

Commission on the Modernization of Federation-*Länder* Financial Relations

Stage 2 of the federalism reform

The Commission on the Modernization of Federation-*Länder* Financial Relations has successfully completed its work. The members of the Commission, at their closed meeting on 5 February 2009, reached agreement in principle on key points and were able to agree the texts of the proposed amendments to the Basic Law at various working group meetings during the subsequent weeks and at a further Commission meeting on 12 February 2009. At the Co-Chairs' proposal, the Commission then adopted a package of measures to reform Federation-*Länder* financial relations on 5 March 2009.

The centrepiece is the introduction of a new joint debt rule for the Federation and the *Länder* (federal states) which will come into effect in the 2011 budget year. In line with this rule, the budgets of the Federation and the *Länder* must generally balance without recourse to borrowing. Limited derogations from this rule are permitted. In order to facilitate compliance with this debt rule, five heavily indebted *Länder* will receive consolidation grants. A new Stability Council will monitor the financial management of the Federation and the *Länder*, particularly the consolidation measures adopted by the five recipient *Länder* (Summary of Decisions).

The package contains proposals for the amendment of Germany's constitution, the Basic Law, and ordinary legislation, together with explanatory memoranda for these proposed amendments, and a proposal for a resolution (Commission Printed Paper 174). At the final vote, with 31 members of the Commission present, the package was adopted with 26 votes in favour, three votes against (Alliance 90/The Greens, the Left Party, Mecklenburg-Western Pomerania) and two abstentions (Berlin, Schleswig-Holstein). The Federal Cabinet noted the proposals with approval on 11 March 2009. The legislative procedure commenced at the end of March 2009 with the first reading in the German Bundestag and has now concluded, with the second/third reading taking place on 29 May 2009 and second passage at the sitting of the Bundesrat on 12 June 2009.

Commission on the Modernization of Federation-*Länder* Financial Relations

Summary of Decisions

The Commission proposes the following reforms:

New joint debt rule for the Federation and Länder (Article 109 of the Basic Law)

1. The budgets of the **Federation and the *Länder*** must generally balance without recourse to borrowing. (This provision is based on the mid-term goal of a structurally balanced budget established by the European Stability and Growth Pact.)
2. Certain derogations from this ban on borrowing are permitted:
 - In the budgets of the **Federation and *Länder***: increased (anti-cyclical) borrowing is permitted during economic downturns for the purposes of symmetrical correction of an economic trend that deviates from the norm (cyclical components); this borrowing must be repaid when the economy has recovered.
 - For the **Federation and the *Länder***: borrowing is permitted in response to natural disasters or extraordinary emergency situations; appropriate repayment arrangements must be established simultaneously.
 - For the purposes of fulfilling the general requirement for a balanced budget in the medium term, the **Federation** may – pursuant to Article 109, para. 3, fourth sentence of the Basic Law – continue to issue debt to a maximum of 0.35 % of gross domestic product (GDP) annually (structural components).
 - A new Article 115 of the Basic Law and an implementing act will elaborate the provisions applicable to the **Federation**.
 - For the ***Länder***, however, no structural component is envisaged; this means that compliance with the ‘balanced budget’ provision is achieved only if the budget includes no income from borrowing.

The ***Länder*** will adopt more detailed provisions in accordance with their constitutional competences.

More detailed provisions applicable to the Federation (Article 115 of the Basic Law)

If actual borrowing deviates from permissible borrowing, the difference must be held in a control account. The negative balance in the control account may not exceed 1.5% of GDP. Once this negative balance exceeds 1% of GDP, it must be reduced as economic conditions permit.

A decision adopted by a majority of Members of the Bundestag is required for exercise of the derogation rule in the event of natural disasters and extraordinary emergency situations.

Transitional rule (Article 143d, para. 1 of the Basic Law)

Under a transitional rule in Article 143d, para. 1 of the Basic Law, the new provisions of Articles 109 and 115 of the Basic Law will come into effect in the 2011 budget year. Compliance with the requirement for a balanced budget is mandatory for the **Federation** from 2016 and for the *Länder* from 2020.

Consolidation grants (Article 143d, paras. 2 and 3 of the Basic Law)

To support compliance with the aforementioned debt rules, five *Länder* will receive **financial support**, amounting to €800 million per annum, for the period 2011-2019, i.e. a total of 7.2 billion (**Bremen** €300 million, **Saarland** €260 million, with **Berlin**, **Saxony-Anhalt** and **Schleswig-Holstein** each receiving €80 million p.a.). The support will be financed on a 50-50 basis by the Federation and the *Länder*. The prerequisite for the granting of this financial support is compliance with a consolidation pathway which enables the *Länder* concerned to balance their budgets by 2020 at the latest and adhere to the new debt rule thereafter. Further details will be regulated in an implementing act to Article 143d of the Basic Law, with specific arrangements being fleshed out in administrative agreements between the Federation and the individual *Länder*.

