model of decentralization and territorial reform strategies; mix of models/hybrid models
- Choice of appropriate reform approach with respect to different subnational/local traditions and contexts
- Flexible combinations of reform elements possible → better acceptance
- Reunification as an important driver and cause of decentralization and territorial reforms in East Germany (adaptation to Western model)
- However, growing resistance regarding territorial mergers due to increasing political conflicts in territorial issues → recent reform failures
- Nevertheless, strong reform pressures remain due to demographic changes and fiscal problems

Principles and Transferability:

- Territorial and functional variations allow for flexible models of local government organization
- Variety of models encourage piloting, adjustments and learning
- However, different models can lead to differences in service provision, treatment of citizens, and varying institutional progress of localities
- Right balance to be found between “too small” and “too big” territorial jurisdictions (taking into account context, starting conditions, and political feasibility)
- General message: continuous monitoring of local governments’ service quality and performance necessary → continuous reforms and adjustments

5. ASSISTING DECENTRALIZATION AND FEDERALISM: FROM A TRANSFER OF PRACTICES TO A DIALOGUE ABOUT OBJECTIVES, PRINCIPLES AND POTENTIAL PRACTICES

Decentralized administrative and political systems – and federations – can offer several advantages and disadvantages for overall development: On the one hand, decentralization provides more space for “bottom-up” political participation and helps to maintain regional and local traditions in self-government; it creates counterbalancing political powers that require collaboration and harmonization; it can help develop institutional mechanisms that foster political consensus; and it often encourages political competition. Provided there are effective revenue and expenditure assignments, federalism can also lead to citizen-oriented service provision, and a more competitive economic framework that encourages local private sector investment, innovation and development.

On the other hand, as we have shown, decentralized systems with options for political participation can also help to articulate political dissent and provide room for political veto players. This can make governing difficult and lead to political instability. Consensus seeking can be costly and time-consuming, and political and administrative gridlock can be a recurrent feature. Too much (or too little) sub-national autonomy may also encourage governments to exit a federation, and uneven development can trigger a quest for even more autonomy and potential secession.

Consequently, policy makers in federal systems, such as Germany, are continuously challenged to maintain the advantages of broad-based political participation and competition that its system provides, while at the same time avoiding too much rivalry and gridlock. They need to bridge differences and ensure some level of societal equality, harmonization and intergovernmental cooperation throughout the federation. This may be healthy politically but, as we have shown, it increases the costs of governing (see Annex 6).

This section will briefly summarize the key features of Germany’s federalism in terms of their importance for a dialogue with decision makers in partner countries. As we will show, we need to move to a slightly higher level of abstraction to make use of what are usually regarded as “transferable lessons”. In particular, we will need to move from German practices to German principles of federalism, and “translate” such principles to potential practices in partner countries. Since the latter process of translation needs to be done while working with local partners, we will only briefly highlight what such a process could look like.

We depart from the idea that any assistance strategy for partner countries with decision makers interested in decentralization and in reforming intergovernmental relations would need **initial analytical work**:

- Review local preconditions;
- Seek clarification of the objectives for such reforms (>SDGs);
- Analyze the interplay of actors, and ...
- Understand local contexts. Such analysis helps to ...
- Review (and translate) practices and move from practices to principles.

Based on the key features of Germany’s federalism, we will highlight **six key principles** that could serve as entry points in partner discussions:

- The development of intergovernmental checks and balances;
- Democratic policy making;
- The application of the rule of law;
- Cooperation and competition among federal entities, cum autonomy of subnational governments;
- The equivalence of living conditions within Germany; and
- Well-defined expenditure and revenue authorities cum fiscal autonomy.

We will review each of these principles in terms of their *translatability* and *transferability* into specific partner contexts.

First: analysis

(i) Clarify preconditions. As we have shown throughout this paper, the development of Germany’s federal system spans quite a long period with a long tradition of fragmented (and rather powerless) national governments and powerful subnational governments. Distinct from many other countries, even within Europe, Germany was highly decentralized before it started its economic and political

modernization in the 19th and 20th century. Given such preconditions, the dynamics of intergovernmental reforms and decentralization are likely to be very different from countries with a different path of historical development.

(ii) Clarifying development objectives with partners is a necessary first step towards ascertaining whether decentralization is the right answer and an appropriate strategy to achieve them. As the case of Germany demonstrates, for some objectives and at specific historic junctures (e.g. during the 19th century), decentralization may rather be a problem than a solution. For other objectives, such as providing citizen-oriented education and health services, more decentralization may indeed be an answer. In most cases, clarifying development objectives essentially means reaching agreement on the role of national and subnational actors in attaining the SDGs.

