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Issues of municipal reform  
and the future role of local  
governments in West Germany

by P. B. Spahn

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by

**P.B. Spahn**

**Research Fellow  
Centre for Research on Federal Financial Relations  
The Australian National University, Canberra**

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The author bears full responsibility for the views expressed in this reprint.

P.B. Spahn

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TABLE

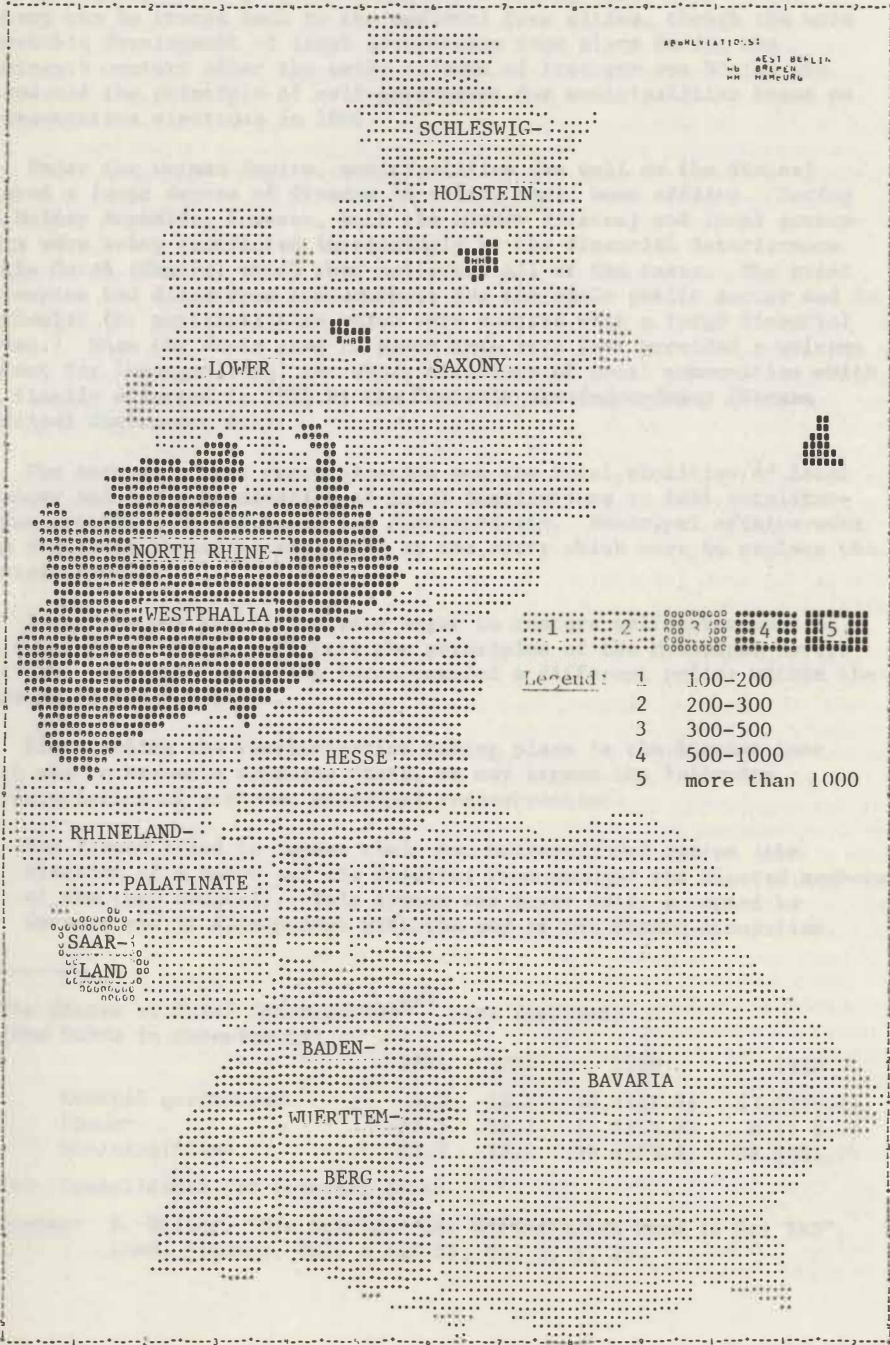
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POPULATION DENSITY OF WEST GERMAN STATES

- Residents per sq.km. -







ISSUES OF MUNICIPAL REFORM AND THE FUTURE ROLE OF  
LOCAL GOVERNMENTS IN WEST GERMANY

1. *Some Historical Remarks*

In Germany local governments have had a long tradition. Their history can be traced back to the medieval free cities, though the more remarkable development of local governments took place during the nineteenth century after the early reforms of Freiherr vom Stein, who introduced the principle of self-government for municipalities based on representative elections in 1808.

Under the German Empire, municipalities (as well as the States) enjoyed a large degree of freedom in ruling their home affairs. During the Weimar Republic, however, both the *Länder* (States) and local governments were being restricted increasingly by the financial interference of the *Reich* (Empire) which then collected all of the taxes. The great depression had disastrous consequences for the whole public sector and in particular for municipalities which were saddled with a large financial burden.<sup>1</sup> When the *Nazis* came to power this very fact provided a welcome pretext for 'reorganising' the whole structure of local communities which was finally effected in 1935 by the *Deutsche Gemeindeordnung* (German Municipal Government Act).

The outcome of the reorganisation was the total abolition of local autonomy and the subordination of local institutions to *Nazi* totalitarianism according to the so-called *Führerprinzip*. Municipal affairs were then regulated by bodies nominated by the party which were to replace the elected councils.

After the war the Allies were eager to restore self-government at the local level and to extirpate the principles of the Municipal Government Act. But each occupying force pursued a different policy within the zones under their control.

Disregarding the reorganisation taking place in the Russian zone which was to become a separate state, we may stress the following characteristics of post-war municipal reconstruction:

- The French tried to impose their own *maire-adjoint* system (the election of a mayor and his deputies from amongst the elected members of the town council). This system was never fully accepted by Germans and it disappeared with the end of the French occupation.

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<sup>1</sup> The Shares of *Total Indebtedness* (a) were (percent):  
(*New Debts* in parenthesis)

	1881	1914	1928	1938
Central government	4.3	15.1	48.8(12.4)	63.0(59.2)
<i>Länder</i>	83.5	51.7	11.6(13.8)	8.4( 9.2)
Municipalities	12.3	33.2	39.6(73.8)	28.6(31.7)

(a) Consolidated for internal debts.

Source: A. Möller, 'Die Schulden der öffentlichen Hand in der BRD',  
*Local Finance*, Vol. 4 (1975), No. 3, p. 19.

- The Americans were essentially encouraging the restoration of the prefascist institutions in a modified form. The Municipal Acts passed in the States of the American zone, though establishing uniformity within each State, still show remarkable regional differences. But since these Municipal Acts followed a long tradition, they essentially remained unaltered even after the achievement of sovereignty by the Federal Republic.
- The British were highly innovative. Instead of promulgating their own system they tried to combine British and German traditions. Despite considerable criticism the characteristic features of these proposals were adopted in the former British zone and they still survive today.

The three main forms of traditional German municipal government can still be distinguished. These are the *Bürgermeisterverfassung* (in particular in Rhineland-Palatinate, and the small communities in Hesse and Schleswig-Holstein) where the elected burgomaster is the dominant executive authority; the *Magistratsverfassung* (in the larger towns in Hesse and Schleswig-Holstein) where the Magistrat, a collective administrative body, is the executive authority which, in its original form, had to approve all decisions of the municipal council. However, this great power attributed to the administration has been reduced considerably. Only in Hesse may the Magistrat take exception to the council's decisions in certain cases. Finally, there is the *Gemeinde- or Stadtratsverfassung* (in Bavaria, Baden Wuerttemberg, Lower Saxony, North-Rhine-Westfalia), which is the most democratic form of all, because the elected municipal council has executive as well as legislative power. In the two northern states, under British influence, administrative control was vested in a civil servant, the *Gemeinde- (or Stadt) direktor*, who was to play his role under the elected body, the *Gemeinde- (or Stadt) rat*.<sup>2</sup> Over time, however, the British version has been moving closer to the *Bürgermeistersverfassung* although the key figure is still the (appointed) *Direktor* not the (elected) burgomaster.<sup>3</sup>

The regulations for the counties are much more uniform because of a lack of historical tradition. In addition to communes and counties, there is also the institution of so-called *Zweckverbände* (Common Purposes Associations) in which several communities have joined together to administer a special common task; in particular the maintenance of utilities under an intermunicipal authority.

There are four local government associations, so-called *Spitzenverbände* (Top Associations) representing the interests of their member governments relative to the state and federal authorities: the *Städtetag*, the *Städtebund*, the *Gemeindetag*, and the *Landkreistag*. By far the most influential of these has turned out to be the *Städtetag* which is a strong organisation of the big cities in Germany.

<sup>2</sup> For more details see R. Hiscocks, *Democracy in Western Germany*, London: Oxford University Press, 1957, pp. 179-184.

<sup>3</sup> See N. Johnson, *Government in the Federal Republic of Germany*, Oxford: Pergamon Press, 1973, p. 127.

## 2. Basic Constitutional Arrangements for Local Government in the Federal Republic

What are the main constitutional regulations for local government in West Germany of today? Only some major points can be outlined here.

- The communes have safeguarded the right to regulate their own affairs within certain limits in Article 28 of the *Grundgesetz*.<sup>4</sup> This is entirely in accordance with the traditional principle of 'universality of competence' granted to local governments. The general assertion is that *Kreise* (counties) and *Gemeinden* (communes) must have elected bodies, and in communes the assembly of the commune may also function as a legislative body.<sup>5</sup>
- The constitutional guarantee of self-governing rights is valid only as a structural principle. It does not include the right of specific communes to exist indefinitely within given territorial boundaries. On the contrary, the adjustment of local boundaries and administrative reorganisation (including the merger of smaller communities) is one of the principal tasks of the reforms which are actually being carried through in all *Länder* of the Federation.
- Except for substantial rights granted to municipalities<sup>6</sup>, particularly over financial and personnel matters, the *Länder* exert control over the communes of their respective jurisdiction. They are also

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<sup>4</sup> See also Appendix 2.

<sup>5</sup> 'The basic and historic local unit is the *Gemeinde* (municipality or commune) which, in area and population, may range from the small rural hamlet with its surrounding fields and farms to the large city. The more populous *Gemeinden* generally have the legal title of *Stadt* (city). If the number of inhabitants attains a prescribed minimum ..., the city may become a *Stadtkreis*, that is, a 'city-county' or, in the English terminology, 'county-borough'. The *Stadtkreis* is detached governmentally from the county in which it is geographically situated and is freed from supervision by the county authorities. Other *Gemeinden* ... remain under county supervision. ...

