

**Panel discussion on Fiscal Federalism
with a focus on Institutional and Legal
Mechanisms
German Case**

Delhi, January 2016

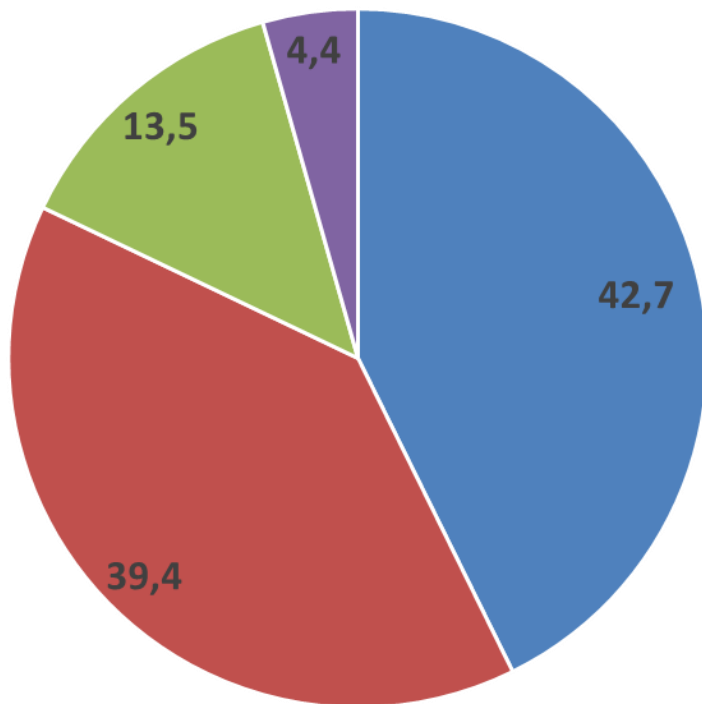
Principles of Expenditure Distribution

General Principle: Every government level has to pay for its own administration and services

- Exemption: federal monetary grants which are executed by the States, but payed partly or totally by the Federation
- Joint tasks (state competencies, but co-financing of federation)
 - Improvement of regional economic structure and costal protection
 - Improvement of agrarian structure
 - Important projects in science research and university teaching
- Federal grants for important regional and local investments (macroeconomic disequilibrium, regional divergence, growth); **but only if the Basic Law confers powers to legislate to the federation**
- **Otherwise ban of cooperation in funding to protect States' autonomy, no "golden reins"**
- No direct financial transfers between Federation and municipalities.

