

# Competition versus cooperation: German federalism in need of constitutional amendments

by Ulrich Karpen

## I. THE STATUS OF ARTS IN FEDERALISM – REFORM IN GERMANY

### 1. *The trend to unitary federation*

German federalism is changing rapidly. It has never been a “dual federalism”, like for example in the United States of America, except during the times of monarchy from 1871-1919. Instead, it has always been – more or less – a “functional federalism.” The legislative power rests predominantly with the federal level, the greater portion of administrative functions with the Länder (states). In this sense it is an “executive federalism.” The Länder participate in federal legislation by a “Federal Council” (Bundesrat). Soon after the Basic Law, the Constitution of the Federal Republic, was adopted in 1949, Germany became increasingly a “unitary federalism” in the sense that the federal level gained considerably more weight, even excess weight, in setting political directives, shaping the format of living conditions, and in formal and informal coordination of the states. Identity of the people was more a national one rather than Länder-based. The next step was “cooperative federalism.” This term might be considered a pleonasm, because a federation always and anywhere forces federal level and state level into cooperative action. In Germany it means, however, that the Federal Government and Länder developed “joint tasks” with joint planning and financing, and moved more and more towards a “network of politics” which was lacking transparency and very often led to a “joint decision trap.” Using the “power of the purse” Federal Government guided the Länder with the “golden harness.”

### 2. *Reasons for centralization – need for diversity*

One may well detect three main reasons for the drift to the centre:

- Firstly, the improvement of economy and living conditions led to the current social- and welfare state,

which was and is in favour of equality, measured against a nation-wide yardstick.

- Secondly, the accelerated development of the European Common Market (and later the European Union) led to transformation of the Länder as states into mere regions of an enlarged area. The Länder, in the process of integration, clearly lost competences and authority to the national and European levels.
- Finally, the unification of Germany after 1990 caused the urgent need to equalize, or at least approximate, economy and social conditions in all parts of the country, east and west. This huge and very costly task could be managed by the centre only.

On the other hand, many politicians and economists have agreed for a long time that more competition, pluralism and diversity are needed in the country and that federalism does provide all instruments for achieving this. Since public budgets dry up, no Land is really willing to pay for equalization subsidies for federal partners who fall back in competition. Finally it is true that the midwives of the Federal Republic, the Allies – namely the United States and the United Kingdom – in designing the new federation in 1947/48 wanted primarily decentralization. Ethnical differentiation, creativeness and flexibility of the constituent parts of the nation in social, economic and cultural matters were preferable; centralism was to be avoided.

### 3. *Amendments to the constitution – a history*

There have been some 50 amendments to the German Constitution. Three of the major ones – 1968, 1969, 1994 – dealt, among other issues, with federalism. In 2003 a Joint Commission of the Federal Diet and the Federal Council was established to design a major reform of federalism, both in the political and financial segments of the Basic Law. In 2004 – at the dawn of the Socialist-Ecologist Coalition of Chancellor Schroeder – the

Commission failed to find a final consensus on a minor question of Higher Education Competences of the Federation. Some say: a voluntary breakage! The Commission resumed its work after the Great Coalition of Conservatives and Socialists was formed in 2005 and has now finished one part of the work: the federalism reform excluding financial matters. Parliament approved the amendments in 2006. By the end of this year another Commission of Diet and Council – the same shape as the first one – received the mandate to prepare a draft of the financial reform. Whether the coalition will work until 2009, and develop sufficient strength to finalise its task, remains uncertain. Certainly the financial issues are even more tricky than the portion which has been accomplished.

## II. WHAT HAS BEEN ACCOMPLISHED?

### 4. *The main issues of the 2006 Amendment*

The main issues of the first phase of the federalism reform, which became law in July 2005, are the following ones:

- redistributing the legislative powers of both levels: federal and Länder;
- reducing the number of legislative areas where the Federal Diet needs the consent of the Federal Council to pass a law;
- reducing the number of “joint tasks” of Federal and Länder levels;
- empowering the Federal Republic to act in European Union matters.

Bringing the first three issues into focus, the main idea of the reform was to improve transparency of responsibilities in federal and Länder matters, in other words: to make clear cuts and avoid mergers of authority. This task has been sufficiently accomplished. There is no longer – as critics said – a system of “organized lack of responsibilities.”