Above (the *Gemeinden*) are the *Gemeindeverbände* which are unions of associations of *Gemeinden* with functions defined by law. The principal type of *Gemeindeverband* covered by Article 28 of the *Grundgesetz* is the *Landkreis* (rural county) ... uniting all the *kreisangehörigen Gemeinden* within the county area. It is called a 'rural county' to distinguish it from the 'city county' which is a city exercising county as well as municipal functions.' R.H. Wells, *The States in West German Federalism*, New York, Bookman Associates, 1961, pp. 75-76.

<sup>6</sup> Specific functions of local government are not listed in the *Grundgesetz* and have largely been defined by jurisdiction. A catalogue of such functions may, however, be found in *Länder* Constitutions, for instance in Article 83 of the Bavarian Constitution.



responsible for the general or framework legislation concerning local governments which may, of course, differ from state to state. The following common principle can be found, however. In all *Länder* the functions of local governments fall into two categories, those which are administered on behalf of the state, and those which they perform as a self-governing jurisdiction. The fact that communes may decide on the volume, the timing and the structure of their own expenditures independently is considered to be a fundamental principle of their autonomy. In recent years, however, the first functional category has been expanding quite rapidly at the expense of the latter, thus relaxing somewhat the direct responsibilities of local government officials to the citizenry.

- The financial independence of local governments is constitutionally guaranteed in Article 106(5) and (6) *Grundgesetz*. These are provisions whereby communes will get revenues from taxes on real property, businesses and local excise taxes as well as a share of the revenue from the income tax. Municipalities have no direct influence on tax legislation in these fields which is uniform for the whole Federal Republic. In the case of taxes on businesses and real property they may vary, within given limits, their local adjustment factors (*Hebesätze*) on the tax base autonomously. Local governments can also set user charges quite freely to recover the cost of some public services provided at the local level. They also may borrow in accordance with the provisions of the state legislation. The supervisory role of the state government in matters of local debt is, however, only formal and not material.
- In the case of a violation of their self-regulating power by state or federal legislation, the municipalities have the constitutional right to complain to the Federal Constitutional Court [*Grundgesetz*, Article 93(1) (4b)].

### 3. *Public Services and the Significance of Local Governments*

In accordance with their long tradition, municipalities in West Germany have always played quite an important economic and social role. Many of the public functions that are assigned to the States in Australia for instance will be performed by local authorities in West Germany. The different roles local governments have assumed in different federations may be roughly illustrated by the distribution of public sector outlays by levels of government.

One should stress, however, that the data given for Germany are calculated in accordance with *net* outlays, i.e. payments of other tiers of government are deducted. This is of particular importance when comparing the figures with those of the United States and Canada, because a quarter of West German local authority expenditure is made on behalf of other government agencies, in particular on behalf of the states. Also, if the city states were being treated as municipalities which, in effect, they are to a large extent, one would have to shift some additional percent points from state to local authorities. It then becomes rather questionable whether local governments 'have a relatively less important

role in Germany than they do in either the United States or Canada'.<sup>7</sup>

Table 1

DISTRIBUTION OF PUBLIC SECTOR OUTLAYS AS A PERCENTAGE OF TOTAL OUTLAYS  
(EXCLUDING INTERGOVERNMENTAL TRANSFERS)

<u>Level</u>	<u>Federal</u>	<u>State</u>	<u>Local</u>
West Germany (1971)	45	33	22(a)
Australia (1970-71)	48	44	8
Canada (1971)	37	29	34(b)
Canada (1971) (c)	40	32	28(c)
United States (1969)	60	14	26

(a) Without city states which exercise state and local functions.

(b) Includes hospital and pension plans (about 8% points).

(c) Excludes hospital and pension plans.

Source: J.S.H. Hunter, *Revenue Sharing in the Federal Republic of Germany*, Research Monograph No. 2, Centre for Research on Federal Financial Relations, The Australian National University, Canberra, 1973, p. 9. The figures for Germany are revised according to the *Statistisches Jahrbuch 1974*, pp. 402-3.

The rough picture given above has to be completed by looking at the structure of local expenditures in more detail. If one concentrates on capital outlays which are of prime importance for the infrastructural provisions of a nation, the role of local governments becomes dominant. Whereas municipalities devote about 36 per cent of their expenditures to fixed asset formation, the *Länder* would spend only 8 per cent, and the Federal Government 5½ per cent. This accounts for the large share of about two-thirds of fixed public capital formation which is administered by the German municipalities.

Table 2

PUBLIC INVESTMENT OF DIFFERENT LEVELS OF GOVERNMENT IN WEST GERMANY  
1966 - 1971

	<u>Federal</u>	<u>State</u>	<u>Local</u>	<u>Total Public Sector</u>
Public Investment (a)				
as % of Total Outlay	11.3	17.4	39.1	23.7
of which: Fixed Assets	5.5	7.7	35.8	16.5
Share of Different Levels in Total Public Invest- ment(a) Spending	25.0	28.9	46.1	100.0
of which: Fixed Assets	16.5	19.4	64.1	100.0

(a) Including financial investment.

Source: H. Kock, *Stabilitätspolitik im föderalistischen System der Bundesrepublik Deutschland*, Köln: Bund, 1975, p. 25.

<sup>7</sup> J.S.H. Hunter, *Revenue Sharing in the Federal Republic of Germany*, Research Monograph No. 2, Centre for Research on Federal Financial Relations, The Australian National University, Canberra, 1973, p. 8.



As already pointed out, there is no specific assignment of local government functions in the West German constitution. However, one would expect municipalities to have specialised over time in activities of specific local interest and to have tried to provide services which are at the margin between public and private goods. Municipal activity also depends on the size of the local jurisdiction (bigger cities tend to engage in cultural activities to a much larger extent) as well as the general economic characteristics of the hinterland and of local production, whether industrial or agricultural, whether labour intensive or capital intensive. The more important areas of local government activities in West Germany are the following:<sup>8</sup>

- Provision and extension of water, gas and electricity supply.
- Water sewage and waste disposal.
- Local transportation (bus, tram services, local road building).
- Sports and recreational facilities (swimming pools, parks, etc.).
- Local welfare (day care, playgrounds, pensioner homes).
- Hospitals.
- Cultural and educational programs (theatre, museums, primary and secondary schools).

This list is, of course, not exhaustive, and it should only give an indication as to what areas local government functions have developed more recently. In addition to these proper local activities, municipalities also undertake tasks on behalf of their respective state governments as indicated above. For one given year, the weights attached to each function can be illustrated by the major net outlay categories of local governments (Table 3).

Apart from the typical category 'communal services', municipalities bear the brunt of public expenditures in the fields of health, sport and recreation (nearly 70 per cent of total outlays), housing and regional policy (40 per cent) as well as primary education, road building and so-called 'profitable enterprises' (with approximately one-third of total government outlays). If one includes the city states (Hamburg, Bremen and West Berlin) which have to bear local services to a larger extent than other states, the picture will reveal a further strengthening of local responsibilities in these functions.

#### 4. *Recent Trends in Local Government Finance*

During the sixties, the average annual growth rate of local expenditures was disproportionately high compared with either the expenditures of other tiers of government or gross national expenditures. This was in sharp contrast to the development of local governments' own tax revenues which, on the average, were much less dynamic than tax revenues of the States and the Federal Government (Table 4).

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<sup>8</sup> See for instance P. Graf, 'Die Aufgaben der Gemeinden', in H. Rausch, T. Stammen, *Aspekte und Probleme der Kommunalpolitik*, München, 1972, p. 47.

Table 3

THE COMPOSITION OF LOCAL GOVERNMENT NET OUTLAYS<sup>(a)</sup> IN 1971

Category	Mill.DM	% of total government outlays in that category		% of total outlay of municipalities
	(b)	(b)	(c)	(b)
General Administration	5,130	39.5	47.3	10.3
Public Security, Law, Order	1,515	16.3	31.2	3.0
Education, Schools	7,429	32.9	40.3	14.9
Social Security	7,227	16.0	20.5	14.5
Health, Sports, Recreation	8,717	69.0	81.6	17.5
Communal Services (Sewage, etc.)	7,019	90.0	98.6	14.1
Agriculture, etc.	426	7.4	8.2	0.8
Roads, Bridges, etc.	6,026	30.4	34.5	12.1
Housing and Regional Policy	1,923	40.1	52.7	3.9
Profitable Enterprises	3,516	33.6	39.7	7.1
Other	943	-	-	1.8
Total	49,871	22.1	27.0	100.0

(a) So-called *Eigenausgaben*.

(b) Without city states.

(c) Including city states.

Source: *Statistisches Jahrbuch 1974*, pp. 403-4. Own calculations.

Table 4

ANNUAL RATES OF INCREASE FOR REVENUES AND EXPENDITURES BY  
LEVEL OF GOVERNMENT - 1970 over 1961

	Federal <sup>(a)</sup>	States	Local	Total <sup>(b)</sup>
Annual Rate of Increase in %				
Expenditures	7.3	7.7	8.8	7.5
Revenues	7.2	7.4	5.6	7.1
Elasticities with respect to Gross National Expenditures				
Expenditures	0.96	1.01	1.15	0.99
Revenues	0.94	0.97	0.73	0.93

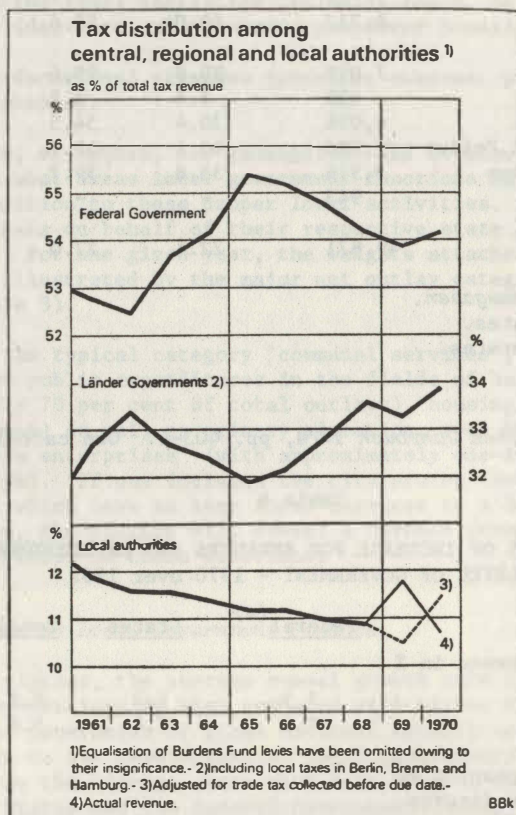
(a) Without special funds (LAF, ERP, Offa).

(b) With special funds.

Source: H. Kock, *op. cit.*, pp. 22, 24, 28, 30. Own calculations.

