Recasting German Federalism?
The Politics of Fiscal Decentralization in Post-Unification Germany

Daniel F. Ziblatt

Why did the idea of fiscal decentralization gain such political currency in Germany in the late 1990s but meet such a relatively dismal political fate by the Summer of 2001? In answering this question, I propose a framework centered around the interaction of ideas and state institutions to study the politics of fiscal decentralization in advanced democratic multi-state systems. First, I show that the new set of politically-charged ideas of fiscal decentralization which gained political weight in Germany in the late 1990s were driven by economic problems associated with German unification, the increasing popularity of "fiscal federalism" in German political circles, and a center-periphery conflict within German political parties. Second, my analysis explains the political failure of these ideas despite their apparent popularity among political and policy elites. Here, I focus on the role of the upper house of the German parliament in order to explain why these ideas have had such little policy impact. After demonstrating that the long-standing tradition of "cooperative" federalism has largely survived German unification, the paper concludes by discussing the potential impact of the European Union's 1997 Growth and Stability Pact on German federalism.

1. Introduction

Between the late 1950s and late 1990s a sea-change in political ideas took place in German political discourse. The doctrine of "cooperative federalism" has been superseded by the fiscally decentralist doctrine of "competitive federalism." At the core of this new political agenda, articulated in government reports, academic studies, German think tank projects, and most recently by regional political leaders in Germany's South is the idea that states ought to have more policy autonomy, more spending sovereignty,

1 The concept of "cooperative federalism" entered German legal discourse in the 1966 Twyberg Expert Commission that was set up by the joint Bund-Land Commission that aimed to reform financial relations between states and the federal government during the 1960s. The aim of the concept was to provide a new legal framework for increasing shared functions and planned joint action between the states and the federal government. An excerpt from the report, cited by Blair (1981: 209): "Cooperative Federalism ... achieves ... a concentration of forces in the federal state, which guarantees the greatest efficiency in the commitment of public resources." It is fascinating to note that the calls for more federal intervention in the Twyberg Report in 1966 utilized the same references to "efficiency" that current calls for less federal intervention now make. For a more complete discussion, see Blair (1981: 307-346) and the important work by Renshack (1991: 209-260).

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and above all the ability to set their own tax rates independently of the federal government.\(^2\)

Though beginning to form the basis of a consensus among many academics and policymakers in Germany, the ideas of fiscal decentralization have had a less successful political fate in the realm of public policy.\(^3\) In fact, this ideological consensus has misled many scholars of German federalism to believe that in the wake of German unification a deep institutional transformation or "resecuring" of Germany's federal structures would be undertaken (Jeffery 1999). The reality has been much more timid: beginning in 1997, in reaction to the perceived challenges of German unification, the four eastern states have orchestrated a semi-cooperative effort to increase the fiscal autonomy of German states, thereby reducing the amount of regional redistribution of fiscal resources in Germany.\(^4\) In the most prominent instance of this agenda, the Minister Presidencies of Bavaria, Baden-Württemberg, and Hessen have often with the sympathy of Germany's largest state Nordrhein-Westfalen carried out their program of public finance reform by meeting several times a year between 1997 and 2000, by releasing joint public statements in 1998 and 1999, by pushing an agenda through the informal Minister President Conference in 1998 and 1999, and by filing a case with the German Constitutional court in the Fall of 1999. While gratuitously avoiding direct references to the deep east-west economic divide in Germany, the leaders of rich states have instead pressed on in their joint statements against the flow of resources from "wirtschaftsfürsten Ländern" ("economically-strong states") to "wirtschafts-schwachen Ländern" ("economically-weak states"). Their aim, partly motivated by a new policy agenda and partly motivated by their own budgetary concerns, was threefold: 1) to end what they perceived as the financial "punishment" of economically strong states by the current system; 2) to give more financial autonomy to states; and 3) to foster institutional competition between states, a new policy criterion, they felt,

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2 For recent examples of this perspective in the German center, see influential publications by the Kieler Economic Institute and the Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung. See also Pöndrack (1999).

3 Of course it must be noted that efforts to "resecure" Germany's federal fiscal system are not of themselves entirely new. Since the end of World War II, German fiscal federalism has been subject to on-going efforts at reform. See discussions by Adelberger (1999), see also Guzekels (1986).

4 The proposals to reduce the amount of regional redistribution have taken four broad forms. First, most recently in the summer of 2001, the states of Hessen, Bavaria, and Baden-Württemberg have filed a case before the Federal Supreme Court in a suit to "punish" the regional redistribution of public health insurance money. Second, similarly, officials in the Social Ministry of the Bavarian state government, beginning in 1997, have repeatedly proposed to "resecure" Germany's over one hundred year-old system of social insurance (unemployment insurance, pension insurance, and health care insurance). Third, in another more modern vein, the state leaders of the richest and largest Western states have sought to transform the German system of public finance, which would also reduce funding to the state governments of "poorer" states. Fourth, in still another form, all of the richest and largest states in Western Germany, for the first time in post-war German history, have expressed support for increasing the financial and legislative autonomy of state governments (e.g. ability to set own tax rates) -- a proposal that Eastern states have either remained silent on or have outright rejected for fear that "autonomy" simply means leaving poor states to fend for themselves.
to economic problems and perceived institutional paralysis of the German political system.

By the Summer of 2001 the main negotiations inspired by the Constitutional Court’s November 1999 decision were finished but the modest policy outcomes marked a striking contrast to the ambitious goals of competitive federalism. The heart of the public finance agreement that was reached in a Minister President Conference in June 2001 was constructed around the Federal government’s promise to contribute 1.5 billion DM annually to the regional redistribution scheme; the wealthiest German states would, in turn, contribute less to the system (Gusicka 2001: 1). Though the Bavarian Minister President claimed “a victory for German federalism”, the goal of decreasing the role of the federal government had in fact backfired, while the goal of increasing the tax autonomy of the states – the centerpiece of the “competitive federalism” vision was put off for another day (Geiber 2001). Indeed, there was an irony at the heart of the accord: to give the states greater spending autonomy, the federal government intervened more actively, taking on a greater share of the redistribution of public finance resources to poorer states. That is, in order for German federalism to survive, the states remain – as always – dependent on federal government transfers.