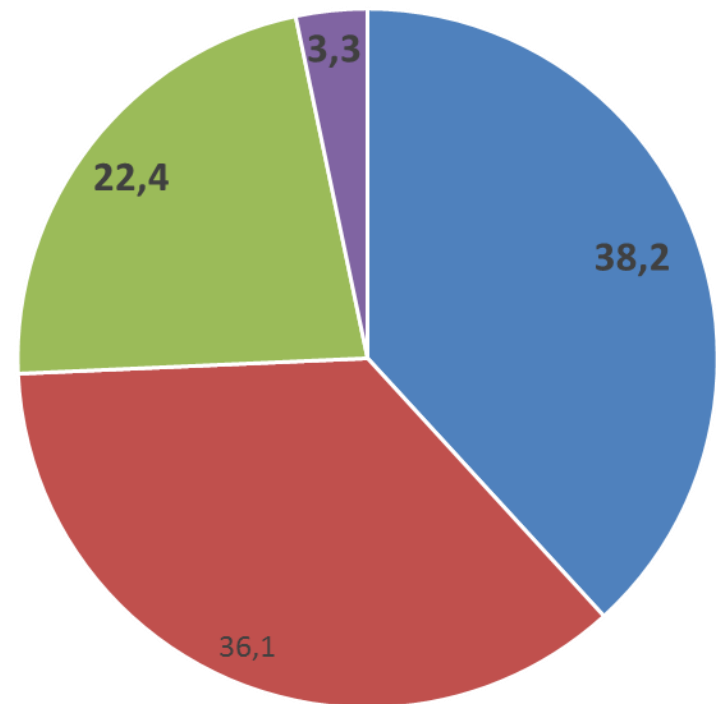
Shares of Government Levels

Tax Income



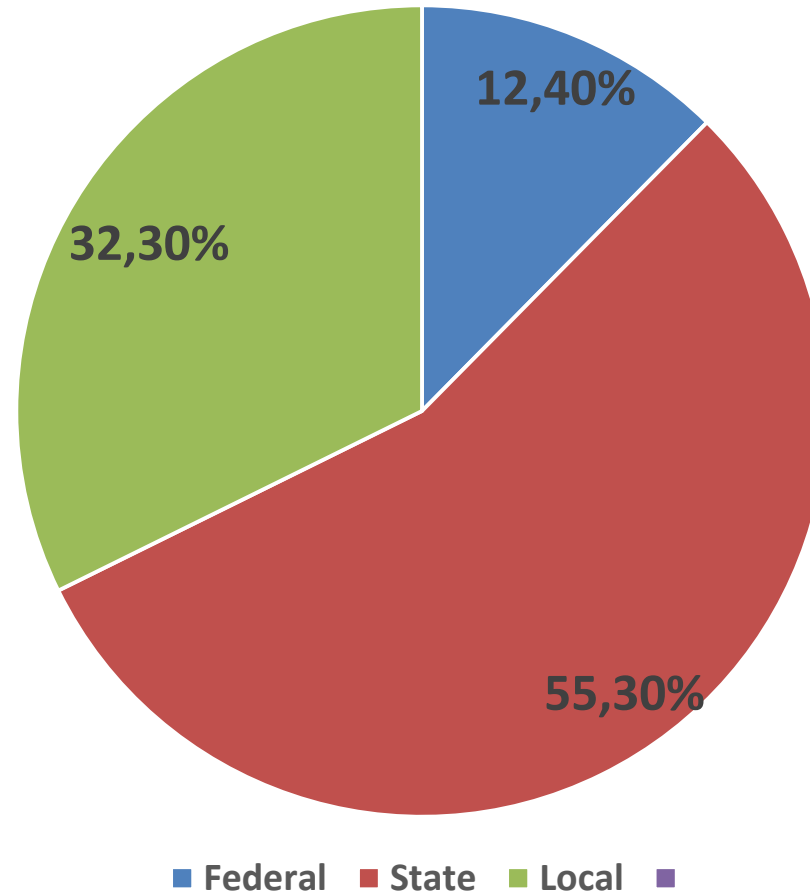
■ Federation ■ States ■ Municipalities ■ EU

Public Expenditure



■ Federation ■ States ■ Municipalities ■ EU

Share of Public Employees



Principles of Tax Distribution

- **Vertical tax distribution between Federation, States and municipalities**
 - by type of tax (laid down in constitution)
 - shared taxes, percentage of tax income (generally codified by constitution, exception VAT by federal law with the consent of Federal Council)
- **Horizontal tax distribution among States and municipalities**
 - State or local tax income (constitution)
 - Exemption VAT: per capita! (constitution)

Distribution by type of tax

- **Federation:**

Tax on petrol, tax on tobacco and alcohol, motor vehicle tax, surtax on the personal income tax

- **States:**

Beer tax, inheritance tax, property tax (suspended)

- **Municipalities:**

Real property tax, trade tax (a certain percentage has to be paid to the federation and the States)

Partition of Joint Taxes

Joint taxes	Federation	States	Municipalities
Personal income tax	42.5 %	42.5 %	15.0 %
Interest discount tax	44.0 %	44.0 %	12.0 %
Corporation tax	50.0 %	50.0 %	
Other income taxes	50.0 %	50.0 %	
Value-added tax	51.4 %	46.4%	2.2 %

Distribution of Tax Revenues

Level of Government	Tax income (2012)	Tax share
Federation	256.3 bn €	42.7 %
States	236.3 bn €	39.4 %
Municipalities	81.1 bn €	13.5%
EU	26.3 bn €	4.4%
Germany total	600.0 bn €	100.0 %