Local expenditures also turned out to be highly sensitive to fluctuations in their tax revenues which were determined to a large extent by the local tax on business enterprises,<sup>9</sup> and local property taxes. Property taxes tend to be stagnant in Germany not only because the supply of land is fixed and variations of local tax rates are limited by law,<sup>10</sup> but also because the assessable value of the property (the *Einheitswert*) had not been adjusted to increases in market values since the thirties.<sup>11</sup> The share of property taxes was therefore declining continuously, reaching about 19 per cent in 1968. The business tax (share in 1968: 72 per cent), in particular the tax on business yields, fluctuates heavily with the business cycle and it is therefore a relatively unreliable revenue source for a steady expansion of local services and long-term communal planning.

Figure 1



**Source:** Deutsche Bundesbank, *Monthly Report*, Vol. 23 (1971), No. 8, p. 18.

<sup>9</sup> This tax is levied on business capital, on business yields and (in some states) also on the wage-bill (*Gewerbekapital-, Gewerbeertrag- and Lohnsummensteuer*).

<sup>10</sup> This was a consequence of the land policy which fostered agriculture and new housing.

<sup>11</sup> A readjustment was made in 1965. However, a reform of the property tax based on these values came into being only in 1974.



Local expenditures relative to own tax revenues of municipalities were therefore increasing tremendously during the last decade, and local debt was skyrocketing.

Table 5

LOCAL EXPENDITURES, LOCAL DEBT AND GRANTS TO MUNICIPALITIES RELATED TO LOCAL TAXES IN WEST GERMANY		1961	1962	1963	1964	1965	1966	1967	1968
1.	Local Taxes <sup>(a)</sup> (bill.DM)	9.3	10.1	10.6	11.3	11.8	12.6	12.6	13.8
2.	<u>Local Expen- ditures</u> Local Taxes	2.58	2.77	2.97	3.15	3.31	3.23	3.23	3.24
2*.	(The Inverse of 2)	(0.39)	(0.36)	(0.34)	(0.32)	(0.30)	(0.31)	(0.31)	(0.31)
3.	<u>Grants to Municipalities</u> Local Taxes	0.61	0.76	0.85	0.88	0.94	0.95	1.00	0.97
4.	<u>Local Debt</u> <sup>(b)</sup> Local Taxes	1.36	1.48	1.66	1.87	2.18	2.32	2.51	2.55

(a) Without local taxes of city states.

(b) Level of Outstanding debt.

Source: H. Kock, *op. cit.*, pp. 24 and 167. Own calculations.

It is easy to see that the expenditure/revenue ratio rose sharply during the early sixties (6½ per cent per annum), yet the debt/tax ratio increased at an even greater rate (12½ per cent per annum). Also, whereas the expenditure/revenue ratio fell slightly during the recession of 1966-67 and remained fairly constant afterwards, the debt/tax ratio continued to increase by an annual 5½ per cent approximately.

It is therefore clear that local government functions had reached a financial ceiling during the second half of that decade, and because of an almost constant grants-tax ratio expenditures could only expand in accordance with the sluggishly developing local tax revenues.

<sup>12</sup> The grant-tax ratio had reached a peak in 1967 with municipal grants equalling the amount of municipal taxes. This ratio has not been attained since (latest data for 1973).

Between 1964 and 1968, an inquiry was made into various aspects of local finance in West Germany by the Troeger Commission,<sup>13</sup> and one of the findings of this commission stressed in particular these tendencies in local finance. In addition it was pointed out in their report that the role of local governments was expected to increase even more in such areas as traffic, hospitals, public utilities and so forth. Recognising the importance of local governments and their expected future role in the West German society, and based on the recommendations of the Troeger Commission, the Federal Government initiated a finance reform which came into effect in 1970.<sup>14</sup>

Table 6

COMPOSITION OF LOCAL GOVERNMENT REVENUES BEFORE  
AND AFTER THE TAX REFORM (1968 AND 1971)

	1968		1971	
	Bill.DM	As a percent of total	Bill.DM	As a percent of total
Total Revenues (a)	40.9	100.0	58.1	100.0
of which:				
Taxes	13.3	32.5	19.1	33.0
User Charges, Fees,				
Fines	7.8	19.2	11.2	19.2
Grants	12.9	31.4	18.0	30.9
Net credits	2.5	6.1	7.5	12.9
Other	4.4	10.8	2.3	4.0
Total Taxes (a)	13.3	90.0	19.1	90.5
+ Local Taxes of City States	1.5	10.0	2.0	9.5
Total Taxes	14.8	100.0	21.1	100.0
of which:				
Tax on Buildings				
and Land	2.5	16.7	2.8	13.3
Business Tax (total)	11.6	78.4	14.1	66.8
(Based on Wage Bill)	(1.0)	(6.7)	(1.8)	(8.5)
Share in Income Tax	-		8.4	39.8
less: Federal-Länder				
Share in				
Business Tax	-		5.2	24.6

(a) Without city states.

Source: H. Kock, *op. cit.*, p. 167, Deutsche Bundesbank, *Monthly Report*, Vol. 28, No. 4 (1976), p. 56. Own calculations.

<sup>13</sup> Kommission für die Finanzreform. Gutachten über die Finanzreform in der Bundesrepublik Deutschland, 2 Aufl., Stuttgart: Kohlhammer, 1966.

<sup>14</sup> Gesetz zur Neuordnung der Gemeindefinanzen (*Gemeindefinanzreformgesetz*) vom 8 September 1969, BGBl I, pp. 1587-88. At the same time, financial relations between the Central Government and the States were being resettled in the Gesetz über den Finanzausgleich zwischen Bund und Ländern, vom 28 August 1969, BGBl I, pp. 1432-36.



The regulations of this finance reform dealing with the vertical imbalances between central governments and municipalities were essentially the following: (i) the municipalities cede an average of 40 per cent of their revenues from the business tax to both the Federal Government and the States to be equally shared,<sup>15</sup> and (ii) are recompensed by a share of 14 per cent of the wage and assessed income taxes.<sup>16</sup> The latter taxes are, of course, much more elastic than any of the local taxes, and municipalities have therefore profited from the new arrangements considerably. The following table shows the actual development of local tax revenues compared with a hypothetical development if there had not been a Financial Reform, i.e. the distribution of taxes had remained unchanged.

Table 7

THE EFFECTS OF THE FINANCE REFORM ON LOCAL FINANCE<sup>(a)</sup>

Bill. DM

Year	Actual Tax Revenues	Status quo ante Tax Revenues	Net Effect	
			Bill. DM	In % of actual taxes
1970	16.5	14.1	2.4	14.5
1971	19.1	16.1	3.0	15.7
1972	23.0	19.0	4.0	17.4
1973	27.2	22.3	4.9	18.0

(a) Without taxes of city states.

Source: R.R. Klein, 'Entwicklung und Bedeutung der Gemeindesteuern in der Bundesrepublik Deutschland', *Local Finance*, Vol. 4, No. 1, p. 4.

The actual average annual rate of increase from 1969 to 1973 was therefore 12 per cent; the *status quo ante* would have produced less than 7 per cent annually.

It can be shown, however, that local governments, despite the 1970 reform, have not been able substantially to improve their financial position relative to the other tiers of government. The reform has, in effect, only restored financial relationships which had prevailed at the beginning of the sixties. For the years 1970-74, local taxes as a share of total taxes were 11.8 per cent (compared to 12.1 per cent in 1961).<sup>17</sup>

<sup>15</sup> *Gemeindefinanzreformgesetz* § 6(2). The actual amount is  $\frac{\text{actual revenue}}{\text{'Hebesatz'}}$  120, where the *Hebesatz* is an adjustment factor applied to the local tax base in per cent.

<sup>16</sup> *Gemeindefinanzreformgesetz* § 1.

<sup>17</sup> See also Figure 1 on page 8.

Hence increased relative costs and swelling demand for public services at the local level do not seem to have been acknowledged by the more recent finance reform.

Also, the share of the local business tax in total local taxes still remains quite high (43.7 per cent in 1973) and the traditional claims for a radical reform of this tax persist.<sup>18</sup> We shall discuss issues of municipal finance later on after having stated our views with regard to the prospective role of local governments in general.

##### 5. *Further Actual Issues of West German Municipal Reform*

Apart from local government finance, there are two other topics in municipal reform which are worth discussion here because of the recent preoccupation of politicians and legislators with them. Firstly, there is the structural and organisational reform which is still being carried through in the States; secondly, the problem of medium and long term planning has become apparent, and questions of the co-ordination of local government policies for reasons of stabilisation and growth have emerged. In addition, there is, *inter alia*, the all-embracing problem of land policy, particularly that connected with problems of urban renewal which we shall have to neglect here.

###### 5.1 *Structural and Organisational Reform*

The structural and organisational reforms of German municipalities are essentially pursuing objectives similar to those striven for by local government reforms in other countries, for instance the reform in England.<sup>19</sup> The basic philosophy is to create local government bodies which are able to perform their services more efficiently than the historical bodies by basing local government on more homogeneous regional economic units. Indeed, the atavistic organisational pattern of the 19th century communes has survived basically unaltered until recently, despite the aforementioned reorganisations after World War II and some minor boundary changes. Yet far-reaching structural changes in the society as well as in the provision of public goods have hitherto taken place. These changes have challenged the efficiency of the present structure of municipalities as developed historically.

Two major strands of local government reform can be distinguished:

- The aim in reforming the metropolitan area is to mitigate the financial disproportions between the centre with its heavy administrative burden and its considerable maintenance costs and the more opulent

<sup>18</sup> See for instance H. Kock, *op. cit.*, p. 174, and the references given there. The criticism is concerned particularly with the local tax on business yields because of competition with the corporation tax, and on grounds of double taxation. Its abolition is also requested for reasons of revenue sensitivity to the business cycle. We shall argue later that there are serious objections against the other two forms of local business taxation also.

<sup>19</sup> See the Local Government Act, 1972, which came into effect on 1 April 1974.

surrounding residential areas. The objective is to draw the administrative boundaries of the big cities in accordance with its economic base, i.e. to try to internalise benefit spillovers of the centre to a large extent.

The problem of smaller communities is different. Here it is sought to strengthen the economic and political significance of very small jurisdictions by merging these units into more powerful local authoritative bodies.

In 1968, there were about 24,300 local governments and government bodies in West Germany, many of them too small even to cope with the needs of the beginning of this century. Yet lots of additional duties have since been heaped upon local governments, particularly in the field of social welfare. In addition to dealing inadequately with these new functions, small jurisdictions were also suboptimal in terms of operating costs per unit of output. This is illustrated by the large share smaller jurisdictions tend to spend on general administration. It can be argued that the merger of communities will reduce these costs considerably with large economies of scale also resulting. In addition there is a strong suspicion that the high labour-intensiveness of most kinds of local services, and in consequence the small chances to profit from technical progress, is widely a 'sign of technological backwardness which could be overcome if the size of the jurisdiction was larger'.<sup>20</sup>

Looking at some figures for Germany as presented in Table 8, the relationship between the importance of general administrative costs and the size of the jurisdictions is evident. However, the usual assumptions made about the distribution of expenditure on wages and salaries among levels of government are not so apparent in the figures given. Clearly the Federal Government's operations are by far the less labour-intensive even when measured in terms of the wage-salary/expenditure ratio. In addition, per capita wage and salaries are much higher at the Federal level than at any other level of government. If one accounts for this by assuming uniform labour costs per capita throughout the government sector, the labour expenditure ratio adjusted accordingly is reduced even further at the central level. However, it is not so obvious that the share of labour costs increases the smaller the jurisdiction becomes, except of course for the rural districts. We shall comment further on this issue later.