This compromised outcome of the public finance debates reflects a larger tendency for the ideas of fiscal decentralization to founder in the political reality of German politics. This paper seeks to untangle the puzzle of why the idea of fiscal decentralization gained such political currency in the late 1990s yet met such a relatively dismal political fate by the Summer of 2001. To do so I trace the political fate of two particular areas of reform that are both part of the broader fiscal decentralization agenda: 1) the effort to give states greater public finance autonomy and 2) the effort to reduce the amount of regional redistribution of unemployment insurance expenditures from rich to poor states. Why study these two areas of reform? The first area is subject to a high level of consensus in policy communities across the political spectrum while the second area is, outside of Bavarian CSU circles, a largely marginal political program that has been criticized by economists, legal experts, and officials throughout Germany. Yet, despite the varying degree of policy consensus between these two programs, these proposals have both foundered in the German political setting. One purpose of this paper is to test the impact of ideological policy consensus on actual reform outcomes. As a result, a comparison of these two areas of reform provides for an explicit variation on the independent variable that provides powerful evidence of the limits of the causal impact of ideas of fiscal decentralization on actual policy outcomes in the German context (King et al. 1994).6

5 Evidence of policy consensus across the political spectrum for the first area of reform can be seen in the range of institutions that support public finance reform (the left-leaning German Institute of Economic Research and the right-leaning Hans Seidel Stiftung). The criticisms of the second area of reform have been numerous and are in Sudan criticisms in Sudan Landtag debates (Plenarprotokoll 13/97, December, 1997, p. 6910).

6 King, Kohane, and Verba (1994: 149) write, “The best ‘intentional design’ reflects observations to ensure variation in the explanatory variable while regard to the values of the dependent variable. Only during the research do we discover the values of the dependent variable and then make our initial causal inference by examining the differences in the distribution of outcomes on the dependent variables for given values of the explanatory variable”.
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tures at reform in Germany. The aims of the paper are thus two-fold: First, I trace how the idea of "competitive federalism" became a part of the political discourse of German regional political leaders in the late 1990s. In so doing I offer an alternative institutional explanation of the push for fiscal decentralization.7 By focusing on how the idea of policy ideas broke into the political discourse of regional political leaders in Southern Germany beginning in the 1980s but reaching a highpoint in the late 1990s, my account seeks to avoid some of the pitfalls of conventional explanations of fiscal decentralization that either see fiscal decentralization as a distant but inevitable response to economic internationalization or as merely the short-term consequence of political leaders who are simply acting in their electoral interests.

The second goal of this paper is to go one step further than the social constructivist approach does, in order to provide an institutional explanation of why the ideas of fisc-


dal decentralization – most notably the idea that states ought to have their own taxing capacity – have had such trouble in German politics.8 If we use other OECD coun-


ctries as our baseline of comparison, we see that Germany stands out in its unwilling-


ness to allow state governments to have their taxing capacities. In the United States, Canada, Denmark, Switzerland, Finland, Sweden, and even most recently in the notori-


eously centralized states of Great Britain and Italy, regional or local governments are allowed discretionary power over income and/or value added or sales taxes which are the most important taxes in the OECD (OECD 1998: 78).9 The difficulty of translating the vision of fiscal federalism in Germany into concrete policies is rooted in Germany’s unique federal system. The difficulties are not the result of a lack of desire or foresight by decentralization’s advocates. Rather, I will show that Germany’s federal system, which incorporates regional political leaders in the national legislative process, works at two levels to constrain the implementation of decentralist ideas. In short, the ideas of fiscal decentralization are themselves politically constructed but these ideas alone are currently not powerful enough to undermine and transform the historically-embedded federal structures of the German political system (Lelouch 2002; Zöblit 2002).

7 The first part of my analysis borrows heavily from the work of Kingdon (1995). For a discussion of the "social constructivist" approach and application to welfare reform in European na-

tion-states, see Cox (2001: 463-498). By naming my account a "social constructivist" account of fiscal decentralization I by no means intend to argue that reform efforts are a response to a very real set of problems associated with contemporary German federalism – problems such as reduced transparency, reduced accountability, and a set of incentives for budget deficits that have received the increasing attention of German scholarship on federalism.

8 Since 1955 all state taxes are set in federal legislation, though of course the state governments can indirectly influence legislation in the upper house of the federal parliament. The only subnational unit in Germany with any taxing autonomy whatsoever are the kreis-level govern-


ments who can set their own local business tax (Gewerbesteuer) within very restricted limits. On average, the unshared communal taxes constitute only 17% of communal real tax reve-


9 For a discussion of recent reforms in Italy, see Peter Giarda (2000).
2. Overview of Argument

Most explanations of fiscal decentralization tend to make one of two mistakes. One type of explanation is too causally "distant" because it fails to specify the causal mechanism that would link very broad factors such as economic internationalization or globalization to fiscal decentralization (Almásia/Spolar/Weingärtner 2000). An alternative type of explanation proposes causes that are so "proximate" to the outcome being explained that they could reasonably be considered part of the outcome itself. For example, arguments that identify the short-term electoral or fiscal interests of political leaders as the cause of fiscal decentralization beg the question of why political leaders find fiscal decentralization to be a "benefit" worth pursuing in the first place and hence run the risk of tautology (German/Haggard/Willis 2001: 235). The inadequacy of both of these approaches calls out for a mid-range approach that focuses on why political leaders turn to fiscal decentralization in the first place, and on the constraints they face in actually trying to implement fiscal decentralization. In the following, I propose a framework that seeks to do just that by borrowing from John Kingdon's (1995) work on agenda-setting. In my account, I link the causal impact of abstract perceived "problems" such as globalization and internationalization with concrete outcomes of fiscal decentralization by focusing on the intermediary role of ideas and politics. Kingdon (1995) argues that "three process streams flow through [any] system - streams of problems, policies, and politics" (Kingdon 1995: 19). Though largely independent of each other, Kingdon notes that "at some critical junctures the three streams are joined, and the greatest policy changes grow out of the coupling of problem, policy proposals, and politics" (Kingdon 1995: 19).

