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The Mother of All Reforms (November 8, 2006)

After years of negotiations, the Bundestag and the Bundesrat passed the first part of the so-called federalism reform in the summer of 2006. The history of the reform effort and the most important changes are summarized in this annual report of the German Council of Economic Experts, an academic body of political advisors.

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IV. Federalism Reform: A Start Has Been Made

456. The German Council of Economic Experts has repeatedly noted in the past that it views the existing structure of federalism in Germany as a serious obstacle to the implementation of fundamental reform (Report 2004, nos. 787 ff.; Report 2005, nos. 30 ff.). More than half of the laws dealt with by the German Bundestag in past legislative periods have regularly required the approval of the Bundesrat. Important economic policy initiatives were contingent upon Bundesrat approval in virtually all cases. Especially because of the different political power configurations in the German Bundestag and Bundesrat, the participatory rights of the Bundesrat delayed decision-making processes. When it came to key issues, in particular, compromises were often made in a faulty and opaque manner, which made it virtually impossible to determine who was responsible for decisions relating to revenue and expenditures. Furthermore, one characteristic of so-called cooperative federalism is that the autonomy of, in particular, local communities and the federal states is greatly limited when it comes to decisions on budgetary revenue matters. In the absence of such autonomy and without the clear-cut division of decision-making competencies, it is difficult for a federal system to cultivate its very advantage – the availability of public services that are closely geared toward citizen preferences. The council has therefore spoken out in favor of the disentanglement of federal-state relations by way of a clearly defined division of decision-making competencies. Moreover, there should be a greater degree of tax autonomy at all levels of government in order to reduce unclear [divisions of] responsibilities in the area of both expenditures – by reducing mixed federal-state funding – and revenue for public budgets.

457. The need for federalism reform has long been recognized in political circles. In 2003, a Joint Bundestag-Bundesrat Commission on Modernizing the Federal System was appointed. Although key and therefore particularly conflict-laden issues in the area of fiscal federalism did

not even form part of the commission's investigatory work, the chairs of the commission declared in December 2004 that the project had failed. However, in the fall of 2005, the results of the commission's deliberations were incorporated into the CDU/CSU and SPD's negotiations on forming a Grand Coalition. Ultimately, a comprehensive appendix was attached to the Coalition Agreement of November 11, 2005; it contained proposals for an amendment to the Basic Law which had already been agreed upon by the coalition partners and the federal and state governments. These proposals were incorporated virtually unchanged in the Act to Amend the Basic Law and the Act Concomitant to Federalism Reform [*Föderalismusreform-Begleitgesetz*], both of which were passed by the German Bundestag on June 30, 2006. Approval by the Bundesrat followed on July 7, 2006.

458. At the heart of the agreed-upon federalism reform is the disentanglement of decision-making processes. In particular, the portion of federal legislation that must be approved by the Bundesrat is to be reduced through a rewording of Article 84 (Basic Law), which, up to now, applied to approximately half of the legislation requiring approval (Burkhart and Manow, 2006).

According to the previous wording of Article 84, Sec. 1 (Basic Law), all federal legislation required Bundesrat approval if the law also contained regulations dealing with its administration and implementation – in Germany, these tasks generally lie within the authority of the federal states. The Federal Constitutional Court ruled that the approval requirement in these cases referred not only to administrative aspects, but also to the political substance of the regulations as well. This gave the federal states extensive opportunities to exert influence. In contrast, according to the new version of Article 84, Sec. 1 (Basic Law), a federal law does not require [Bundesrat] approval if the federal government also regulates the related administrative procedures; instead, it expressly allows for deviations from these procedures in the form of federal state legislation. The share of legislation requiring approval should be reduced in accordance with the law's explanatory memorandum from the previous level of 60 percent to roughly 35-40 percent. It remains to be seen if this will be achieved. The approval requirement for most legislation dealing with shared state and municipal taxes (Article 105, Sec. 3, Basic Law) remains unchanged by this reform. Also, Article 104a, Sec. 4 (Basic Law), created new cases requiring approval: cases in which – in simple terms – federal legislation is tied to investments from federal state budgets to third parties. All in all, the named reservations do nothing to change the fact that this part of the federalism reform should be expressly welcomed.

Another positive development is the abolishment of framework legislation pursuant to Article 75 (Basic Law), within whose scope two subsequent legislative procedures have been necessary at the federal and state levels up to now. The corresponding areas of competency were divided up within the framework of the reform between the federal government and the federal states. In particular, legislative competence for remuneration, pensions and related benefits for state employees and state judges was transferred from the federal government to the federal states. Personnel costs play a major role in federal state budgets, and they will be significantly affected by steep increases in benefit expenditures in the future. Instead of the federal framework law in the area of higher education, concurrent legislation limited to the regulation of admission to

institutions of higher education and the conferment of degrees entered into force; this legislation was connected with the right of federal states to deviate from federal law (Article 72, Sec. 2 Basic Law). The decentralization of competencies in individual areas is open to criticism, however. In the field of education policy, for example, the organization of the school system is correctly placed within the purview of the federal states, but shared, uniform federal achievement standards are still necessary in order to compare the educational achievements of individual federal states (Report 2004, nos. 588 ff.). Setting such central educational standards is possible, in principle, through the Standing Conference of Ministers of Education and Cultural Affairs of the Federal States. It is questionable, however, whether the ministers will be able to agree on equivalent standards that would apply to all federal states.

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Source: Sachverständigenrat zur Begutachtung der Gesamtwirtschaftlichen Entwicklung [German Council of Economic Experts], Annual Report 2006-07, "Widerstreitende Interessen – ungenutzte Chancen" ("Conflicting Interests – Missed Opportunities"), November 8, 2006, Chapter 6, Part 6, <http://www.sachverstaendigenrat-wirtschaft.de>.

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