There is no doubt, however, that the structural and organisational reform of municipalities is a *conditio sine qua non* if local governments are to be able to deal with the necessities of the last quarter of this century. The reforms are being carried out at the State level under different historical, social and economic circumstances and with different enthusiasm, but with more or less the same objectives. The number of communities was reduced from 24,300 in 1968 to merely 14,200 in 1974, and it is expected that the number of municipalities will diminish even further to about 8,000 to 9,000. Also the number of independent cities was scaled down drastically from 135 in 1968 to 89 in 1975.

<sup>20</sup> D. Netzer, 'State-Local Finance and Intergovernmental Relations', in A.S. Blinder *et al.*, *The Economics of Public Finance*, Washington, D.C., Brookings, 1974, p. 383.



Table 8

GENERAL ADMINISTRATIVE EXPENDITURES AND PERSONAL EXPENDITURES  
ACCORDING TO THE LEVEL OF GOVERNMENTS OF DIFFERENT SIZES - 1971

	All Levels	Federal States	States (a)	City States	Big Cities (b)	Smaller Cities (c)	Rural Districts
A. General Administration expenditures as a percentage of total net outlays	5.8	2.9	6.2	9.2	7.6	11.5	19.0
B. Wages and salaries as a percentage of total outlays	32.6	17.4	42.4	45.5	32.9	18.5	35.9
(adjusted) <sup>(d)</sup>	(32.6)	(12.7)	(41.4)	(45.5)	(36.0)	(20.7)	(39.2)
As percentage of current outlays	44.1	21.7	55.8	57.0	48.8	35.6	55.5
(adjusted) <sup>(d)</sup>	(44.1)	(16.0)	(54.8)	(57.0)	(52.3)	(38.9)	(58.9)
C. Adjusted per capita wages and salaries related to the average (e)	1.00	1.45	1.04	1.00		0.87	

(a) Except city states.

(b) *Kreisfreie Städte*.

(c) *Kreisangehörige Gemeinden und Ämter*.

(d) This value is obtained by  $\frac{B^*}{100+(B^*-B)}$ , where  $B^* = \frac{B}{C}$ .

(e) See Appendix 1.

Source: *Statistisches Jahrbuch 1974*, pp. 400-03 and 411. Own calculations.

Some more recent figures may illustrate the communal structure of the Federal Republic of Germany (Table 9).

It can easily be seen that North-Rhine-Westphalia and Hesse, and to some extent also Baden-Wuerttemberg, are the States with the larger communal units both in terms of population and area. The most inappropriate municipal structure is found in Rhineland-Palatinate. Yet apart from this particularly poor record, all the other States seem equally capable of further improvements in their local structures, at least in terms of

Table 9

COMMUNES, POPULATION AND MUNICIPAL AREAS IN WEST GERMANY'S STATES<sup>(a)</sup>

- 30.6.1973 -

	Number of Communes(b)	Population in 1,000(b)	Population per Commune in 1,000 (b)	Land Area per Commune in km <sup>2</sup>
Schleswig-Holstein	1258 ( 2)	2574 ( 503)	2.1 (252)	12.5
Lower Saxony	2571 ( 8)	7237 (1500)	2.8 (187)	18.4
North-Rhine Westphalia	948 (25)	17216 (7325)	17.5 (293)	34.6
Hesse	848 ( 5)	5558 (1390)	6.6 (278)	24.9
Rhineland- Palatinate	2469 ( 5)	3698 ( 680)	1.5 (136)	8.0
Baden-Wuerttemberg	2147 ( 5)	9211 (1620)	4.3 (324)	16.7
Bavaria	4383 ( 6)	10816 (2458)	2.5 (410)	16.1
Saarland	345 ( 1)	1116 ( 124)	3.2 (124)	7.4

(a) Except city states.

(b) The figures in parenthesis are for communes with more than 100,000 inhabitants.

Source: *Statistisches Jahrbuch 1974*, pp. 35 and 43. Own calculations.

population per unit. The area per commune ratio is more favourable for these States, however, except perhaps for the Saarland. The Saar problem is also discussed in Germany in connection with regional reform of the state territories; the Saar will eventually be combined with Rhineland-Palatinate and possibly both with Hesse. This is, however, not a matter of pure re-organisation, but a constitutional issue, and it requires referenda in those States.<sup>21</sup>

Table 9 illustrates quite clearly those German States that have attacked local government reform more enthusiastically than others. However, the picture is somewhat distorted because of the different initial historical conditions which made, for instance, North-Rhine-Westphalia a more densely populated State than all other regions even before the municipal reforms.

<sup>21</sup> In accordance with Article 29 *Grundgesetz*.



## 5.2 Co-ordination and Financial Planning

Another important topic of more recent discussion on the role of municipalities is the problem of co-ordinating their policies with Federal policies for stabilisation and growth. Connected with this issue is the problem of medium and long-term planning in municipal finance. There are two different aspects of the problem:

- On the revenue side, the discussion is centering around the question of how to transfer a secure and steadily expanding financial basis to municipalities, that is more or less independent of the business cycle, yet strong enough to enable communes to deal with their needs. The more recent developments in Germany have already been outlined briefly in connection with problems of local finance. Whether the 1970 finance reform has really brought about a more permanent solution will have to be discussed later.
- On the expenditure side there is the complex problem of the actual local planning process itself, from the assessment of local demand for public goods (including the spillover problem) to questions of implementation and control of these policies. Yet a second major issue is how to co-ordinate the multiplicity of government agencies horizontally, and how to integrate their policies into general policies designed at the Federal or State level. Only this second aspect will be pursued here.

The main difficulty with the integration of municipal finance into a centrally designed fiscal policy stems from the constitutional guarantee of municipal autonomy in Article 28 *Grundgesetz*. This Article, according to the prevailing interpretation, applies primarily to local expenditures.<sup>22</sup> Traditionally, the Federal Government as well as the States have tried to promote desired policies at the local level by means of grants, in particular conditional grants. This can be illustrated by the following Table 10.

These tendencies have been criticised heavily for their 'excavation' of local autonomy to such a large extent. Indeed, the more municipalities become dependent on financial grants relative to their own revenues, the narrower the scope for autonomous local policy will become, particularly when grants-in-aid are combined with matching ratios. However, legislation and actual policies toward local governments seem to be moving in this direction despite all these objections. More recent developments along this line include the *Gemeindeverkehrsfinanzierungsgesetz* (Municipal Traffic Finance Act) of 1971,<sup>23</sup> which gives Federal grants-in-aid as well as a certain portion of the tax on mineral oil<sup>24</sup> to municipalities for

<sup>22</sup> H. Kock, *op. cit.*, p. 66. The autonomy of municipalities on the revenue side is limited to variations of the *Hebesätze* on local taxes, to user charges, and to local borrowing.

<sup>23</sup> *Gesetz über Finanzhilfen des Bundes zur Verbesserung der Verkehrsverhältnisse der Gemeinden*, vom 18 März 1971, BGBl I, pp. 239-42.

<sup>24</sup> *Gemeindeverkehrsfinanzierungsgesetz* § 10(1).

Table 10  
 FEDERAL AND STATE GRANTS TO MUNICIPALITIES  
 1961 and 1971

		Unconditional		Conditional		Total
		Fed.(a)	State	Fed.(a)	State	
Grants in mill.DM						
	1971	-	7,851	1,875	7,846	17,572
	1961	4.0	2,659	655	2,387	5,705
Grants in percentage of Municipal Expen- ditures						
	1971	-	11.7	2.8	11.7	26.2
	1961	0.0	10.9	2.7	9.8	23.5
Grants in percentage of Municipal Taxes						
	1971	-	41.0	9.8	41.0	91.8
	1961	0.0	28.2	7.0	25.3	60.5

(a) Without Equalisation of Burden Fund and European Recovery Program.

Source: H. Kock, *op. cit.*, pp. 24 and 216. Own calculations.

the improvement of the local traffic system, including the construction of roads, tramway and subway systems, bus stations, and parking lots designed to facilitate the switching from private cars to the local transportation system.<sup>25</sup> Also the special grants program for the improvement of communal infrastructure<sup>26</sup> with a volume of 1.2 bill.DM (to be equally shared by the Federal Government and the States) as well as a 1 bill.DM loan from the European Recovery Program seems to confirm this tendency, although assistance is given to all sorts of traditionally local tasks which, of course, eases the restrictive character of conditional programs.

It is therefore apparent that the municipalities in West Germany are regarded more like private business firms than constituents of public authority by the central government. This contrasts with the general characteristics of the German federal machinery established to integrate federal and state policies, in particular with respect to stabilisation and growth policies, which is largely co-ordinative in the sense that 'decision-making responsibility is shared and the policies of different governments are co-ordinated'.<sup>27</sup>

<sup>25</sup> *Gemeindeverkehrsfinanzierungsgesetz*, § 2.

<sup>26</sup> *Sonderprogramm zur Förderung der kommunalen Infrastruktur*. For details see, for instance, *Local Finance*, Vol. 4, No. 6, p. 40.

<sup>27</sup> R.L. Mathews, 'The Changing Pattern of Australian Federalism', Paper presented to the Nigerian Institute of International Affairs International Conference on Federalism, May 1976, p. 51.

We shall go into some basic elements of this federal-state machinery so as to outline briefly the background for West German local government reform within the existing co-ordinative framework.

- In a more general sense all constitutional arrangements rotating around the *Bundesrat* as the States representatives' House and its role in federal legislation can be understood as being part of this co-ordinative machinery. There is no similar participatory institution of local governments. Such an institution would not appear to be constitutional or even viable given the large number of municipalities.
- More specific arrangements were derived from Article 109 *Grundgesetz*. This provision states the autonomy and independence of Federal and *Länder* budgeting and administration, yet due account should be given to 'the requirements of overall economic equilibrium' by both levels of government, and principles established by federal law which govern, *inter alia*, budgetary law and medium-term financial planning. This constitutional provision was the basis for the *Stabilitätsgesetz* (Stability and Growth Act)<sup>28</sup> with the *Mittelfristige Finanzplanung* (Medium-Term Financial Planning), and the *Haushaltsgrundsätzegegesetz* (General Budgetary Act).<sup>29</sup>
- An essentially new constitutional co-ordinative concept was established by Article 91a *Grundgesetz*, the so-called *Gemeinschaftsaufgaben* (Joint Tasks).<sup>30</sup> In three major areas of public policy originally attributed to the States, responsibility is now equally shared between the Federation and the *Länder*.