To understand the origins of the proposals of fiscal decentralization that emerged in Southern Germany in the late 1990s, my argument contends that it is necessary to focus on the intersection of three factors, each of which is analytically insufficient: 1) the emergence of a perceived problem with German federalism after German unification in the mid 1990s; 2) the increased intellectual predominance of the ideas of fiscal federalism in academic and policy circles throughout Germany; and 3) growing center-periphery political tensions within the Bavarian CSU party in 1996 that made the adoption of a strongly regionalist fiscally-decentralized agenda so appealing. To explain the emergence of the push for fiscal decentralization it is not enough to point to

10 This epistemological distinction between "distant" and "proximate" causes draws directly on Kinsch (2000).
11 The authors themselves point to this potential pitfall of their focus on political leaders' "interests" when they write, "These reflections on the origins of federalism ... raise the daunting problem of endogeneity. For the purposes of this analysis we have sharply distinguished the internal organization of political parties from the fiscal structure of the state and have suggested that fiscal decentralization is driven by how parties are organized ... An alternative argument could reverse the causal arrows" (German et al. 2006: 235).
12 A decisive background condition for all of this was the persistence of structural tensions between Eastern and Western parts of Germany after 1990. The persistence of a geographical economic gradient in post-unification Germany has altered the German political landscape and undoubtedly contributed to the push in Western German states for greater state spending and taxing autonomy.
"distant" causes such as economic internationalization or too overly "proximate" causes such as the electoral or fiscal interests of political leaders. Rather, an explanation must account for three separate questions: how a long-standing condition or "difficulty" of German federalism came to be seen as a "problem" (Kington 1995: 109); why fiscal decentralization or "competitive federalism" survived the Chmielniks selection process of intellectual competition to be such a dominant force in academic and policy communities in Germany; and finally why "competitive federalism" was perceived as a potential solution to Germany's troubles by Southern German political leaders.

But to understand why these policy proposals have had such difficulty in the German political system, Kington's (1995) framework is insufficient. We have to turn away from the explanatory role of ideas to the explanatory role of institutions. The German federal system is unique insofar as it gives a formal "seat" to all state governments in the federal institution of the Bundesrat. This constrained fiscal decentralization in two ways: First, the federal system institutionalizes formal and informal "euro" points that make the adoption of any form of fiscal decentralization less likely because poor states (which constitute a majority in the Bundesrat) will tend to vote against any legislation that would make them significantly worse off than they currently are. Second, this same institutional framework (centered around the Bundesrat) that gives an organized voice to the permanent majority of regional interests that are "receiver states" has an additional consequence: Not only are fiscally decentralist proposals not adopted, but also, they are often not even seriously proposed because their advocates recognize "the political unfeasibility" of such an agenda. In both instances, we see how a particular configuration of institutions and interests in a political system can, at least in the short term, defeat even the power of "an idea whose time has come".

3. The Emergence of the Idea of "Competitive Federalism" in German Political Discourse during the 1990s

In the mid-1990s these facets came together to push the agenda of fiscal decentralization to the fore of German political debate: 1) the perceived financial crisis caused by German unification; 2) the emergence of a coherent vision in German policy-communities of "competitive federalism" that stood as an alternative to the long tradition 13 Though at first glance a focus on the collision of states for and against reform might seem sufficient to explain why reform has failed, a more thorough and comparative analysis reveals this is not the case. Without the existence of the particular state institutions that provide a formal arena for these interests in the legislative process - the Bundesrat, then the constraints on reform would not nearly be as strong. For an example of an inclusive and important example of such an interest-based account, see Douglas Webster (1997: 227-255).

14 My account largely confirms the findings of Addelberger (1999) who also focuses on the Bundesrat as an institution that constrains efforts at decentralization. But, in contrast to Addelberger, who focuses exclusively on the construction of majorities in the Bundesrat, my account argues that in addition to the structural reasons favoring continued centralization, a set of pressures historically-produced informal norms and practices in the institution of the Bundesrat itself are critical in shaping what policy proposals are even discussed. A complete discussion of this point follows in the last section of this paper.
of "cooperative federalism"; and 3) a center-periphery crisis within the CSU party itself, which, within the context of persistent East-West German structural tension, prompted a search for a new set of regionalist themes that could be used for the purpose of mobilizing the CSU party electorate and membership.

The first step in the emergence of a new policy proposal is the recognition of a policy problem. No single issue highlights the existence of a policy problem more clearly and clearly than the hard constraints imposed by budgets (Kingdon 1995: 105). In the mid-1990s, as the financial challenges of German unification became increasingly clear and German economic growth rates slowed to under 2% — the lowest since World War II, regional political elites in Germany's richest regions faced declining revenue growth and began to discuss the "costs" of regional redistribution. The diagezis of the political system's institutional ills converged around a set of slogans borrowed from a growing policy-community and academic consensus that took as its main target the perceived political incapacity of the federal government — "Reformzusatz" (refuse gridlock) and "Politikdezentralierung" (political joint decision making). In Bavaria, where the reform issue received the most political attention, this diagnosis implied in turn a set of logically connected policy prescriptions that fit nicely with the governing Bavarian CSU's long-time themes of regional independence in Germany: in the mid to late 1990s there emerged increasing calls by political leaders, borrowing from the scholarly community, for the "Einführung" (diminishing) or "Regionalisierung" (regionalization) of German political life (Scharpf 1989).