(iii) Analyzing key actors and key players. In order to assist partners effectively, proper actor mapping is still most likely to be a good exercise for understanding local power structures, and ascertaining who wants what, when, how, and why, in decentralization reforms. It also helps to identify potential winners and losers of such reforms and define targeted strategies for assisting affected groups and supporting like-minded alliances for managing the reform.

(iv) Practices are context specific. As we have shown throughout the text, many of the well-developed administrative practices make perfect sense in Germany. They constituted domestic institutional responses to context-specific problems agreed upon by local actors, although they often required institutional capacity and came with negative externalities. Given such particularities, German administrative practices (“solutions”) may therefore be of limited use in other country societal contexts, even if the patterns of problems look quite similar.

(v) Focus on a reflection of principles. Instead of seeking an appropriate transfer of administrative practices, and coming up with premature solutions, development practitioners could focus on the objectives and principles that have guided the development of existing practices. For example, Germany’s sophisticated fiscal equalization schemes follow principles such as transparency and equality or, more precisely, equivalence of living conditions. Reflecting and debating these principles may help policy makers in partner countries to clarify whether they match their own principles and whether they may deliver appropriate guidance for the development of local practices.

Second: reviewing key principles

What are **the core principles that have guided the development of Germany’s federalism?** As we have indicated repeatedly in our paper, Germany’s decentralization and federalism today has been both the result of historic preconditions, and a particular state-building effort after the Second World War that was based on the same preconditions. Having experienced a dictatorship and the terror of the Nazi regime, the parliamentary council (and the occupation powers) wanted to make sure that the new German state was firmly embedded in a system of institutional restraints, multiple checks and balances. Reflecting these concerns, the country’s new constitution (The Basic Law, 1949) defined the state as federal, democratic and law-based. It defined how the federation was to be run and how subnational actors were supposed to participate in the nation’s affairs.

The Basic Law’s guiding idea was that by no means should the nation state ever be allowed to “go it alone and turn authoritarian. The power of the nation state was therefore deliberately constrained by **three interconnected principles:**

- i) Institutionalized participation (and veto powers) of subnational governments via a second chamber;
- ii) Democratic participation of citizens at all levels of government, jointly with the protection of human freedoms;
- iii) An independent judiciary to ensure the rule of law and for upholding human rights.

Transferability: It may be quite worthwhile to discuss these three interconnected principles with partner countries. Since they serve as institutionalized constraints to keeping nation states (and statehood in general) effectively checked, they could be relevant for some policy makers. They can also serve to discuss the key objectives of decentralization reforms and the implications of choices to be made. Besides democratic participation, building fully independent judiciaries that protect human rights had been a particular concern of civil society deprived of justice and fairness during the Nazi period. Moreover, federalism seems to have critically influenced Germany’s style of politics. With constitutional rights to democratic participation of its members and the need for democratic consent, federalism has led to a rather consensus-based democracy and the development of institutional arrangements that encourage consensus among political key actors. However, among its negative externalities there are many veto players, joint-decision traps, and institutional gridlock.

A **fourth principle** relates to the workings of federalism. In the German context, federal structures have ensured both smooth cooperation as well as sufficient levels of competition among and with its members. In addition, they helped

to preserve subnational autonomy. Too much competition would have undermined cooperation, and inflexible patterns of cooperation would have undermined autonomy and competition. While recognizing the importance of each of these contradicting objectives, the art of governing obviously has been the ability to strike a balance between them, and keeping this balance sufficiently flexible when needed. However, and despite all preparedness as the German example has shown, there is always the risk that the pendulum swings too strongly into one direction, or that actors find themselves caught in “joint-decision traps”.

Transferability: This principle – a cooperative federalism that ensures competition and preserves autonomy – could serve as a good starting point in a dialogue with partner governments regarding the objectives of (more) decentralized governance. It could help to illustrate the virtues of each of the above objectives, while at the same time highlighting the constructive use of a combined approach. A discussion of this principle could also exemplify the merits of flexible federal arrangements that allow for adjustments over time and as needed. Federations are not meant to be fixed forever, but rather to operate in a continuous process of adaptation among largely self-sustained governmental levels.