The regulations on medium-term financial planning as well as the joint-task concept are also of particular relevance for the future of local governments, thus further details ought to be discussed. It is important first of all to stress the point that there is no legal provision binding the Federal Government, States or municipalities to integrate their budgeting and planning *materially*. If there was such a provision it would evidently run counter to Article 109(1) as well as to Article 28(2) of the Federal Constitution referred to earlier. Yet the Stability Act prescribes medium-term planning for the Federation and the States<sup>31</sup> with an institutionalised mutual consultative and informative process.<sup>32</sup>

<sup>28</sup> *Gesetz zur Förderung der Stabilität und des Wachstums der Wirtschaft vom 8 Juni 1967*, BGBl I, pp. 582-89.

<sup>29</sup> *Gesetz über die Grundsätze des Haushaltsrechts des Bundes und der Länder, vom 19 August 1969*, BGBl I, pp. 1273-83.

<sup>30</sup> See Appendix 2. The Joint Tasks are (i) the expansion of institutions of higher education, (ii) the improvement of regional economic structures, and (iii) the improvement of the agrarian structure and of coast preservation. The three pieces of legislation regulating the details of these tasks were all passed in 1969 (BGBl I, pp. 1556-59, 1573-75 and 1861-63).

<sup>31</sup> *Stabilitätsgesetz*, § 9(1) and § 14.

<sup>32</sup> *Stabilitätsgesetz*, § 17.



The promising features of this attempt to co-ordinate multilevel planning in the German Federation are found on the *formal* side. Medium-term planning and in particular the General Budgetary Act have contributed to the ending of isolated planning and budgeting processes by providing consistent and comparable uniform standards for all levels of government. Uniform budgeting and planning standards do not restrict the autonomy of any of the tiers of government materially, yet they are able to enhance the intelligibility of budgeting and to reveal interdependences of public policy implemented at different levels.

This part of the medium-term planning exercise was therefore never really controversial in Germany, and it was also quite easy to get local governments to conform to these regulations.<sup>33</sup> The material side of co-ordinative planning is, of course, in much greater dispute. At the present time, an institution, the *Finanzplanungsrat* (Financial Planning Council),<sup>34</sup> which consists of representatives of all levels of government including municipalities, is attempting to effect material co-ordination. This Council is supposed to give co-ordinative recommendations which are enforced by a self-imposed unanimity rule.<sup>35</sup> However, it cannot be expected that the material part of this planning process will be binding among the different executives involved, particularly with respect to local governments which send only four representatives.<sup>36</sup>

In addition, the planning is always subject to revisions by the legislature. Despite these limitations stemming from the Federal Constitution itself, some marginal impacts on material decisions will result from this formal reconciliation of plans also. These minimum advantages can be derived from:<sup>37</sup>

- the necessity for more permanent and regular consultations and the establishment of an institutional body to effect the integration of diverging views;
- the necessity to base budgetary plans on consistent and uniform assumptions of the future development of the economy;
- the necessity to reconcile diverging views on tax forecasts and in particular on the percentages of jointly shared taxes going to each tier of government;
- the necessity to assign priorities to expenditure categories in particular to different investment programs; and
- the necessity to make annual budgeting compatible with the medium-term plans, in particular the necessity to account for the consequences of today's decisions on subsequent budgets (operating costs, etc.).

<sup>33</sup> By the *Gesetz zur Neuordnung des Kommunalen Haushaltsrechts*.

<sup>34</sup> *Haushaltsgrundsatzgesetz*, see § 51.

<sup>35</sup> § 6 of the *Finanzplanungsrat's* standing order (*Geschäftsordnung*).

<sup>36</sup> *Haushaltsgrundsatzgesetz*, § 51(1)(3).

<sup>37</sup> See, for instance, H. Kock, *op. cit.*, p. 137.



Hence, medium-term financial planning will to some extent produce some of the advantages of the planning-programming-budgeting-system concept (although at a reduced scale, of course). Financial planning is, however, also an instrument used to stimulate early discussions between the different public agents, to reveal inconsistencies and conflicts, and therefore provides the necessary conditions for accommodating these conflicts. More cannot be expected from an institution like the Financial Planning Board, given the restrictions of the Federal Constitution. There are proposals which try to strengthen the role of the planning institution by increasing the liability of executives so as to ensure recommendations of the body are followed. This would *de facto* weaken the planning authority's role, for it would undoubtedly narrow the area of consent considerably to issues of minor importance.

The joint task concept is, however, more promising as a co-ordinative device. We shall demonstrate the workings of this concept by reference to the task 'improvement of the regional economic structure',<sup>38</sup> though the regulations of all joint tasks are quite similar. For every joint task a common *Rahmenplan* (framework plan) has to be established which will have to be integrated into the medium-term financial planning of both the Federation and the States.<sup>39</sup> This framework plan must delimit the area of common planning and contains the planning goals as well as the proposed means to achieve these goals, disaggregated according to budget periods and individual States. It also defines the financial contributions the Federation and the States will have to allocate for the joint tasks during the planning period.<sup>40</sup>

The planning process for joint tasks comes much closer to the PPBS than the medium-term financial planning concept. Also the co-ordinative arrangements are much stronger than those of the financial planning council. Co-ordination is here effected by a *Planungsausschuss* (Planning Board) in which the Federal Government and all State governments are represented. Each State has one vote, the Federal Government's vote equals the sum of all State votes. The Planning Board's decisions require a majority of three-quarters of all votes,<sup>41</sup> i.e. the *Länder* can never outvote the Federal Government but the Federal Government together with half the number of States can control, to some extent, the other half of the States.

The initiative for joint tasks comes from the States. They will annually propose projects to be incorporated into the framework plan to the Federal Government (before 1 February). Simultaneously, the consent of the *Land* required by Article 91a(3) *Grundgesetz* is assumed to be given, according to which the States have to allow the carrying out of projects in their respective jurisdiction. This implied consent can, however, be discarded at any time. Once the Board has come to an

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<sup>38</sup> *Gesetz über die Gemeinschaftsaufgabe 'Verbesserung der regionalen Wirtschaftsstruktur', vom 8 Oktober 1969, BGBl I, pp. 1861-63, later referred to as the 'Regional Act'.*

<sup>39</sup> Regional Act, § 4.

<sup>40</sup> Regional Act, § 5.

<sup>41</sup> Regional Act, § 7.

agreement, its financial plan is binding for the *Länder* executives among themselves and with regard to the Federal Government.<sup>42</sup>

The joint tasks implemented by this procedure are carried through and administered by the States. However, responsibility and particularly the costs are shared between both levels of government.

The institution of joint tasks is part of the German Constitution and yet it has been criticised as essentially undermining the autonomy of the States and strengthening the unitary elements of the German Federal Republic.<sup>43</sup> On the other hand it has been stressed, for instance by Kock,<sup>44</sup> that, *de facto*, *Länder* autonomy, in particular that of the financially poorer States, has been increased compared to their prior status. Indeed, they now have legal access to financial sources of the Federation which they did not have before. Also the influence of the central government is legally well defined whereas previously when the States were largely dependent on financial assistance grants,<sup>45</sup> they were susceptible to involuntarily agreeing to quite restrictive federal impositions associated with the grants.

This characterisation of the prior *de facto* dependence of one or more of the States is comparable to the actual *de facto* dependence of local governments on the States, and one is tempted to think along the same lines of co-operative arrangements in municipal reform, at least in West Germany. We shall try to explore some of the consequences this may have on the future of local government policy.

#### 6. *Background to the Future of Local Governments*

Of course, characteristics of future municipal reforms cannot be outlined in the same way as the details of recent reforms now in the past. They remain highly speculative. Yet some basic social trends and more stable political conditions likely to determine future reforms can be traced out as a background for the discussion. We shall concentrate on some major issues only.

Demographic trends have undoubtedly determined the role of municipalities in the past and they will continue to do so in the future. Whereas West Germany's population was increasing during the whole post-war period up into the first half of this decade,<sup>46</sup> the domestic

<sup>42</sup> Regional Act, § 7(1). It is not binding with respect to the legislatures, however.

<sup>43</sup> See for instance H.B. Heier, *Gemeinschaftsaufgaben von Bund und Ländern und ihre Finanzierung*, Diss. Köln 1970, p. 332; quoted by H. Kock, *op. cit.*, p. 117.

<sup>44</sup> *Ibid.*

<sup>45</sup> These grants are based on Article 104a(4) *Grundgesetz*.

<sup>46</sup> The average annual increase was 1 per cent during the fifties, and  $\frac{3}{4}$  per cent during the sixties.

population is expected to decline slightly during the rest of this century.<sup>47</sup> The following characteristics have to be stressed in particular:

- Life expectancy which has risen continuously during this century will continue to increase.<sup>48</sup> Any medical breakthrough increasing the normal span of life would have revolutionary social consequences.
- Also the average of hours worked will decline further, in particular as a consequence of the limited availability of job opportunities in the producing industries and because the labour participation rate of women will continue to rise which tightens the labour markets further.<sup>49</sup> Social legislation, equal pay and strong economic and social pressures are likely to reinforce these tendencies in the near future. One of the consequences of this will be a proliferation and marketisation of services formerly produced by women outside the marketplace, i.e. child care, education, and other 'crypto-servant' functions.<sup>50</sup>
- Urbanisation will also be a major issue of the coming decades. In comparison to other countries, however, West Germany profits from a more equal distribution of locational centres and a developed regional transportation system which is likely to be further improved.<sup>51</sup> On the other hand, West Germany is itself rather 'crowded' and has special regional problems due to overpopulation in some areas such as the *Ruhrgebiet* or the Rhein-Main region. We shall neglect the specific problems of metropolitan areas here.
- Also, West Germany will not be able to reduce its 'guest worker' population to any considerable extent, which is likely to generate

<sup>47</sup> Until 1990, the domestic population is expected to decline by an annual  $1\frac{1}{2}$  per cent -  $2\frac{1}{2}$  per cent, according to a forecast of the Statistical Office (Statistical Yearbook 1974, p. 48).

<sup>48</sup> The average length of life time in Germany was:

	<u>1901-10</u>	<u>1932-34</u>	<u>1960-62</u>	<u>1970-72</u>
Male	44.8	59.9	66.9	67.4
Female	48.3	68.5	72.4	73.8

<sup>49</sup> The average participation rates were:

	<u>Women</u>	<u>Men</u>
1970	37.3	77.8
1972	39.1	77.5

However, whereas 93 per cent of all employed men were working more than 40 hours a week, the percentage for women was only 35 per cent.

<sup>50</sup> See J.K. Galbraith, *Economics and the Public Purpose*, Houghton Mifflin, Boston, 1973, Chapter VI.