Such diagnoses and prescriptions were welcomed and promoted by political elites in rich Länder who felt overburdened by a central state and the task of financing distant, poor regions. With declining resources from their own state budgets and with only limited constitutional ability to raise their own revenues independently (Article 105 of the Constitution), officials in states such as Bavaria began to seek other sources of revenue. Predictably, the policy areas that became targets for fiscal decentralization were areas which were extremely visible and easily quantifiable: the redistribution of public finance money and the redistribution of unemployment insurance money.15 Simultaneously, these same political elites searched for a set of political ideas to underpin their efforts to change existing federal relations to give themselves more financial and legislative autonomy. The following section provides an account of how a set of ideas that in the early 1990s were not central in German political life — the philosophy of "competitive federalism" — became central themes across the political spectrum in all the richest states of Germany.

15 Visible and easily quantifiable programs become the targets of efforts to cut redistribution for several reasons. To begin with, as Kingdon (1995: 90) notes, "People in and around government could amend to a long list of problems. As a result, that certain problems capture the attention of these people rather than other problems is often the consequence not of "some sort of political pressure or perceptual slight of hand but because some more or less systematic indicator simply shows that there is a problem out there." (Kingdon 1995: 90). In a similar vein, Wezlerky (2002) argues that the more transparent a system of redistribution, the more likely it will become the object of fiscal backlash.
3.1 Discovering the "Problem" of German Federalism

In the mid-1990s a set of short-term fiscal challenges confronted the Bavarian state government which focused its leaders' attention on the regional redistribution of public resources away from Bavaria and on what came to be conceived of as "the problems" of German federalism. In 1996 in particular it became increasingly clear to the Bavarian Finance Ministry that Bavaria was facing the onset of a budget crisis. As Table 1 shows, between 1990 and 1997 annual growth rates of pre-redistribution tax revenues for the state of Bavaria experienced a rapid decline.

Table 1: Annual Growth Rates in Bavarian Pre-Redistribution Tax Revenues, 1991–1997

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage Increase in Total Tax Revenue over Previous Fiscal Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990–91</td>
<td>10.9%</td>
</tr>
<tr>
<td>1991–92</td>
<td>9.3%</td>
</tr>
<tr>
<td>1992–93</td>
<td>4.5%</td>
</tr>
<tr>
<td>1993–94</td>
<td>4.2%</td>
</tr>
<tr>
<td>1994–95</td>
<td>4.3%</td>
</tr>
<tr>
<td>1995–96</td>
<td>4.1%</td>
</tr>
<tr>
<td>1996–97</td>
<td>1.6%</td>
</tr>
</tbody>
</table>

Average Annual Growth Rate, 1990–1997: 6.5%

In addition to the shortfall caused by a general economic downturn, there was also a dramatic increase in the amount of money taken directly out of the Bavarian state budget for regional redistribution in the wake of German unification. The "horizontal" component of Germany's highly complex public finance system of Länderfinanzausgleich (State Equalization System) equalizes public resources among rich and poor states by redistributing tax revenue directly out of the budgets of states with an above-average tax revenue base to states with a below-average tax revenue base (Vesper 1998: 762–771). As displayed in Table 2, direct transfers of money from rich states to poor states ("horizontal" redistribution) increased significantly after 1990, especially between 1994–1995, as the costs of financing the budgets of poor states after German unification fell heavily on Western Germany's richest states. Additionally, as the poorer Eastern states were incorporated into the equalization scheme after unification, Bavaria had begun to gradually shift its status from that of a "receiver" state to a "donor" state in the equalization system.

16 This analysis is based on my own calculations. Data source: Statistisches Bundesamt 1990–1997.
17 It should be noted that the agreements that formed the Solidarity Pact in 1993 between the federal government and the states assured that the federal government would assume 90 percent of the costs of public finance funds to the Eastern states. Additionally, the German states increased their share of the VAT revenue from 37 to 44 percent under the terms of the Solidarity Pact. For a discussion of the negotiations, see Sally and Wohrer (1994: 18–60).
Table 2: Horizontal Financial Equalization, Contributing States, 1990–1998
(Mill. of DM)18

<table>
<thead>
<tr>
<th>Year</th>
<th>Bavaria</th>
<th>Hamburg</th>
<th>Hesse</th>
<th>NRW</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>2421.6</td>
<td>35.9</td>
<td>7.9</td>
<td>1445.6</td>
<td>62.8</td>
</tr>
<tr>
<td>1991</td>
<td>2505.9</td>
<td>4.4</td>
<td>6.0</td>
<td>1332.9</td>
<td>7.8</td>
</tr>
<tr>
<td>1992</td>
<td>1506.9</td>
<td>0</td>
<td>0</td>
<td>1862.6</td>
<td>5.3</td>
</tr>
<tr>
<td>1993</td>
<td>1012.8</td>
<td>12.4</td>
<td>0</td>
<td>2139.3</td>
<td>0</td>
</tr>
<tr>
<td>1994</td>
<td>409.9</td>
<td>618.9</td>
<td>0</td>
<td>1827.2</td>
<td>0</td>
</tr>
<tr>
<td>1995</td>
<td>2803.9</td>
<td>252.0</td>
<td>117.0</td>
<td>2155.0</td>
<td>344.0</td>
</tr>
<tr>
<td>1996</td>
<td>2521.0</td>
<td>286.2</td>
<td>482.0</td>
<td>3240.0</td>
<td>3125.0</td>
</tr>
<tr>
<td>1997</td>
<td>2423.0</td>
<td>307.9</td>
<td>364.0</td>
<td>3130.0</td>
<td>3033.0</td>
</tr>
<tr>
<td>1998</td>
<td>3473.0</td>
<td>2901.0</td>
<td>613.0</td>
<td>3653.0</td>
<td>5095.0</td>
</tr>
</tbody>
</table>

The costs of regional redistribution were not, however, the only reason German federalism began to be blamed by Bavarian officials. This horizontal regional transfer system is built around the uniquely visible (in cross-national comparison) — and hence politically troublesome — method of regional redistribution that transfers money directly out of the budgets of rich states to the budgets of poor states. In comparison to other federal states such as Canada, Australia, and the United States, where there is a greater reliance on the "vertical" transfer of money from the federal government to poor states, Germany relies much more heavily on this visible "horizontal" method of redistribution (Seidel/Vesper 1999). Since the horizontal method of redistribution draws money directly out of state budgets (rather than a national budget), rich states are more likely to protest in a system dominated by horizontal redistribution. It is in this sense that an economic downturn turned attention to both the costs and the structure of Germany’s system of public finance, turning Germany’s federal system into lightning rod for the fiscal challenges faced by the Bavarian state government.