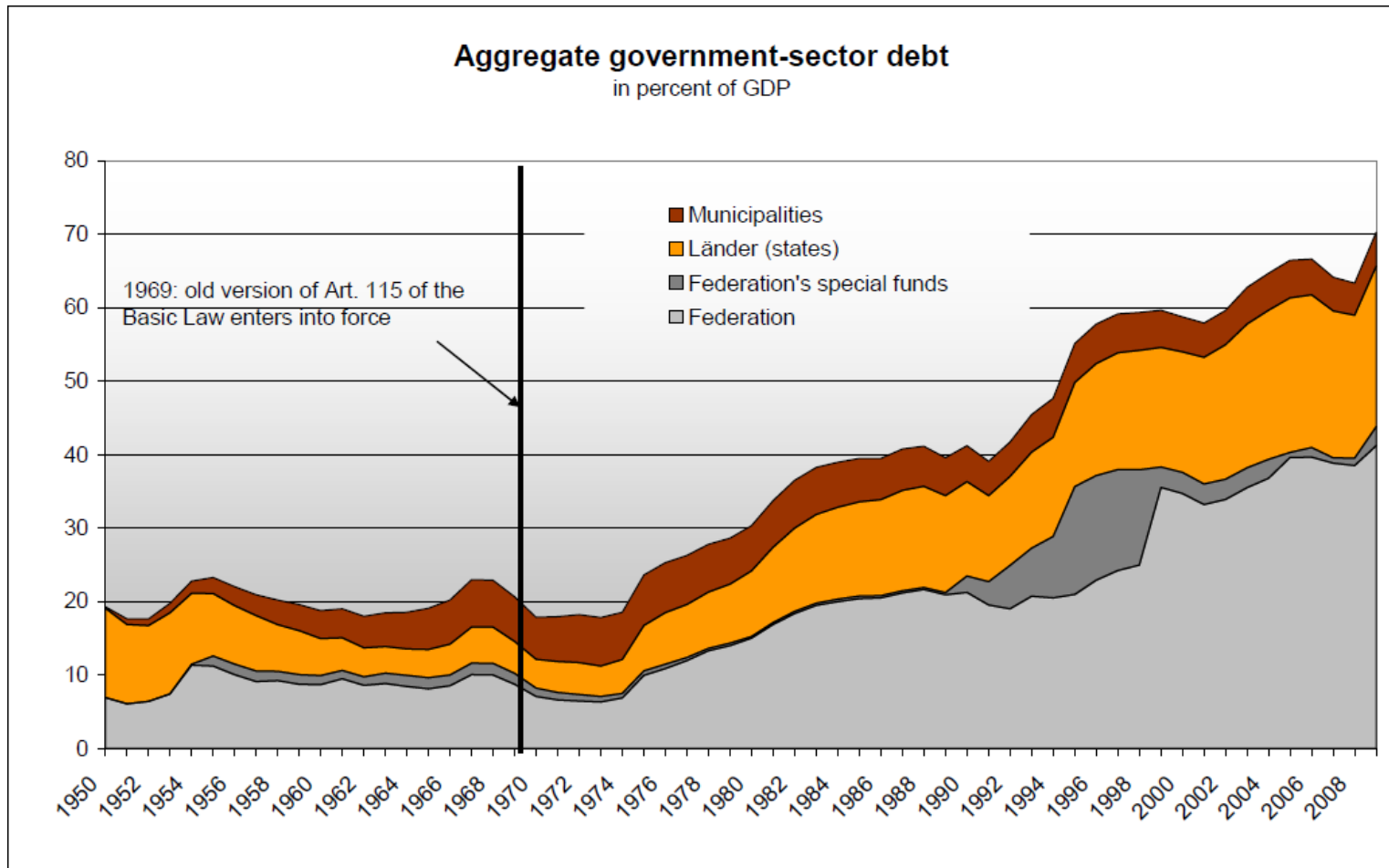
Fiscal Equalization between Federation and States

1. Distribution of 25 % of the States share of the value-added tax according to low tax potential (i.e tax income per capita)
 2. Horizontal system of payments between the states (according to relative tax potential)
 3. Vertical system of payments of the Federation to states with still low tax income (including tax income of municipalities) and special needs
- ▶ **“Reasonable equalization” of per capita income of States**