A **fifth principle** of German federalism is related to maintaining legitimacy. Since reconstruction and development in the 1940s and 1950s, with millions of refugees in the new Germany, carried with it the risk of social inequality and political instability, the Basic Law mandated governments to ensure an equivalence (not equality!) of living conditions throughout the territory, basically by means of redistributive measures and fiscal equalization schemes among and within subnational entities. Although this principle is still receiving considerable political support in today’s Germany, there are an increasing number of critics favoring a thorough overhaul of the system and “slightly” more competition amongst the members of the federation.

Transferability: Given this special context, it is questionable whether and how far this equivalence principle would be relevant in partner countries. Although other federations employ similar redistributive schemes among its federal entities, countries with high inter-regional differences and a

highly skewed income distribution may find this fiscally and politically unattainable. Given increasing inequality in some partner countries, however, evaluating the principle may serve as one entry point for a discussion of the objectives of a decentralized system, and the demands of subnational actors. Equal access and comparable quality of service provision across jurisdictions could be another. In addition, discussions about attaining the SDGs within partner countries may help address the role of national and subnational governments, potential inequalities and disequilibria.

The **sixth principle** is related to the latter: fiscal federalism. On the basis of clearly defined expenditure and revenue authorities, it should ensure that subnational governments enjoy sufficient (in particular, own-source) revenues to finance their own affairs, and to guarantee timely and efficient public services. In addition, federal grants and contributions would help to cover financing gaps or fund federally mandated tasks at the local level.

Transferability: For many years, this principle has been widely discussed in partner countries. Given the many deficiencies in public service delivery, subnational policy makers have been strong supporters of such measures. However, as the German example has clearly indicated, following this principle on the ground requires high levels of administrative capacity at subnational level and the willingness of governments to establish auditing and monitoring instruments to avoid fraud and corruption. Bottom-up and top down accountability is required for sharing revenues and expenditures effectively and efficiently.

Reviewing *principles* jointly and iteratively with officials and decision makers in partner countries – instead of simply adjusting practices of German federalism for using them in local contexts – is largely in line with the approaches discussed in Andrews et al. (2017) and Pritchett et al. (2010) regarding multiple capability traps and persistent implementation failures (and situations in which “the solution is the problem”). Our ideas also reflect those presented in Kirsch, Siehl and Stockmayer (2017) on smart implementation in governance programs and Problem-Driven Iterative Adaptation (PDIA).

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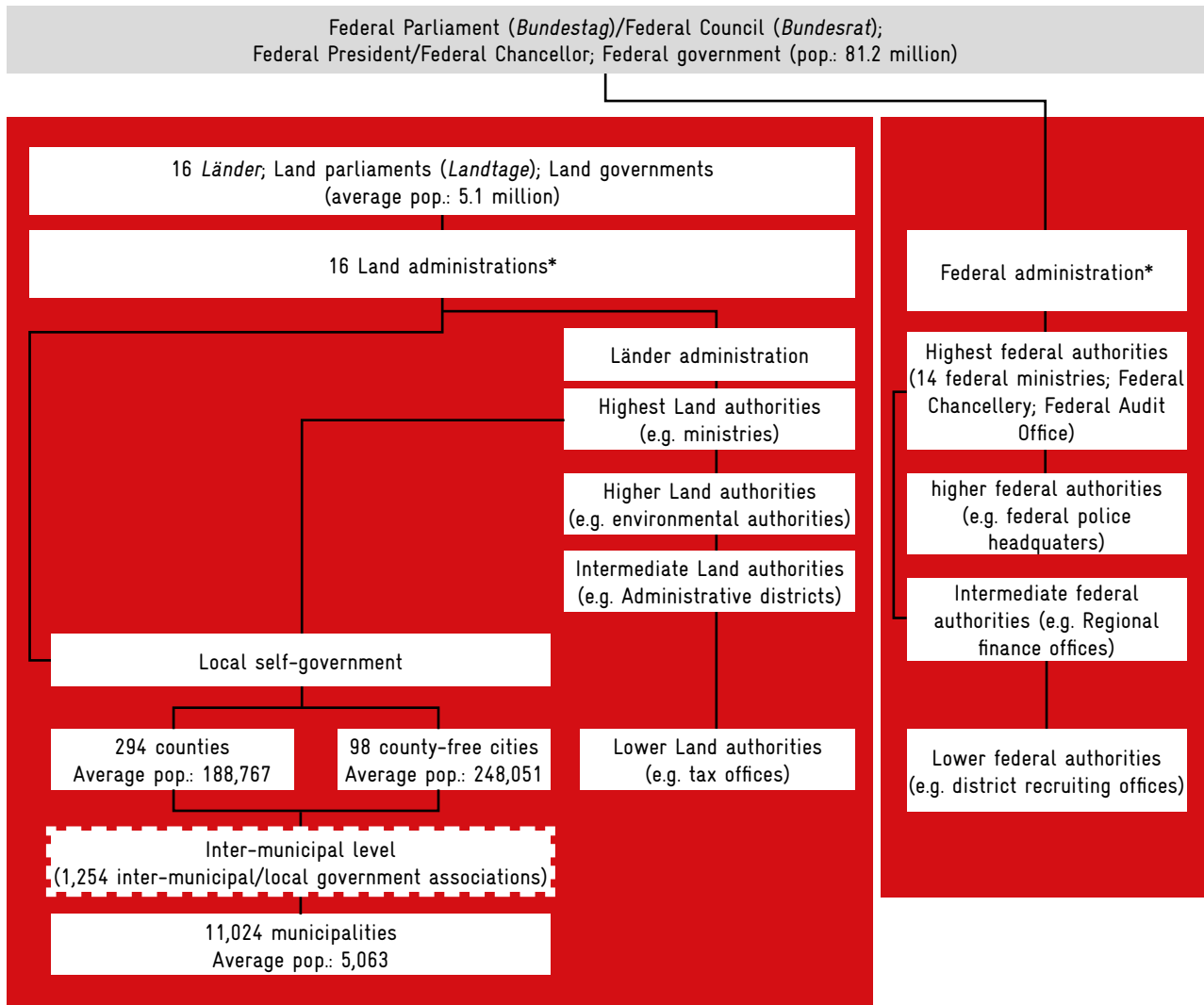
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ANNEX 1: THE GERMAN ADMINISTRATIVE SYSTEM (2017)