3.2 Finding a Policy Solution

As a result of these structural shifts and institutional features of German federalism, in the Summer of 1996, advisors close to the new Bavarian Minister President Edmund Stoiber began increasingly in internal discussions in the Bavarian Staatskanzlei to explore the policy applications of the idea of "competitive federalism", a concept that had been an important neo-liberal idea in the scholarly world of economics for some time. The immediate motivation of the search for such a policy solution arose from the budget shortfalls facing the Bavarian state. But the concept of "competitive federalism" offered members of the Bavarian Staatskanzlei a sweeping and strong counterpart to the idea of "cooperative federalism" that had dominated legal thinking on federal relations since 1966. While the idea of "cooperative federalism" had developed in an era of expanding financial resources and was used to justify massive increases in redistribution between states, Bavarian policy-makers around Stoiber viewed the new vision of "competitive federalism" as a new way of organizing federalism in an era of

18 Dr. Dieter Vesper of the German Institute of Economic Research (DIW) provided me with these data.
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... decreasing public resources, growing internationalization of the economy, and the perceived decreased importance of the nation-state.

The intellectual genealogy of the idea of competitive federalism or fiscal decentralization can be traced to work done by Anglo-American economists as far back as the 1950s (Throop 1956: 416-424). More recently, economics in the United States and Europe have sought to link federalism, the decentralization of raising and spending competencies, and tax competition between sub-national units to higher rates of economic growth (Wälti 1995). The entry of these ideas into German academic circles has taken place over the last twenty years (Wellsch 1995). The growing prescriptive relevance of this literature in Germany’s long-standing “cooperative” and relatively centralized federal system began to be noted in the 1980s and 1990s. In the mid-1990s, for example, the OECD sponsored an influential and largely critical study of German federalism that argued that the German system’s “shared taxes and low reliance on own taxes make for a relatively inefficient control over public spending.” The OECD study went on to conclude, “In public finance terms, the German system that does not achieve the allocational benefits which should accrue to a federal fiscal system” (OECD 1998: 93).

In Germany, the growing criticism of high levels of fiscal redistribution based on the idea of “competitive federalism” reached a high-water mark in the late 1990s with several definitive and influential research projects sponsored by some of the more well-financed think tanks and research institutes in Germany. The Bertelsmann Foundation, with an annual budget of over 100 Million DM, sponsored a multi-year study of German federalism that organized conferences among academics and advocated introducing decenteralizing reforms into Germany’s federal system (Bertelsmann 2000). Similarly, the even more influential quasi-independent Council of Economic Advisors (Sachverständigengen zur Begutachtung der Gesamtwirtschaft) ran by a leading group of German economists, published in its agenda-setting annual report a study calling for the reform of German federalism.

Finally, the “cross-pollination” effect of the scholarly world and the political world can be seen in its political party support of the ideas of “competitive federalism.” In one especially important example of this, it is no accident that the Bavarian CSU’s own think tank, the Hanns Seidel Foundation, organizes publications of collections of essays by leading scholars on “competitive federalism” and additionally organizes regular “expert seminars” for political students to discuss federalism with prominent Bavarian state politicians (Meier-Walter/Hinscher 1999). In short, over the last ten years the ideas of fiscal decentralization and competitive federalism have been transformed in Germany from a marginal stream of economic theory to the centerpieces of the scholarly and policy worlds among German economists and policy-makers.

19 The criticisms of the inefficiencies of cooperative federalism have become with a rare and important exception (Lehmbruch 1998) among the conventional wisdom in German scholarly circles. For several prominent examples of this literature, see Abouzet (1992), Scharpf (1994), and Schultze (1999).
3.3 Enter "Politics": Building a New Regional Political Agenda

But why did competitive federalism gain such political clout in 1996, especially in Germany’s Southern state of Bavaria? How did a relatively obscure set of economic theories in the United States in the 1950s find such appeal among Bavarian governing officials in the late 1990s? It is here that we must turn our attention to political tensions within the Bavarian governing political party (the CSU), which initiated (against the will of East German CDU officials and Bavarian SPD officials) all formal efforts to reform German federalism. With elections coming in the Fall of 1998, the philosophical emphasis on the autonomy of states that logically emerges from a commitment to "competitive federalism" was a new way of emphasizing "Bavarian" regional interests, an old and still powerful strategic electoral pitch of the CSU in Bavarian electoral politics. But within the CSU leadership a significant center-periphery political cleavage emerged in the late 1990s. The cleavage started in the head at the November 1997 CSU Party Congress in Munich, where, together with worries about the upcoming fall 1998 elections and declining Bavarian tax revenues, the first concrete calls for "competitive federalism" and the "regionalization" were made. What precisely was the center-periphery conflict within the CSU? After sixteen years in power in Bonn (with the CDU), tensions within the CSU between national-level and state-level politicians were reaching a new degree of dissonance. According to most accounts, Bono CSU officials had long viewed themselves as the "carme de la cērce" of the party. At the same time, however, Bavarian Land CSU officials in 1997 wanted, according to one Landtag representative, to send a message that "the music now plays in Munich." (Nürnberger Nachrichten 31/29/1997).