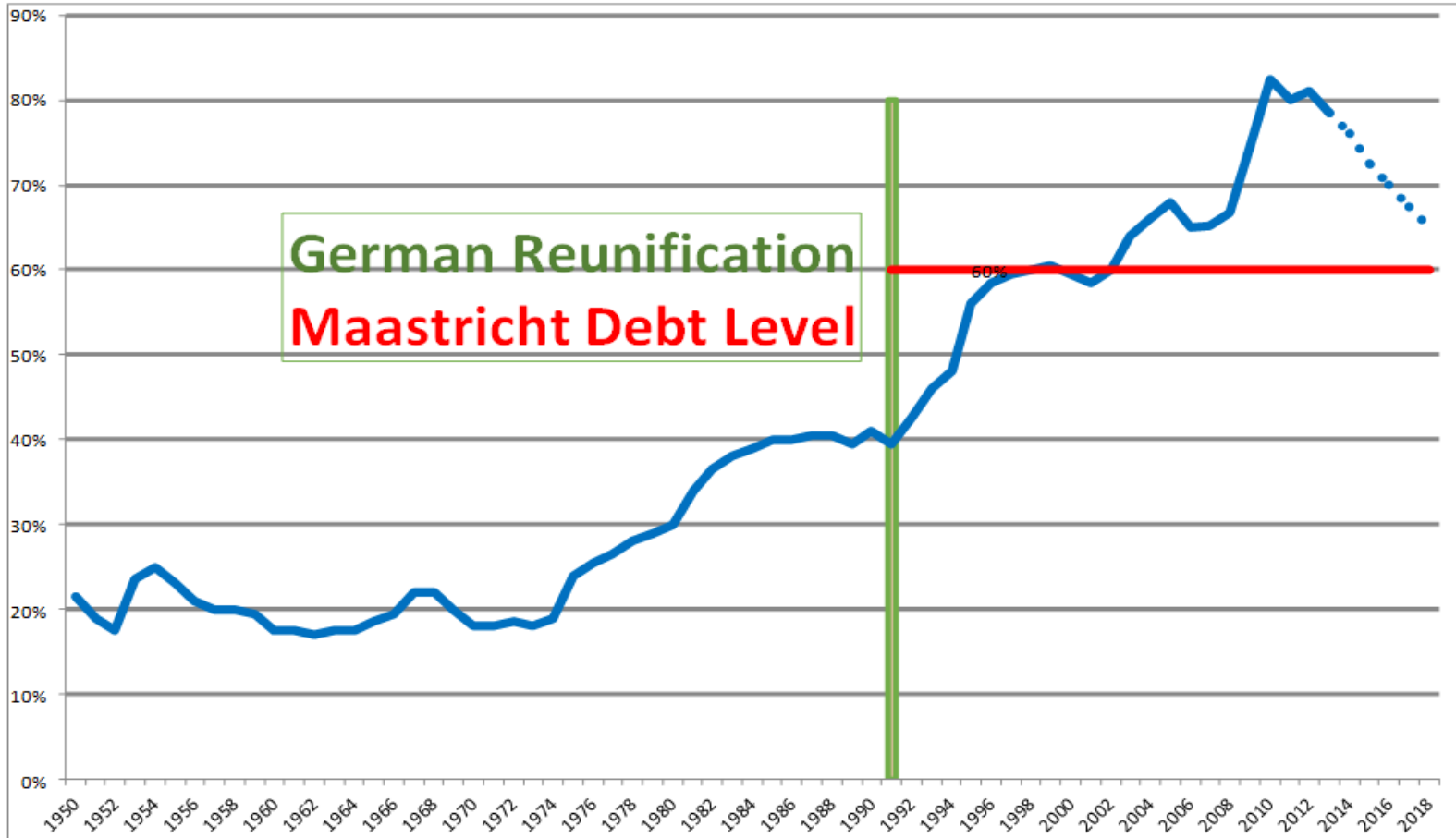
Budget Management

- ***“The Federation and the States are autonomous and independent of one another in the management of their respective budgets.”*** (Art 109 sec 1 BL)
 - ***“The budgets of the Federation and the States shall in principle be balanced without revenue from credits.”*** (Art 109 sec 3 BL)
- Generally no hierarchy or supervision by Federation!**