Source: Adapted from Kuhlmann and Wollmann 2014 (with updates)

ANNEX 2: THE GERMAN PUBLIC SECTOR WORKFORCE

Level	Public sector employees (FTE)	Public sector employees (FTE in %)
Federal administration	614,990	15.2%
Länder administrations	1,731,515	42.7%
Local administrations	1,438,505	35.5%
Social insurance	271,810	6.7%
Total	4,056,825	100%

Source: Statistisches Bundesamt, 2018

ANNEX 3: SIZE OF MUNICIPALITIES IN GERMANY

Land	Municipalities 31.03.2015	Population 31.12.2013	Average Population per Municipality 31.03.2015
Baden-Württemb.	1,101	10,631,278	9,656
Bayern	2,056	12,604,244	6,130
Brandenburg	418	2,449,193	5,859
Hessen	426	6,045,425	14,191
Mecklenb.-Vorp.	783	1,596,025	2,038
Niedersachsen	973	7,790,559	8,007
NRW	396	17,571,856	44,373
Rheinland-Pfalz	2,305	3,994,366	1,733
Saarland	52	990,718	19,053
Sachsen	430	4,046,385	9,410
Sachsen-Anhalt	218	2,244,577	10,296
Schleswig-Holstein	1,110	2,815,955	2,537
Thüringen	878	2,160,840	2,461
BRD	11,093	80,767,463	7,281
– West Länder	8,422	62,229,583	7,388
– East Länder	2,670	12,529,895	4,692

Source: Adapted from Bogumil 2016

ANNEX 4: OUTCOME OF TERRITORIAL REFORMS IN EAST GERMAN LÄNDER

Land	Outcome of municipal-level territorial reform			Outcome of territorial reforms					
				At county-free city-level			At county level		
	Municipalities (incl. county-free cities)		Change (in %)	County-free cities		Change (in %)	Counties 1990	Counties 2018	Change (in %)
	03.10.1990	2018		1990	2018				
Saxony-Anhalt	1367	218	-84	3	3	0	37	11	-70
Brandenburg	1793	417	-76	6	4	-33	38	14	-63
Saxony	1626	421	-74	6	3	-50	48	10	-79
Thuringia	1707	849	-50	5	6	+20	35	17	-51
Mecklenb.-West Pom.	1117	750	-33	6	2	-66	31	6	-80

Source: Adapted from Kuhlmann et al. 2018 (with further references)