The tension was not merely symbolic. A subtle power struggle had erupted between the long-time party chairman and federal finance minister Theo Waigel and the up-and-coming Minister President of Bavaria, Edmund Stoiber. From the perspective of some of the CSU rank and file, Theo Waigel, along with other federal officials such as Health Minister Horst Seehofer, were too willing to compromise on Bavarian interests. A leader of the small CSU Osterland from the Lower Bavarian town of Steinbach sought to place Stoiber on the party chairman candidate list. The effort was unsuccessful, but the declining support for the federal wing of the CSU among party delegates culminated in over fifteen percent of the CSU delegates defecting and voting against Waigel's re-election as party chairman, the lower support he received in his ten-year tenure as party chairman (Frankfurter Allgemeine Zeitung 1997). These shifting orientations within the CSU membership base were also the basis of demands that a leader emerge to put Bavarian "interests" above the interests of the federal govern-

20 In one account, in 1997, the CSU-Vorstand was clearly divided into two camps — supporters of Stoiber and supporters of Waigel. According to this account, the Stoiber supporters in the Vorstand included the Bavarian Social Minister Barbara Stamm, the Bavarian Economics Minister Otto Wiesten, the Bavarian Agriculture Minister Reinhold Beckler, and the Munich State Secretary Kurt Fahlbusch among others. In the Waigel camp could be counted the following: Horst Seehofer, Federal Health Minister, Dagmar Wielch, Bundestag representative, Renato Blahk, Bundestag representative, Carl Dieter Spranger, Federal Minister for Development, and Ernst Hinsken, Undersecretary for Agricultural Affairs, among others (Tegernsee 1997).
most. CSU officials in the federal government were outraged at the explicit display of regionalism. One prominent CSU federal official, Klaus Rose, the parliamentary undersecretary in the Defense Ministry, announced the "separatist tendencies" within the local CSU. In clear reference to the separatist Lega Nord in Italy, Rose went on to warn that the party should avoid becoming the "Lega-Süd" of Germany. It was, however, precisely this gap between the federal representatives of the party and the party's local base from which Stoiber hoped to benefit.

In short, in the face of an economic slowdown, an upcoming state election, and growing center-periphery tensions within the CSU itself, a group of political leaders led by Stoiber and others in his Land government undertook an effort to articulate a more "regionalist" profile for the party. The broad message of the Party Congress was most clearly stated in Stoiber's speech at the beginning of the Congress before over 1,000 delegates (Stoiber 1997). The Minister President's speech emphasized above all the "regional" interests of "wanderer Holmset Bayern" ("our homelands Bavaria"). A phrase that was repeated at least four times throughout the speech. At the heart of Stoiber's speech was an outline of his commitment to a program that would reduce the regional redistribution of public resources away from Bavaria and increase fiscal autonomy by specifically 1) reducing the public finance payments in the Länderfinanzausgleich system; and 2) ending de facto regional social insurance transfers (health care, unemployment) from rich states to poor states by establishing an explicitly "regionalized" system of social insurance in which wealthier states would demand lower social insurance contributions from citizens and poorer states to make up the difference, would be required to ask for higher social insurance contributions from their citizens.23

Stoiber's justification for this regionalist program was based on what he claimed to be the "unfairness" and "inefficiency" of the current system. Stoiber declared provocatively, "It must end that Bavarian employers must pay for the mistakes of Herr Schröder and Herr Lafontaine" (Stoiber 1997). Stoiber continued, "The SPD-governed states that have mismanaged their economies have to think of something else besides simply opening their hands and expecting money from the financial equalization system" (Stoiber 1997: 25). It is significant that the main object of Stoiber's criticisms was the "North German states" and that his only explicit reference in the entire speech to the Eastern states (the main recipients of public transfers) was the vague assurance, "To the new Bundesländer, I say that we want to solve the consequences of economic mismanagement of forty years of SED dictatorship together. There is no question" (Stoiber 1997: 15). The unwillingness of the CSU explicitly to use anti-Eastern sentiments in their party congress despite these regionalist calls for decentralization is surprising and important. The causes of this restraint will be explored later in this paper.

By February 1998 - three months after the CSU Party Congress - Stoiber and his government had an even better articulated vision of conservative federalism and more

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23 The official proposal ("Wirtschaftsföderalismus und Regionalisierung in der Sozialversiche-
 rung") was brought up for a vote in front of the CSU on November 21 by Barbara Naumer, Ba-
varian Social Minister, and Markus Söder, Chairman of the Junges Union Bayern; and it was
approved but went on to committee for further discussion (CSU, Freikahl über die Beschlüsse
der Parteitages 1997).
importantly had developed a multi-state strategy of putting the ideas into action. In Sinzger’s “Regierungserklärung” (“State of the State” Address) before the Bavarian Landtag, he outlined the three main areas in which his government hoped to pursue change: 1) reform of Germany’s social insurance system (Sozialgesetzbuch). 2) reform of financial relations between states and the federal government to increase the financial autonomy of the states (Finanzautonomie); and 3) reform of legislative relations between states and the federal government to increase the legislative autonomy of states (Georgsgehöftkompetenz) (Sinzger 1998). To Sinzger and his government it was clear that the first area of change would require amendments to federal social law (Sozialgesetzbuch, Articles 1, 3, 4, 5, 6, and 11). The latter two areas would require constitutional change (2/3 Bundesversammlung approval, Grundgesetz, Articles 70–74, 91b, 104a). To achieve this end, Sinzger knew he had to find sympathetic allies in other rich states. The following will explore the politics of these proposals and will trace the fate of the Bavarian government’s effort to find allies in other states between the Fall of 1997 and the Spring of 2000.

4. Institutional Constraints on Reform: Proposals of Fiscal Decentralization in the German Political System

Though a focus on the three factors of problems, policies, and politics can explain why a new set of ideas come to be proposed, to understand actual policy outcomes, we must turn our attention to the particular institutional constraints within a political system. The three sweeping proposals that constitute “competitive federalism” in the Bavarian world-view stumbled into the more complicated reality of the German political system in 1998–1999. Unfortunately from the perspective of the Bavarian Staatskanzlei, in the world of politics, policy proposals once made can not be automatically implemented. And even more fundamentally, policy ideas once invented do not automatically become serious policy proposals. Rather, within the German political system, like any political system, a set of institutional and interest-based constraints exist that often make efforts at policy innovation a story of strategy, failure, and frustration (Hall 1989). A review of the political fate of two of the main ideas of “competitive federalism” – regionalizing social insurance and reforming financial relations between the states – reveals precisely how the institutions of German federalism shape which policy ideas come to fruition in the German political system.