<sup>51</sup> By the so-called *Integrierter Nahverkehr* concept, where roads and rails, private and public transportation are integrated.



the specific problems of ethnic ghettos in local jurisdictions.<sup>52</sup> With respect to this problem, West Germany is certainly not comparable to the United States, yet the manifest difficulties encountered there could provide an example of what long-term results may stem from local inactivity in this field.

The economic trends of the coming decade may be characterised as follows:

- Citizens are becoming increasingly aware of the 'quality of life' aspects of production, i.e. *inter alia* the pollution and congestion problems, and of the limitations of the environment, particularly the limits to raw materials. This will stimulate the redevelopment of land, the recycling of resources and a re-examination of conventional technologies, for instance the use of energy. These economic trends are likely to produce large external benefits (or avoid external costs) and they are likely to involve government activities to a great extent. They also impose new requirements on the co-ordinative machinery of the German Federation. *Prima facie* one may expect the present centralising forces in environmental control to be perpetual. Yet they stem from the initial necessity to derive uniform standards for pollution abatement and policy directions, to stimulate research in these new areas centrally, even at the EEC level. The centralisation may also be due to the actual inadequacies of local government co-operation, but they may well be reversed at a later stage when actual environmental control has to be implemented at a local or regional level.<sup>53</sup> Pollution is essentially a regional phenomenon and so is congestion.
- On the other hand, society is becoming more complex and more urbanised, more conscious of the inadequacies of specific public policies, of the distribution and sometimes misuse of private economic power (particularly of land) and, to some, of the deficiencies of the whole economic system. This is likely to strengthen the role of governments in areas like welfare, land policy (including housing), consumer protection, public utilities, local transportation and so forth. These are all areas of traditional local government function and are probably more efficient at the regional level, except perhaps in the case of health, where a greater degree of centralisation may be expected in the future.

<sup>52</sup> In 1973, West Germany had about 4 million registered foreigners living on its territory, which is 6½ per cent of the population. Of these, 2.3 million were guest workers (or 8.6 per cent of the work force). *De facto*, the numbers are considered to be much higher due to illegal immigration.

<sup>53</sup> This is because a single regional unit for performance of the service is often suggested by the nature of the production function. It is interesting to note that the need for planning environmental policies at the regional level has also been emphasised in Australia more recently. See *Proposals for a New Environmental Planning System for New South Wales*, Government Information and Sales Centre, Sydney, 1975.



- The increasing professionalism of women and the concomitant marketisation of former housewife activities will also challenge the responsibilities of State and local governments in the areas of 'crypto-servant' functions. There are two trends reinforcing these tendencies. On the demand side, the equal-opportunity argument will lead to pressure for a provision of these functions by the government rather than by private institutions which would discriminate against low income earners. On the supply side, there is a tendency towards seeking employment in the public rather than in the private sector because there they are more secure. This tendency will progress with growing structural unemployment and may also be related to improving educational standards and the increasing percentage of well-educated people, for one of the more important sectors offering white-collar type of employment is the government sector.
- In addition to that, there will be an expansion of government activities in such traditional areas as youth, care for the aged, recreation and so forth. This is largely a consequence of the increasing number of professionally inactive persons; either the elderly or the young who are still being educated or re-educated. It is also a consequence of the greater importance of leisure that arises either by the reduction of hours worked or by involuntary unemployment.
- With respect to the issue 'costs of public services', the inverse relationship between the size of the jurisdiction and the share of labour costs was not so obvious for German authorities, except for the rural districts. Also, during the sixties, the rate of increase of local government labour costs fell short of the average for the public sector.<sup>54</sup> Yet the question of labour costs and, more generally, of operating costs will become dominant in future local government finance. The considerable expansion of employment in education, characteristic of the sixties, has had large repercussions on State finances<sup>55</sup> and on the average for the public sector. This distorted the relationship in favour of the local authorities. This expansion seems now to have reached a ceiling,<sup>56</sup> whereas local government activities are expected to expand, because the demand for labour-intensive services in such fields as health, social security, recreation, child care, nursing homes, etc., is increasing. For these categories the increase in personal expenditures was, in some cases, nearly twice as high as the average increase. Also, in accordance with our earlier assumption on the increasing marketability

<sup>54</sup> From 1960 to 1972, municipal labour costs increased by about 40 per cent. The average for the public sector was 45 per cent. From *Local Finance*, Vol. 4, No. 2, p. 38.

<sup>55</sup> 45 per cent of the State employees are occupied in education.

<sup>56</sup> This ceiling is more political and financial and hence is determined by supply rather than demand. Demand is still exceeding supply. It is expected, however, that the introduction of oral contraceptives which has led to a sharp decline in birth rates since 1965 will imply, with a twenty year lag, a comfortable reduction in the demand for higher education. This may explain the reluctance of politicians to base actual educational employment decisions on today's level of demand.

of hitherto voluntary non-market activities, a reduction of honorary functions of citizens will have to be accounted for. In addition to that, the acquisition of computers by every individual authority in a multi-organisational environment like the German communal system will produce rocketing costs as long as the scope for co-operative efforts between the individual authorities is small.

In addition to these demographic and economic developments, there are political forces which support the idea of local governments becoming more important in the future than they were in the past. Demands for more responsive local governments and citizen participation have been increasing during the last decade not only by small militant groups but also on a broader regional basis, as the *Bürgerinitiativen* (citizen initiatives) in Marckolsheim or Whyll have demonstrated.<sup>57</sup> One should perhaps not be too optimistic about the zealotness of these initiatives as nearly all of them have proved to be relatively short-lived. The fear that these political developments could immobilise local governments is therefore unsubstantial.<sup>58</sup> Yet these initiatives bear testimony to the unresponsiveness of municipal governments to certain demands made by their citizens. One may well wish to re-establish the links between the local electorate and the local legislators and administrators which actually seem to be rather remote and unpredictable in West Germany.

All these demographic, economic and political tendencies seem to point toward an increasing importance of municipal public functions and the strengthening of the role of local governments in the future. The re-examination of their prospective role as well as a corresponding municipal reform to enable local governments to contribute to the survival of tomorrow's society therefore constitutes a major task in our time.

#### 7. *Deficiencies of the Actual Local Government Structure and the Characteristics of Future Municipal Reforms*

Let us develop our ideas about the necessities of future municipal reform on the grounds of the following, maybe somewhat provocative, statement:

*The chief threat to local autonomy in post-war Germany has not come from the centripetal forces at the Federal or State level, an eventuality the Constitution seems to be concentrating on. The de facto deterioration of the principles behind Article 28(1) of the Constitution has to be attributed to the heavy reliance of local officials on powerful local private agents and the strong competition among municipalities for the settlement of large firms within their jurisdictions.*

<sup>57</sup> Both citizen initiatives were directed against the installation of industrial plants; the first against the installation of a lead plant, the second against the installation of a nuclear power plant in a region particularly famous for its wine production.

<sup>58</sup> See M.M. Reeves, P.N. Glendening, 'Background for Controversy', in M.M. Reeves, P.N. Glendening, *Controversies of State and Local Political Systems*, Allyn and Bacon, Boston, 1972, p. 51.

Several factors have contributed to create this situation:

- Local tax revenues were and still are predominantly determined by the business tax. Therefore municipalities have to attract firms for the sake of an alleged 'financial independence'. At the same time they become dependent on private businesses and the interests of these firms may widely determine the 'interest of the community'.
- The expansion of local functions and the relative narrowing of the local financial basis not mitigated by federal and state grants has driven municipalities into increasing indebtedness. In some instances, credits to local governments are offered by and accepted from powerful local firms or individuals, particularly in the construction industry, which further enhances the dependence of local authorities on alien interests.<sup>59</sup>
- Although the top municipal associations and the *Institut für Urbanistik* in Berlin may have filled some gaps, German communes do not have any intergovernmental agency providing expertise and assistance to its member governments in technical, financial or other matters such as communal planning and so forth. Local legislators are therefore highly dependent on the advice of experts from either their own bureaucracy or from local private institutions. This makes local autonomy even more susceptible to injury.
- The German *Gemeindeordnungen* (commune statutes), in particular the *Bürgermeisterverfassungen* and over time also the *Gemeinderatsverfassungen*, have come to relax the direct responsibilities of government officials to the citizenry. Once the burgomaster is elected, he has a very strong position and sometimes a long and almost unassailable standing.<sup>60</sup> Also, re-election considerations fade in view of the fact that compliance with State authorities or local business may well enhance the chances of local government officials being able to win promotion into State official functions or to obtain influential positions in the local private industry.
- In addition, the hybridisation of public and business functions (for which the Germans would use the word *Filzokratie*) as well as the multiplicity of responsibilities and abilities at lower levels of government create adverse conditions for a more responsive and participatory system.

Once this characterisation of the West German municipal structure is accepted, a first consequence seems to be the following (which may sound a bit odd at first sight):

- (1) *Local autonomy may have to be restored or strengthened by a centralisation of certain local functions.*

These functions fall into either of two categories:

<sup>59</sup> For this the level of the local debt outstanding is decisive.

<sup>60</sup> As an example, Adenauer's mayoralty of the city of Cologne lasted from 1919 to 1933.



Firstly, what may be called *obsolete local functions with a responsibility impact*. Here all material functions should be included whose benefit spillovers have been increasing since their original assignment to municipal authorities *and* whose expansion in terms of financial burdens has been restricting municipal responsibilities in other fields of local activity. Local health services seem to fall into that category, for instance. Their share in total communal expenditures was only 14 per cent in 1971, but the dynamics of this type of expenditure point toward an increasing importance in the future for its is (i) highly labour-intensive, and (ii) labour costs in this particular area rose by 76 per cent from 1960 to 1972 compared to an average increase in municipal labour costs of about 40 per cent for the same period. Relieving local governments of increasing burdens stemming from this type of activity seems to be reasonable and should be a major issue of municipal reform. However, the radical solution which would shift these functions onto a central government body competes with a solution similar to the joint task concept at the Federal-State level, and it may well be in the interest of the system's efficiency to envisage modified joint task arrangements at the State-local or regional level also.

A second category are the *administrative functions* which, as outlined above, constitute a major burden for all communities in particular the smaller ones. As long as one does not consider administration to be an aim in itself, the centralisation of these functions would in no way reduce the direct responsibilities of municipalities.

To centralise these functions should therefore be compatible with the principles of Article 28 *Grundgesetz*, and communes would be relieved of relatively large financial commitments. This would be particularly important to the smaller communities and rural districts.<sup>61</sup>

An intergovernmental administrative agency with branches in each State or even smaller regions could perform administrative functions on behalf of local governments such as accounting, financial reporting, cash management and other treasury functions much more efficiently than can be done by the individual localities themselves. Today's telecommunication facilities can be used for transmitting the information back and forth at relatively low cost,<sup>62</sup> and private enterprises have long ago integrated these facilities into their management techniques for co-operation with their different subsidiaries.