ANNEX 5: ADMINISTRATIVE DISTRICTS IN GERMANY

Admin. Distr.	Land	Population in millions	Inh./km ²
Mittelfranken	BY	1.7	231 / km ²
Schwaben	BY	1.7	173 / km ²
Oberbayern	BY	4.0	228 / km ²
Niederbayern	BY	1.2	112 / km ²
Oberfranken	BY	1.1	154 / km ²
Unterfranken	BY	1.3	155 / km ²
Oberpfalz	BY	1.0	109 / km ²
Arnsberg	NRW	3.8	478 / km ²
Detmold	NRW	2.1	375 / km ²
Düsseldorf	NRW	5.3	1000 / km ²
Köln	NRW	4.2	572 / km ²
Münster	NRW	2.6	375 / km ²
Freiburg	Ba-Wü	2.1	224 / km ²
Tübingen	Ba-Wü	1.7	195 / km ²
Karlsruhe	Ba-Wü	2.7	384 / km ²
Stuttgart	Ba-Wü	3.9	368 / km ²
Kassel	He	1.3	154 / km ²
Darmstadt	He	3.7	496 / km ²
Gießen	He	1.0	197 / km ²
Trier	RPf	0.5	103 / km ²
Neustadt	RPf	2.0	291 / km ²
Koblenz	RPf	1.5	186 / km ²
Chemnitz	Sachsen	1.5	255 / km ²
Dresden	Sachsen	1.7	210 / km ²
Leipzig	Sachsen	1.1	245 / km ²
LVvA Halle	S-Anhalt	2.5	122 / km ²
LVvAWeimar	Thüringen	2.4	146 / km ²

ANNEX 6: BENEFITS AND COSTS OF DECENTRALIZATION REFORMS

Source: Adapted from Kuhlmann et al. 2018 (with further references)

Decentralized administrative and political systems – and federations – can offer several of advantages and disadvantages for overall development: On the one hand, decentralization provides more space for “bottom-up” political participation and helps to maintain regional and local traditions in self-government; it creates counterbalancing political powers that require collaboration and harmonization; it can help develop institutional mechanisms that foster political consensus; and it often encourages political competition. Provided there are effective revenue and expenditure assignments, federalism can also lead to citizen-oriented service provision and a more competitive economic framework that encourages local private sector investment, innovation and development.

On the other hand, decentralized systems with options for political participation can also help to articulate political dissent and provide room for political veto players. That can make governing difficult and lead to political instability. Consensus seeking can be costly and time-consuming, and political and administrative gridlock can be a recurrent feature. Too much (or too little) subnational autonomy may also encourage governments to exit a federation and uneven development can trigger a quest for even more autonomy, and potential secession.

Consequently, policy makers in federal systems, such as Germany, are continuously challenged to maintain the advantages of broad-based political participation and competition that its system provides, while at the same time avoiding too much rivalry and gridlock. They need to bridge differences and ensure some level of societal equality, harmonization and intergovernmental cooperation throughout the federation. This may be healthy politically, but it increases the costs of governing.

The evidence presented in our paper has shown that decentralization and strengthening federalism can be part of a strategy to improve the effectiveness of the state. It encompasses mechanisms that increase openness and transparency, better incentives for participation in public affairs, and where appropriate, bring governments closer to the people and to the communities it is meant to serve. Such reforms, however, also carry some serious risks.