### 5. *Opposition from the Federal Council benches*

Prior to the amendments of 2006 far more than 50 per cent of draft laws, which had passed the Federal Diet to become law, required the consent of the Federal Council, which is the representation of the Länder governments. The reason was, in most cases, that the Federal Law contained provisions for administrative procedures. Administering laws, be they federal or Länder laws, are in most areas within the responsibility of Länder administration (“executive federalism”). Fewer and fewer draft laws, as enacted by the Federal Diet (as the “First House”), remained subject to objection by the Federal Council (the “Second House”), which can be rejected or overruled by the Diet with a qualified majority. If the majority of Länder governments – as being represented in

the Council – were of a different colour to the majority of the Diet – in “opposition” so to speak – it was easy to obstruct Diet majority and Federal Government from the Council bench by simply not consenting to drafts. This is exactly what happened, often enough to be regarded as a standard strategy.

This knot was untied by redistributing legislative competences between federal and Länder levels, mostly in favour of the latter. For compensation purposes, the consent areas have been reduced significantly. In addition, a new mechanism was introduced: Länder who disagree with the draft, but cannot stop it any longer by not consenting, are entitled to deviate from the federal law, as enacted, by Länder legislation.

### 6. *Joint Federal/Länder responsibilities*

Furthermore – and equally important – the amendment reduced the number of joint Federal/Länder responsibilities (“joint tasks”). Joint tasks cover joint planning and financing (50/50), and apply for example when building higher education facilities, improving regional economic structures, and undertaking coastal preservation. Introduced by the amendment of 1969, they were the result of a lascivious offer by the (then) rich Federal level to assist and support the Länder in doing their job. In the meantime, the climate and the power of the purse have changed, and the Länder competences with respect to Higher Education and culture were returned to the Länder by the reform.

### 7. *Federal and Länder level in European Union matters*

A third and vital objective of the reform was to strengthen the interstate Federal and Länder organization and procedures for acting in European Union affairs. The Länder wanted to have a say in supranational regulation dealing with matters which, according to the national constitution, fall into their authority. They wanted to participate in the European decision-making process, which is negotiated mainly by national governments, in the case of Germany consequently by Federal Ministers. Nowadays, in the European Council of Ministers, the highest European body in Brussels, the Federal Republic can be represented by a member of the government of one Land, as designated by the Federal Council. This applies to matters which traditionally fall into Länder responsibility, such as (higher) education, science, culture and broadcasting. Whether this marks the final development of the process is open to discussion. It means, however, using the emergency brake versus Federal Government and Diet, which – in the course of integration – transferred Länder responsibilities to European authorities without taking care of proper Länder participation.

## 8. Other amendments

Minor amendments made by the reform of 2006 address the role of Berlin as the capital of the Federal Republic and smaller issues of financial harmonization between Federal and Länder levels. Long desired is the fair provision that, according to the principle of connectivity of tasks and financial burden sharing, the Federal government cannot transfer public tasks to municipalities and countries without offering sufficient budgets.

## 9. First evaluation

If one wants to balance the accounts of the first phase of the reform, one may find positive results:

- There is a good deal more transparency of responsibilities; the profiles of Federal and Länder authorities are drawn more sharply;
- Länder are less tempted to obstruct Federal Government politics from Federal Council benches;
- The old truism that the music is chosen by him who pays has been underlined.

## III. WHAT REMAINS TO BE DONE?

### 10. A basket of open topics

This positive balance reflects the completion of only half the task – if not less. The reform of the financial part of the Basic Law is missing. By the end of 2006 the coalition succeeded in installing a (second) Joint Commission of Diet and Council to prepare the ground. The guideline for negotiations is an annex to the amendment of July 2006. This “open collection of topics” covers some nine points which are very general and even vague, and do not provide guidelines for the decision-making process.

The Financial Constitution is, by nature, an accessory adjunct constitution to the political part. In other words, its purpose is to stabilise the division of competences from a funding perspective. The guideline for solving this problem is easy. Paragraph 104a of the Basic Law says: “The Federation and the Länder shall separately finance the expenditures resulting from the discharge of their respective responsibilities, insofar as this Basic Law does not otherwise provide.” But when it comes to detail, one has to admit that the financial constitution of the Land, including the tax-related parts, is definitely one of the most complicated in the world of federations, probably the most complicated. Experts have confessed that they are unable to comprehend the system in its entirety. One could assume that some 25 per cent of legal literature worldwide is written in the German language. However, when it comes to finance and tax law related material, about 60 per cent of all literature is in German. The 1994 Commission to draft constitutional amendments stopped short of designing a new financial section, and so did the commission of

2003. Nevertheless, the main issues facing the Commission can be briefly summarized, namely the revenue system, equalization and public debt.