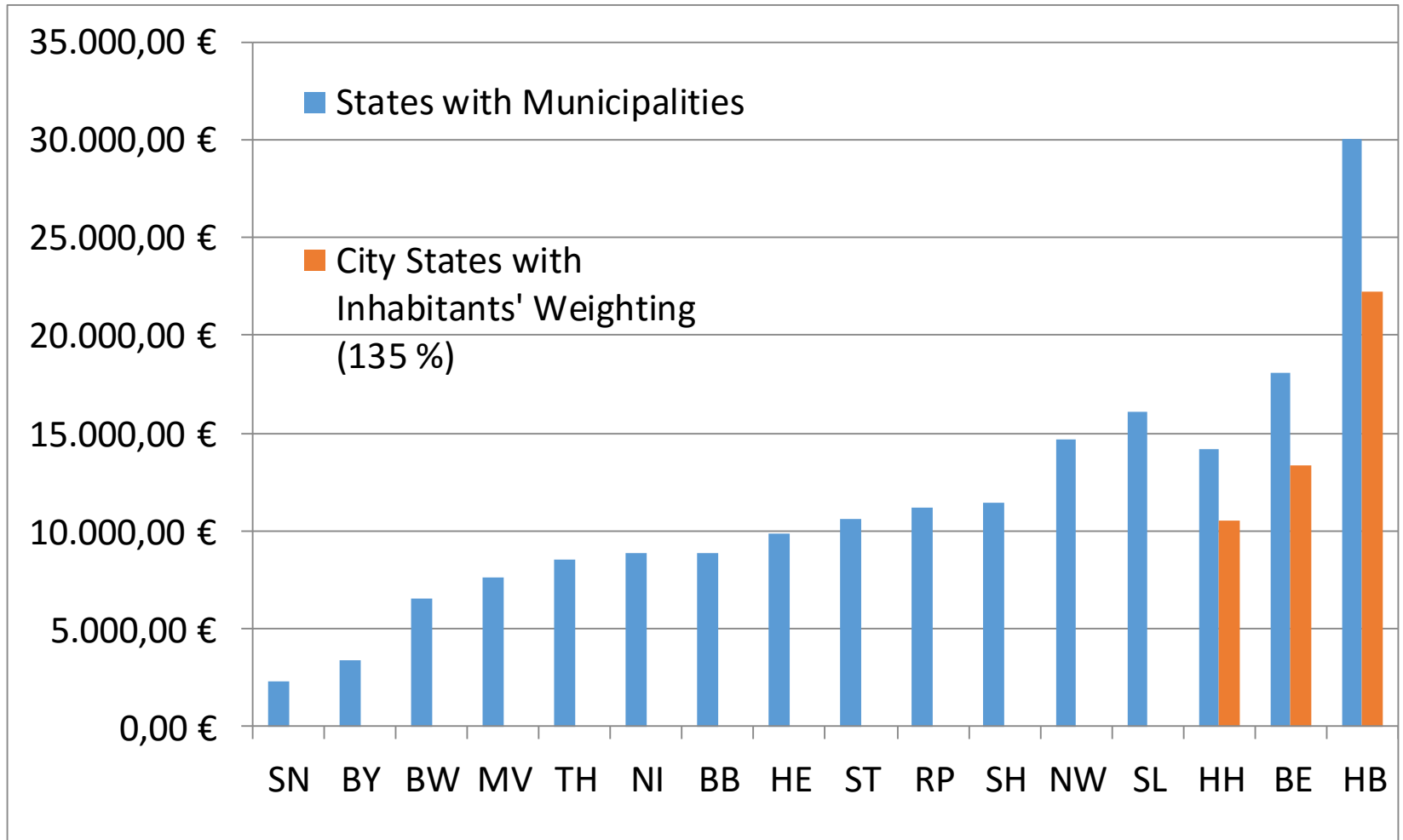
Public Debt in % of GDP



Public Debt and EU Debt Criterion



Public Debt per Capita 2012 (States & Municipalities)



Stability Council

- Members: Federal Minister of Finance (16 votes) and all 16 *State* Ministers of Finance, decisions need $\frac{2}{3}$ majority
- Necessary because of the principles of budget autonomy and balanced budgets
 - **Coordination of fiscal policy**
 - **Long-term financial planning**
 - **Compliance with debt brake**
- Independent advisory board of experts
- All decisions, data, reports and recommendations are published
- **But no sanctions except for consolidation assistance which can be revoked in case of noncompliance up to 2020**
- **Only moral persuasion and pressure by the electorate**

Thank you for your attention!

Annex

The Role of Municipalities

- **3 City States (Berlin, Hamburg and Bremen) have the status of State and take part in the Federation-States equalization schemes (but the inhabitants are multiplied by 1,35)**
- **All other municipalities are part of the individual States, local Tax Income (65 %) is added to State tax income in the Federation-States equalization, therefore only fiscal equalization schemes between State and its municipalities, no direct Federal payments to the municipality)**