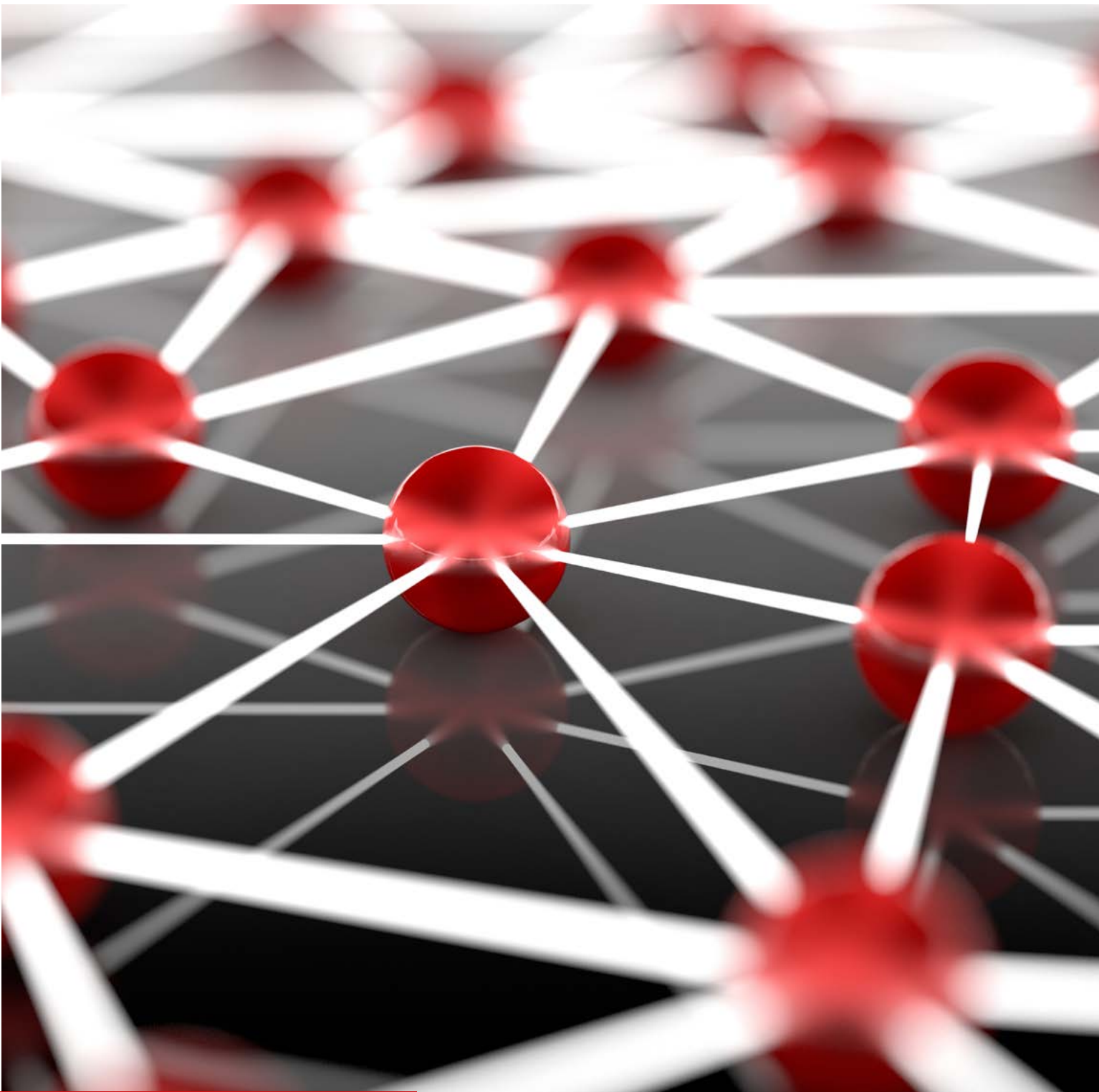
Upgrading public sector capabilities at all levels of government will take time and requires paying close attention to the potential dangers. There is a risk that efforts to open up government to a broader array of needs and interests will not improve effectiveness or accountability if they tend to shut out other groups further.

But the experience of governments the world over suggests some clear starting points:

- Work to ensure broad-based public discussion and evaluation of key policy directions and priorities. This means making information available in the public interest, and establishing consultative mechanisms such as advisory councils, deliberation councils, and citizen committees to gather the views and preferences of affected groups.
- Encourage, where feasible, the direct participation of users and beneficiary groups in the design, implementation, and monitoring of local public goods and services. Enhance the capacity and efficiency of local organizations and institutions rather than replace them.
- Where appropriate, adopt a carefully staged or sectoral approach to decentralization in priority areas. Introduce strong monitoring mechanisms and make sure that sound intergovernmental rules (and vertical incentives) are in place to restrain arbitrary action at central and local levels.
- At the local level, focus on the processes (and horizontal incentives) for building accountability and competition. Where local governments are weakly accountable and unresponsive, improving both horizontal and vertical accountability will be a vital first step towards achieving higher state capability.

Given political legacies and institutional path dependency, it may turn out to be quite difficult for developing countries to properly design and build “their” federal system from scratch. Societal actors often regard such projects as a zero-sum game and resist (or delay) decentralization policies right from the beginning. It is definitely much easier for policy makers to deal with upcoming challenges that federal systems impose once such a system has been in place for a while.

However, such obstacles are not insurmountable. The first step towards decentralization is making the objectives of reform clearly intelligible to citizens and the business community. Such communication and consensus building will reap a double benefit. Not only is the support for reform likely to increase, the government will also be armed with a better sense of how to do it right.



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