Procedure for the prevention of budget crises (Article 109a of the Basic Law)

In addition to the new debt rule, the introduction of a **cooperative early warning system** is proposed to prevent budget crises. A new **Stability Council**, comprising the Federal Finance Minister and the Finance Ministers of the *Länder* as well as the Federal Minister of Economics and Technology, will monitor the financial management of the Federation and the *Länder* and especially the progress being made by the above-mentioned five recipient *Länder* towards budget consolidation. To this end, the financial situation of the Federation and the *Länder* will be presented and discussed on the basis of reports every year. Should budget crises arise, the Stability Council will agree remedial measures. The Stability Council's decisions will be published.

Tax administration

To increase efficiency in the tax administration,

- The rights of the Federal Central Tax Office to participate in external audits will be reinforced and its opportunities for data access improved;
- The Federal Ministry of Finance may agree enforcement targets with the supreme financial authorities of the *Länder*;
- The tax collection process applicable to persons with limited tax liability will be centralized at the Federal Central Tax Office.

Insurance tax/fire protection tax

At present, the Federation has legislative competence for insurance tax and is responsible for the assignment of the revenue accrued. It also has legislative competence for fire protection tax. The Commission proposes a new arrangement whereby the *Länder*'s current administrative competence for both these types of tax be transferred to the Federation in the interests of efficiency, but with responsibility for the assignment of revenue from fire protection tax remaining with the *Länder*. To safeguard revenue accruing from the fire protection tax, detailed regulations for the establishment and control of the assessment basis will be adopted.

IT in the public sector (Article 91c of the Basic Law)

To improve administrative cooperation in the field of information technology with a view to establishing a secure, efficient and cost-effective IT infrastructure for the public administration, amendments to the Basic Law, ordinary legislation and framework provisions established in inter-*Länder* agreements are proposed.

A new Article 91c of the Basic Law will establish the legal basis for cooperation between the Federation and the *Länder* in the planning, development and operation of the IT systems required for their effective performance. The Federation will be granted the competence to establish and operate a core network linking up the federal and *Land* IT networks; it will also be granted exclusive legislative competence to adopt more detailed regulations in this area.

An inter-*Länder* agreement will regulate the bases of cooperation in more detail, including in particular the establishment of an IT Planning Council as the coordination and steering body, which will also adopt decisions on IT interoperability and security standards. The legislative proposal for linkage of the federal and *Land* IT networks should include provisions on institutional structures, data exchange, procurement and funding.

Benchmarking (Article 91d of the Basic Law)

The Commission regards benchmarking as a helpful tool in the modernization of the public administration. It proposes that a new Article 91d of the Basic Law be adopted to create a constitutional basis for voluntary cooperation between the Federation and the *Länder* on

benchmarking in the administration, thus encouraging a willingness to carry out such benchmarking in Germany.

Cancer Register

The Commission has agreed to support the draft Federal Cancer Register Data Act submitted to the Commission at the request of the Federal Ministry of Health and to propose its inclusion in the legislative procedure for stage 2 of the Federalism Reform. On the basis of this legislation, a National Cancer Register will be established which will contain cancer data for Germany as a whole and facilitate regional and inter-*Länder* studies. Any unresolved issues between the Federation and the *Länder* should be clarified during the legislative process.

Downgrading of federal trunk roads which are no longer relevant to long-distance traffic

The Commission proposes that the German Bundestag and the Bundesrat prepare a resolution for the downgrading of federal trunk roads which are no longer relevant to long-distance traffic. Following the completion of the Commission's work, the Federation and the *Länder* should seek a prompt and mutually acceptable solution regarding the individual routes as well as agreement on a timescale and other downgrading and compensation modalities. Further procedural arrangements will also be established.

Broadening the scope for financial assistance from the Federation (Article 104b of the Basic Law)

The current Article 104b of the Basic Law restricts the scope for the Federation to grant financial assistance to those areas in which the Federation has legislative powers. In light of the new provisions of Article 109 and Article 115 of the Basic Law, the Commission proposes lifting this restriction for the specific case of natural disasters or extraordinary emergency situations. This would ensure that as part of the efforts to manage such emergencies – e.g. the current financial and economic crisis – the programmes that are required to revitalize public investment activity in all sectors can be carried out with the Federation's support.