### 11. Raising and spending taxes

Currently, the country has a mixed system of revenue collection and distribution. Fiscal law is predominantly Federal law. The Federal level collects most of the money. The Länder receive most of their budgets as part of the centrally collected money according to constitutional and statutory provisions. The Länder want – and, one has to admit, need – more autonomy on the tax-income side. They want to raise their own taxes, and to have structural options for their budget. They want, for example, the constitutional right to introduce a surcharge or a discount on a tax. They require the right to set the tax rate on the income-tax share accruing to them. It is obvious that remodelling the revenue system in this form would encourage competition.

### 12. Equalization

But this would have – on the other hand – serious consequences for the current system of financial equalization. Germany is – next to Switzerland – the only federation in the world where equalization of the economic and financial capacity of the federal units is made by horizontal distribution, not by allocation of funds from the centre. Currently, the yardstick of equalization is to provide for equivalent – if not homogenous – living conditions for citizens in all Länder. Well-to-do Länder – like Bavaria and Hessen – have to support the other ones, some of which are close to bankruptcy. In some cases everybody would accept this fact voluntarily. This is true, for example, for the five Länder, which formerly comprised the German Democratic Republic and have to shoulder tremendous fiscal burdens. In other cases, the “giving” Länder do not fully agree with the philosophy, practice and budget-discipline which the “taking” Länder apply in doing their job. The current system of equalization, in other words, does not favour competitive federalism.

### 13. Public debt

A third problem is the deplorable situation of public budgets, namely the increase of debt. For some years the debt-ratio of the Federal budget far exceeded the European ceiling of 3 per cent of GNP – which is binding on the Member States! And neither the Federal nor most Länder budgets observe Paragraph 115 Basic Law which states that “revenue obtained by borrowing shall not exceed the total of investment expenditures provided for in the budget.” I shall use the financial situation of Berlin as an example. The capital city – a City State – is fiscally in a critical situation after the amalgamation of two former capital cities: Berlin-West and Berlin-East. This everybody will admit. Berlin’s annual budget consists of roughly €20 billion. The total

debt of Berlin amounts to €55 billion. Interest consumes 14 per cent of the budget – €25 billion per year, €11 million per day. Berlin filed a suit before the Federal Constitutional court for subsidies from the Federation and the Länder according to the federal solidarity principle, but the court held in 2006 that there is no constitutional basis for this claim and that every Land, in principle, is responsible for its fiscal policy.

**14. New Länder borders?**

Many difficulties which contribute to the current fiscal situation point to the need for a new delineation of Länder borders. Why does the country need 16 Länder – some of them (like Bremen and Saarland) with a population of less than one million? Why does one need 16 Länder parliaments and governments? The idea is to amalgamate, from 16 down to six or so. There have been – and are – several expert opinions. Some years ago the attempt to merge Berlin and the belt-Land Brandenburg failed in a plebiscite. Needless to say, Germany shares this problem with other federations.

**15. Perspectives of the fiscal reform**

For approaching competitive federalism

The next steps of constitutional reform are crucial for the approaching competitive federalism. On March 8, 2007 the work of Hercules began. The Second Joint Commission of the federal Diet and the Federal Council – under a fresh double chair – held its constituent session to deal with the main issues of the financial reform of the Federal System. Hopefully this timely start will encourage politicians to carry on, as the reform process has lost some drive. The government is getting close to the first half of its term and other urgent reforms (the health system, unemployment, education) take priority.

The Commission will need – even more than the first one – support, advice and comparison from outside sources, with other federations providing the benefit of their history and practice. For, as the Founding Fathers of the United States, in drafting the constitution, said: “Let us be guided by experience, because reason might mislead us!”

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Jesus College, University of Cambridge

**Twenty-fifth International Symposium on Economic Crime**

*The wealth of nations – at risk*

Organising institutions include CIDOEC (Centre for International Documentation on Organised and Economic Crime), the IAACA (International Association of Anti-Corruption Authorities) and the IALS

Further details from Mrs Angela Futter, Symposium Manager (tel: 01223 872160; email: [symposium@jesus.cam.ac.uk](mailto:symposium@jesus.cam.ac.uk))

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