4.1 Regionalizing Social Insurance

The German system of quasi-independent unemployment insurance run by the federal-organized Bundesagentur für Arbeit and funded by employers, employees, and the federal government has always entailed an implicit regional redistribution of unemployment insurance money in Germany (Bundesagentur für Arbeit 1999). As Table 3 shows, in 1996 (the most recent year for which data are available) an implicit form of regional redistribution took place between rich and poor regions in terms of unemployment insurance. The figures of course reflect the deep east-west gradient in the united Germany.
Table 3: Net Receivers and Net Donors of Unemployment Insurance, 1996/22

<table>
<thead>
<tr>
<th>Region</th>
<th>Net Receivers (Unemployment Insurance)</th>
<th>Net Donors (Unemployment Insurance)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hamburg</td>
<td>-1,595,869 DM</td>
<td>Schildau-Holstein: + 21,895,560 DM</td>
</tr>
<tr>
<td>Meck.-West Pomerania</td>
<td>-1,056,461 DM</td>
<td>Lower Saxony: + 2,864,372 DM</td>
</tr>
<tr>
<td>Bremen</td>
<td>-599,607 DM</td>
<td>North Rhine-Westph.: + 12,227,990 DM</td>
</tr>
<tr>
<td>Rhineland-Palatinate</td>
<td>-2,215,236 DM</td>
<td>Hessen: + 21,284 06E</td>
</tr>
<tr>
<td>Berlin/Brandenburg</td>
<td>-2,775,713 DM</td>
<td>Saarland: + 1,598,680 DM</td>
</tr>
<tr>
<td>Saxony-Anhalt</td>
<td>-1,295,189 DM</td>
<td>Baden-Württemburg: + 4,748,695 DM</td>
</tr>
<tr>
<td>Saxony</td>
<td>-2,691,129 DM</td>
<td>Bavaria: + 1,380,997 DM</td>
</tr>
<tr>
<td>Thuringia</td>
<td>-6,610,860 DM</td>
<td></td>
</tr>
</tbody>
</table>

This system - which has always contained an implicit element of regional redistribution of unemployment resources - has gone virtually unquestioned in Germany since its founding in 1952. Only after German unification, at the amount of transfers from west to east skyrocketed, has it become a political issue.

But it is not only the costs of the system that have made it, like every other Länderfinanzausgleich (as discussed above), a political lightning rod. Just as the transparent structure of the horizontal Länderfinanzausgleich made that system an easy political target, so too has the transparency of the redistribution of unemployment money made it an object of political attack. Remarkable evidence of this fact is revealed in the way that regional redistribution of unemployment resources is measured by the budget office of the Bundesministerium für Arbeit itself. Between 1952 and 1996 the Bundesministerium für Arbeit published in its annual statistical report the amount of contributions and the amount of expenditure by state (the amount that each state contributes to the unemployment insurance system and the amount that each state receives from the system). In 1996 this all changed as the Bavarian state government began to make noise about the "unfairness" of the redistribution of unemployment money away from rich states. In reaction to the political controversy, a leading official of the Bundesministerium für Arbeit at the time called for a radically new accounting method that would not reveal in the annual statistical report how much each state contributes to the system (Interview, Bundesministerium für Arbeit, March 20, 2000).23 Indeed, by making the system less transparent and thereby removing it from the realm of electoral politics, it has been more difficult for Bavarian politicians to make a case for undoing the system.

Nevertheless, in Bavaria, the greatest advocates of "regionalizing" social insurance have been the Bavarian Social Ministry and the Bavarian Business Association (the state branch of the federally-organized Employer Association). The Bavarian Social Ministry's agenda is to "protect workers' interests" in Bavaria. According to one official in the Bavarian Social Ministry, "Why should a hard-working construction worker...

22 Data source: Bundesministerium für Arbeit (1996). An important caveat is that when contributions are measured against real contributions rather than simply against unemployment insurance benefits in the Bundesministerium für Arbeit annual budget, several states switch from donor to receiver status, including, ironically, Bavaria.

23 In the words of one official at the Bundesministerium für Arbeit, the data on contributions to the unemployment insurance system was removed from public view "because certain politicians were misusing the data".
in Bavaria have to pay for the problems of unemployment in Mecklenburg-Western Pomerania!" (Interview, Bayerische Sozialminister, March 24, 2000). While Bavarian Labor Union representatives remain quiet on the topic and ambivalent about competitive federalism in general, the Bavarian Social Ministry has been the strongest advocate of the regionalization of social insurance and the reduction of Bavarian employer contributions to the system (Interview, Bayerische IG Metall, February 15, 2000).

The second social base that potentially benefit from the regionalization of social insurance contributions— the Bavarian business community— has begun since 1999, after initially supporting the idea, to have doubts about the technical and political feasibility of the plan (Interview, Vereinigung der Bayerischen Wirtschaft, May 4, 2000). With the prospect of having to contribute less to employees’ unemployment, retirement, and health benefits, social insurance specialists in the Munich-based Vereinigung der Bayerischen Wirtschaft (Bavarian Business Association) have worked behind the scenes in the late 1990s to support the regionalization agenda. Even as late as February 9, 2000, two leaders from the Bavarian Business Association met with the Bayerische Sozialminister Barbara Stearns in closed-door meetings to discuss ongoing efforts to regionalize social insurance (Interview, Vereinigung der Bayerischen Wirtschaft, May 4, 2000). The argument for Bavarian business leaders is powerful. Not only would the regionalization of social insurance lower costs for Bavarian businesses, but it would also serve as a competitive incentive for business from other states to move to Bavaria to lower their costs. It is ironic that in an earlier era it was precisely these same trade associations, chambers of commerce, merchants, and manufacturers throughout Germany that were, according to most historical accounts, the greatest advocates of greater political centralization (Hamerow 1972: 337-347; Craig 1978: 20). Today these same groups are arguing for the exact opposite goal.