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<sup>61</sup> This view is in contrast to D. Netzer's, for instance who has argued that, beyond a certain threshold, 'scale economies tend to be unlikely, for two reasons. First, most state-local functions continue to be very labour-intensive, although this may become less true. Secondly, the quality of the service provided may be diluted if single production sites are used to supply service over wide areas' (*op. cit.*, p. 381). This standpoint overlooks that parts of the service supplied (for instance the administration, research components) are amenable to produce scale economies when centralised.

<sup>62</sup> Compared to other countries, the telecommunication costs in the Federal Republic of Germany are still quite high. This stems from the fact that the *Deutsche Bundespost* has the telecommunication monopoly which it uses to set rather prohibitive tariffs.



In addition to its mere administrative functions, this body could give technical and administrative advice to its member governments for a fee of cost restitution. This would help to exchange information, develop standards for communal services (swimming pools, local transportation systems, etc.) based on supraregional experience, on own research or on successful pilot projects. Furthermore this body could help to compare and appraise cost estimates of private firms for like projects and give corresponding recommendations to its members.

A centralised administrative and planning agency of this type would undoubtedly reduce the dependence of local government officials on the expertise of private interest groups to a large extent. The centralisation also facilitates medium-term planning and, generally, formal co-ordination within the framework of the financial planning concept described above. This kind of formal co-ordination would be a prerequisite for corporate planning of communities which will stress the benefits derived from using communal resources as corporate resources.<sup>63</sup> Moreover, relieving the smaller communities and rural districts from the heavy burden of administration seems to be an enormous step toward fiscal equalisation from the expenditure side which avoids the inefficiencies of equalisation by shifting revenues.

As local governments are unlikely to erect such a body by themselves, a more feasible solution would be to sponsor the institution by means of direct State grants with the assistance of the Federal Government. At a higher level, issues of local government reform could even be defined as joint tasks between the Federation and the States, because of their close relation to the complex 'regional economic problems'.

(2) *Local government autonomy is restricted by the degree of municipal indebtedness or, in other words, it relates positively to the strength and reliability of local revenues.*

As described earlier, the 1969 finance reform has brought but a temporary relief to local governments. A further broadening of the shared tax base seems to be unavoidable.<sup>64</sup> The pros and cons of tax sharing have been discussed extensively in the literature,<sup>65</sup> yet in West Germany the

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<sup>63</sup> The inappropriateness of regarding local resources (such as buildings, etc.) as belonging to a particular department, committee or agency has been outlined, for instance, by J.D. Steward. See his 'From Corporate Planning to Community Planning', *Local Government Finance*, Vol. 76 (1972), pp. 155-59.

<sup>64</sup> Apart from further increases in benefit taxation, charges and user fees that act as prices for services provided.

<sup>65</sup> See for instance W. Anderson, 'The Perils of "Sharing"', and R.A. Freeman, 'Perils of not Sharing', in M.M. Reeves, P.N. Glendening, *Controversies of State and Local Political Systems*, *op. cit.*, pp. 117-22 and 123-26, who argue pro and contra the Heller proposals for tax sharing in the United States. Most of the literature on tax sharing has been brought together in the collection *Revenue Sharing and Its Alternatives: What Future for Fiscal Federalism?*, U.S. Congress, Joint Economic Committee, Washington D.C., Government Printing Office, 1967.

constitutional setting (in particular the obligation to assure the uniformity of living conditions) points clearly toward central tax collection with tax sharing rather than toward autonomy in raising local taxes. These characteristics of the German *Finanzverfassung* (financial constitution) contrast sharply with the prevailing attitude of most American writers on the issue who tend to stress the allocative aspects of a tax system.<sup>66</sup> In the potential conflict between efficiency and equity criteria in a federal system, West Germany has constitutionally emphasised the latter. These are aimed at securing 'a high degree of uniformity in the provision of public services in all regions of the federation'.<sup>67</sup> As an exception to the principle of uniform taxation only differentials in the taxes of regional impact are acceptable.<sup>68</sup> This seems to be a case for local 'effluent charges' (pollution taxes).<sup>69</sup> In addition, the spirit of the Troeger Commission is still alive, according to which tax sharing arrangements are to be combined with the abolition of the local business tax, in particular the highly fluctuating tax on business yields. One could go even a step further and do away with the business tax altogether, first of all because it would relax the financial dependence of municipalities on private business firms and so diminish the competitive local tax erosion and undue influence on local policy; and secondly because this part of the tax labyrinth is likely to be sacrificed anyway in connection with the harmonisation of taxes within the EEC.<sup>70</sup> It could be either incorporated into the turnover tax or into the corporation tax.

We shall not go into details of what taxes should be included in tax sharing arrangements, yet our own preferences would suggest an expansion into the value-added tax base rather than into the income tax. This is particularly for two reasons:<sup>71</sup>

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- <sup>66</sup> As Oates has put it: 'To match benefits with costs in order to promote a more effective selection of worthwhile programs implies ... the desirability of having each group explicitly finance the programs that significantly affect its welfare', W.E. Oates, *Fiscal Federalism*, New York, Harcourt, Brace, Jovanovich, 1972, p. 124.
- <sup>67</sup> H. Haller, 'Changes in the Problems of Federative Public Economies', *German Economic Review*, Vol. 8 (1970), No. 3, p. 193.
- <sup>68</sup> So-called 'Steuern mit örtlich bedingtem Wirkungskreis'. See for instance Wissenschaftlicher Beirat beim Bundesministerium der Finanzen, *Organische Steuerreform*, Bonn 1953, p. 77.
- <sup>69</sup> See for instance, C.E. McLure, 'Revenue Sharing: Alternative to Rational Fiscal Federalism', *Public Policy*, Vol. 19 (1971), No. 3, pp. 466-68.
- <sup>70</sup> Within the EEC, only Luxembourg has a tax similar to the *Gewerbesteuer*, which is generally considered to be indirect, i.e. shifted to a large extent, hence distorting the prices of German products in comparison to product prices of its international competitors.
- <sup>71</sup> Further advantages are discussed by the Wissenschaftlicher Beirat beim Bundesministerium der Finanzen, *Gutachten zum Gemeindesteuersystem und zur Gemeindesteuerreform in der BRD*, Bonn 1968, pp. 34 ff, and in Kommission für die Finanzreform, *op. cit.*, Tz. 365. The *Kommission* does not favour municipal tax sharing of the turnover tax, however.

- The value-added tax is a more reliable source of revenue in the sense that it is less sensitive to the business cycle than the income tax.<sup>72</sup> Many of the objections held against the local tax on business yields are also valid against income tax sharing.
- Horizontal equalisation is more equitable and corresponds more to the notion of the consumer-voter (Nordhaus) if based on local turnover rather than on income.<sup>73</sup> Local authorities may then be a bit less inclined to make concessions to economically powerful local individuals or firms.

The horizontal distribution of a value-added tax share has to have regard to two particular problems: (i) If collected by firms with premises in several local authorities, the tax would have to be apportioned accordingly. Apart from the rateable value of the premises on which the actual distribution of the corporation tax to the *Länder* is based in Germany<sup>74</sup>, one could also imagine the wage-bill paid by the subsidiary as an appropriate base for distribution. This would then be undoubtedly an incentive for municipalities to attract labour-intensive rather than capital-intensive industries. (ii) If collected at two (or more) different rates, the value-added tax will be charged at one level and refunded later which may distort local revenues seriously (particularly in rural districts where the principal industry, agriculture, is zero-rated). In these cases one may have to rely on average rates instead of the factual ones.

These ideas will, of course, have to be developed further. In particular tax sharing arrangements like this may not satisfy the needs of metropolitan areas claiming additional measures either outside the general tax sharing or with a combination of the turnover tax *and* the income tax in the shared base.

*(3) Local government capital budgets are particularly important in West German public policy. Here an institutionalised co-operative machinery is strongly required.*

The first part of this thesis is evident, and so should be the second. The question is how such a co-operative institution should operate, whether it is politically feasible and how it can be integrated into the framework of the Federal Constitution.

Let us imagine we had some sort of a common municipal investment fund which is supported, financially and politically, by the Federal Government, the States and municipalities themselves, and possibly administered by an

<sup>72</sup> The Troeger Commission's proposals, on which the actual modified arrangements according to §1 *Gemeindefinanzreformgesetz* are based, do account for this by limiting the income tax revenue bases to that part which is derived from the proportional zone of the tariff only. Yet even then the fluctuations may be greater than in the case of the value-added tax, due to fluctuations in employment.

<sup>73</sup> J. Hinnendahl (*Die Steuerverteilung Zwischen Bund und Ländern in der BRD*, Baden-Baden, Nomos, 1974, p. 148) has calculated the regional variation of taxes in West Germany by States. The variation-co-efficient for the per capita value-added tax is only slightly smaller than the co-efficient for the income taxes (0.37 : 0.41), yet one expects the difference to be more substantial at the local level.

<sup>74</sup> *Gesetz über die Steuerberechtigung und die Zerlegung bei der Einkommensteuer und der Körperschaftsteuer (Zerlegungsgesetz)*, vom 25 Februar 1971, BGBl I, pp. 146-48.



intergovernmental administrative agency. Furthermore, private investment funds could be mobilised by means of tax benefits accorded to private firms (or individuals), maybe similar to the Swedish investment fund concept, which would strengthen this communal fund. Combined with co-ordinated borrowing, this fund could then be much more successful in achieving a steady expansion of local investment activities than most other proposals one may think of. It would also enhance the chances of implementing large intergovernmental and combined public-private projects that will be increasingly forthcoming, especially in the area of environmental protection (for instance heat and material recycling, air pollution abatement, etc.). Communes could apply for these projects in much the same way as the *Länder* do for the joint tasks. The fund would have to co-ordinate the projects and ensure the financing, the projects themselves being administered by local authorities, possibly with the assistance of the intergovernmental planning agency.

Is such a concept politically feasible in West Germany? Would it violate the constitutional rights of local governments? It is certainly not an economist's task to answer these questions, yet the concept seems to be compatible with the main characteristics of the actual federal-state co-ordinative machinery outlined earlier. It would also be astonishing if it was not possible to realise such a concept at the national level when it was possible to construct similar institutions on the international level, such as the International Bank for Reconstruction and Development (World Bank), which co-ordinates development projects, or the European Investment Bank, which plays an important role in the EEC's regional development plans.

In this paper only some of the problems of future local governments have been dealt with from an economist's standpoint. Yet there are many other topics affecting the future of municipalities which one may wish to discuss. One, of course, is the question of how the responsiveness of local governments and the participation of citizens will evolve, whether one should encourage the citizen initiatives movement, by revitalising concepts like the *referendum* or recall, whether direct negotiations between local officials and the leaders of sometimes militant minority groups should be institutionalised, or whether the Scandinavian *ombudsman* is an appropriate institution to deal with these problems.<sup>75</sup> And there is the problem of land policy, particularly in metropolitan areas, which in Germany in connection with the passing of the *Städtebauförderungsgesetz*<sup>76</sup> has kindled the discussion about the *Planungswertausgleich*<sup>77</sup> and the

<sup>75</sup> This concept seems to have appealed in particular to American politicians. See for instance F.P. Zeidler, 'An Ombudsman for Cities?', *The Annals of the American Academy*, Vol. 377 (May 1968), pp. 123-27.

<sup>76</sup> *Gesetz über städtebauliche Sanierungs- und Entwicklungsmaßnahmen in den Gemeinden, vom 27 Juli 1971*, BGBl I, pp. 1125-56.

<sup>77</sup> This is a concept which would allow communes to skim off the windfall profits occurring to land-owners by municipal policies, in particular the opening up of land and the alteration of zoning regulations.



*Bödenwertzuwachssteuer.*<sup>78</sup> There are the problems of municipal management, inflation and municipal finances, and many other questions, not least the impact of the European integration on the future of local authority.

The various aspects of local government reform and the likelihood of an increasing role for municipalities in the future may explain why these issues predominate in the discussion of public finance problems, to which the present paper hopes to have modestly contributed.

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<sup>78</sup> Capital gains tax on land, whether the gains are realised or not.

APPENDIX 1

THE RAW DATA FOR THE CALCULATION OF TABLE 8, POSITION C, AND THE  
ADJUSTMENTS MADE

	<u>Total</u>	<u>Federal</u>	<u>States</u>	<u>City States</u>	<u>Local Governments</u>
	mill.DM				
Personal Ex- penditures 1971(pp.400/401)	73,457	17,118	30,962	7,114	18,263
- for 'Other Purposes' (only Fed.Gov.)* 1971(p.407)	-9,986	-9,986	-	-	-
- Estimated Pensions**	-2,190	-2,190	-	-	-
Adjusted Personal Expenditures	61,281	4,942	30,962	7,114	18,263
	Persons				
Employed 1972 (p.411)	2,281,659	295,567	1,026,006	243,765	716,321
- Military	-178,473	-178,473	-	-	-
+ Employed in communities under 1,000 inhabitants (Footnote 1, p.411)	+ 5,037				+ 5,037
Adjusted total	2,108,223	117,094	1,026,006	243,765	721,358
Per Capita Expenditure (DM)	29,068	42,205	30,177	29,184	25,318

Page numbers refer to *Statistisches Jahrbuch 1974, op. cit.*

\* To account roughly for military personal expenditures.

\*\* Own estimate.

APPENDIX 2

THE CONSTITUTIONAL FRAMEWORK FOR MUNICIPALITIES AS DEFINED BY  
THE BASIC LAW\*

*Article 28 (Federal guarantee of Länder constitutions)*

- (1) The constitutional order in the *Länder* must conform to the principles of republican, democratic and social government based on the rule of law, within the meaning of this Basic Law. In each of the *Länder*, counties (*Kreise*), and communes (*Gemeinden*), the people must be represented by a body chosen in general, direct, free, equal, and secret elections. In the communes the assembly of the commune may take the place of an elected body.
- (2) The communes must be guaranteed the right to regulate on their own responsibility all the affairs of the local community within the limits set by law. The associations of communes (*Gemeindeverbände*) shall also have the right of self-government in accordance with the law and within the limits of the functions assigned to them by law.
- (3) The Federation shall ensure that the constitutional order of the *Länder* conforms to the basic rights and to the provisions of paragraphs (1) and (2) of this Article.

*Article 91a (Definition of joint tasks)*

- (1) The Federation shall participate in the discharge of the following responsibilities of the *Länder* provided that such responsibilities are important to society as a whole and that federal participation is necessary for the improvement of living conditions (joint tasks);
  1. expansion and construction of institutions of higher education including university clinics;
  2. improvement of regional economic structures;
  3. improvement of the agrarian structure and of coast preservation.
- (2) Joint tasks shall be defined in detail by federal legislation requiring the consent of the Bundesrat. Such legislation should include general principles governing the discharge of joint tasks.
- (3) Such legislation shall provide for the procedure and the institutions required for joint overall planning. The inclusion of a project in the overall planning shall require the consent of the *Land* in which it is to be carried out.
- (4) In cases to which items 1 and 2 of paragraph (1) of this Article apply, the Federation shall meet one half of the expenditure in each *Land*. In cases to which item 3 of paragraph (1) of this Article applies, the

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\* Excerpt from the English version of the *Grundgesetz* in G. Goldman, *The German Political System*, Random House, New York, 1974, Appendix C.



Federation shall meet at least one half of the expenditure, and such proportion shall be the same for all the *Länder*. Details shall be regulated by legislation. Provision of funds shall be subject to appropriation in the budgets of the Federation and the *Länder*.

(5) The Federal Government and the Bundesrat shall be informed about the execution of joint tasks, should they so demand.

*Article 93 (Federal Constitutional Court, competency)*

The Federal Constitutional Court shall decide:

4b. on complaints of unconstitutionality, entered by communes or associations of communes on the ground that their right to self-government under Article 28 has been violated by a law other than a *Land* law open to complaint to the respective *Land* constitutional court.

*Article 104a (Apportionment of expenditure, Financial assistance)*

(1) The Federation and the *Länder* shall meet separately the expenditure resulting from the discharge of their respective tasks in so far as this Basic Law does not provide otherwise.

(2) Where the *Länder* act as agents of the Federation, the Federation shall meet the resulting expenditure.

(3) Federal laws to be executed by the *Länder* and involving the disbursement of funds may provide that such funds shall be contributed wholly or in part by the Federation. Where any such law provides that the Federation shall meet one half of the expenditure or more, the *Länder* shall execute it as agents of the Federation. Where any such law provides that the *Länder* shall meet one quarter of the expenditure or more, it shall require the consent of the Bundesrat.

(4) The Federation may grant the *Länder* financial assistance for particularly important investments by the *Länder* or communes or associations of communes, provided that such investments are necessary to avert a disturbance of the overall economic equilibrium or to equalize differences of economic capacities within the federal territory or to promote economic growth. Details, especially concerning the kinds of investments to be promoted, shall be regulated by federal legislation requiring the consent of the Bundesrat, or by administrative arrangements based on the federal budget.

(5) The Federation and the *Länder* shall meet the administrative expenditure incurred by their respective authorities and shall be responsible to each other for ensuring proper administration. Details shall be regulated by a federal law requiring the consent of the Bundesrat.

*Article 106 (Apportionment of tax revenue)*

(5) A share of the revenue from income tax shall accrue to the communes, to be passed on by the *Länder* to their communes on the basis of income taxes paid by the inhabitants of the latter. Details shall be regulated by a federal law requiring the consent of the Bundesrat. Such law may provide that communes shall assess communal percentages of the communal share.

(6) Revenue from taxes on real property and businesses shall accrue to the communes; revenue from local excise taxes shall accrue to the communes or, as may be provided for by *Land* legislation, to associations of communes. Communes shall be authorized to assess the communal percentages of taxes on real property and businesses within the framework of existing laws. Where there are no communes in a *Land*, revenue from taxes on real property and businesses as well as from local excise taxes shall accrue to the *Land*. The Federation and the *Länder* may participate, by assessing an impost, in the revenue from the trade tax. Details regarding such impost shall be regulated by a federal law requiring the consent of the Bundesrat. Within the framework of *Land* legislation, taxes on real property and businesses as well as communes' share of revenue from income tax may be taken as a basis for calculating the amount of such impost.

(7) An overall percentage, to be determined by *Land* legislation, of the *Land* share of total revenue from joint taxes shall accrue to the communes and associations of communes. In all other respects *Land* legislation shall determine whether and to what extent revenue from *Land* taxes shall accrue to communes and associations of communes.

(8) If in individual *Länder* or communes or associations of communes the Federation causes special facilities to be established which directly result in an increase of expenditure or a loss of revenue (special burden) to these *Länder* or communes or associations of communes, the Federation shall grant the necessary compensation, if and in so far as such *Länder* or communes or associations of communes cannot reasonably be expected to bear such special burden. In granting such compensation, due account shall be taken of third-party indemnities and financial benefits accruing to the *Länder* or communes or associations of communes concerned as a result of the institution of such facilities.

(9) For the purpose of this Article, revenues and expenditures of communes and associations of communes shall be deemed to be *Land* revenues and expenditures.

*Article 107 (Financial equalization)*

(1) Revenue from *Land* taxes and the *Land* share of revenue from income and corporation taxes shall accrue to the individual *Länder* to the extent that such taxes are collected by revenue authorities within their respective territories (local revenue). Federal legislation requiring the consent of the Bundesrat may provide in detail for the delimitation as

well as the manner and scope of allotment of local revenue from corporation and wage taxes. Legislation may also provide for the delimitation and allotment of local revenue from other taxes. The *Land* share of revenue from the turnover tax shall accrue to the individual *Länder* on a per-capita basis; federal legislation requiring the consent of the Bundesrat may provide for supplemental shares not exceeding one quarter of a *Land* share to be granted to *Länder* whose per-capita revenue from *Land* taxes and from the income and corporation taxes is below the average of all the *Länder* combined.

(2) Federal legislation shall ensure a reasonable equalisation between financially strong and financially weak *Länder*, due account being taken of the financial capacity and financial requirements of communes and associations of communes. Such legislation shall specify the conditions governing equalization claims of *Länder* entitled to equalization payments and equalization liabilities of *Länder* owing equalization payments as well as the criteria for determining the amounts of equalization payments. Such legislation may also provide for grants to be made by the Federation from federal funds to financially weak *Länder* in order to complement the coverage of their general financial requirements (complemental grants).

*Article 109 (Separate budgets for Federation and Länder)*

(1) The Federation and the *Länder* shall be autonomous and independent of each other in their fiscal administration.

(2) The Federation and the *Länder* shall take due account in their fiscal administration of the requirements of overall economic equilibrium.

(3) By means of federal legislation requiring the consent of the Bundesrat, principles applicable to both the Federation and the *Länder* may be established governing budgetary law, responsiveness of the fiscal administration to economic trends, and financial planning to cover several years ahead.

(4) With a view to averting disturbances of the overall economic equilibrium, federal legislation requiring the consent of the Bundesrat may be enacted providing for:

1. maximum amounts, terms and timing of loans to be raised by public administrative entities, whether territorial (*Gebietskoerperschaften*) or functional (*Zweckverbaende*), and
2. an obligation on the part of the Federation and the *Länder* to maintain interest-free deposits in the German Federal Bank (reserves for counterbalancing economic trends).

Authorizations to enact pertinent ordinances having the force of law may be issued only to the Federal Government. Such ordinances shall require the consent of the Bundesrat. They shall be repealed in so far as the Bundesrat may demand; details shall be regulated by federal legislation.