Despite the strong economic arguments, the formal and informal institutional context of German political life has served to mute this regional revolt. First, as a result of the formal institution of the Bundesrat, opposition emerged within the CSU itself. After the proposal was first submitted at the 1997 CSU party congress, the idea was also submitted for discussion in the Bayerische Landtag (Bayerischer Landtag Plenarsitzung 13/97, December 12, 1997). In the parliamentary discussion, Green and SPD politicians responded with an outrage that reflected the opinions of state politicians throughout Germany that viewed the proposal as an effort to undo the basic political structure of the German nation-state. The SPD leader in the Bayern Renate Schmidt declared that the proposal was an "offensive statement of chauvinism, primitive Staatlichkeit populism and straightforward egoism" (Bayerischer Landtag Plenarsitzung 13/97, December 12, 1997: 6911). In the press, journalists made accusations that the CSU was playing a dangerous accession to "Eiga-Stah" politics (Stiller 1997).

For federal level CSU officials and for members of the Staatskanzlei who faced the task of co-operating on a daily level with the leaders of other states in the Bundesrat, the proposal was simply too radical. As one CSU official who works at the federal level put it, "Regionalising social insurance would bring many economic benefits but even more political costs that would outweigh the economic benefits". The same official went on to say that as of Spring 2000 "Some saydeons (wise guys) in the Bavarian Social Ministry may even still think it makes sense but that it is only because their
The Politics of Fiscal Decentralization in Post-Unification Germany

political world is centered around Bavaria and they don’t have to do politics at the national level." (Interview, CSU Landtagsgruppe, February 10, 2000). It is for this reason that a constraining divide within the CSU is inevitable. Further evidence of this constraining dynamic generated by the institution of the Bundesrat makes itself clear in the frequently made criticisms by some Bavarian Landtag representatives that even Smither, now that he has access to the instruments of federal power (in the Bundesrat), is too willing to compromise on Bavarian interests (Interview, Bavarian Landtag Enquete Kommission München, February 14, 2000). In this sense, it can be argued that the formal institutional constraint of Bundesrat resulted in the loss of enthusiasm by the Bavarian Minister President for this most radical component of the competitive federalism agenda.

The second factor that finally doomed the proposal to "regionalize" social insurance was an informal feature of the German federal system: the biannual closed-door meetings between the heads of the 16 Länder, called the Minister-Pastor-Conference. Despite the waning enthusiasm in 1998 in some CSU circles, the Bavarian government still pushed forward on the proposal to regionalize social insurance through the fall of 1998. In the December 3-4, 1998 Minister-President Conference held in Peenges, the heads of the sixteen states—largely at the impetus of Bavaria, Baden-Württemberg, and Hesse governments—agreed to undertake a comprehensive overview and study of federalism. At that meeting a massive catalogue of nineteen issues was proposed by different states to set the agenda of what was hoped would be an on-going discussion on federalism between state leaders. The nineteen discussion themes were divided into four broader thematic categories: 1) Distribution of legislative tasks (Aufgabenverteilung Bundesländer); 2) Financial Relations (Finanzverteilung); 3) General federal issues (Bilanze der bundesstaatlichen Ordnung); 4) Additional financial issues (Sonstige finanzielle Leistungen) (Ministerratsonderordnung, September 28, 1999). The issue of "regionalizing social insurance," was included under the fourth, elusive category "Additional financial issues." It was a topic that was included on the agenda with a greater scope of resistance from some of the poorer states and entirely at the impetus of the Bavarian government (Ministerratsonderordnung, July 15, 1999). The Bavarian government, though not sure of the political chances of its proposal, hoped to find allies in the other rich states to begin an active discussion of this topic at its highest political level (Interview, Bavarian Staatskanzlei, March 1, 2000).

But given the "collegial" and consensus-seeking atmosphere of the Minister-President Conference, it became clear that this relatively radical proposal would soon be dropped from official discussion. Indeed, after the new Minister Presidents met with the new Chancellor Schröder on December 17, 1998 in Bonn where he committed to forming a "Bund-Land" Special Government Committee to explore possible reform of

24 The Minister-Pastor-Conference is an informal meeting of the heads of each of the 16 German states that occur twice a year that is not open to the public or the press. In their meetings the Minister-President seek to reach a consensus to speak with one "voice" via-à-via the federal government with regards to legislation that is up for a vote in the Bundesrat or Bundestag. Given its importance in the German legislative process several scholars have noted the death of scholarly literature on the subject (Lahnum 1998). A more complete discussion of the Minister-President Conference follows in the next section.
federal system, resistance began to emerge. The Minister Presidents met again on June 24, 1999 to set up a final agenda for the joint “Bund-Land” Committee. Again, the Bavarian government pushed, but this time in very technical terms that cautiously weighed the pros and cons of their regionalization plans (Ministerial Correspondence, May 5, 2000). Likewise, several states (Mecklenburg-Western Pomerania, Saarland, Saxony-Anhalt and others) expressed their disapproval of the plans. In the consensus and insulated negotiations between the Minister Presidents and their Fach experts, away from broader political pressures of German society, participants in the negotiations report a “collegial”, respectful, and problem-solving working environment in which real problems and possible solutions can be proposed (Interview, North Rhine-Westphalia Staatskanzlei, May 16, 2000). 23 It is in this consensus-seeking environment where political posting is not necessary and deliberation is possible that the proposals to regionalize social insurance were finally dropped. By the time of the first meeting of the Joint Bund-Land Committee with Chancellor Schröder in December 1999, the item had been entirely removed from the agenda (Interview, Bundeskanzleramt, May 2000). 24 What is critical to note, however, is that this was not simply a case of Bavaria being voted down. In exchange for giving in on this issue, the poor and Eastern states allowed other Bavarian issues (including proposals for transforming financial relations to increase state financial autonomy) on the agenda of discussion. Likewise, as part of this bargain, the wealthiest states in all their official statements explicitly stated that the Eastern state’s Aufheben Ort would remain untouched. In short, because the institutional context of German federalism allows for a pattern and culture of bargaining and compromise over inter-state conflicts, the Bavarian government was both able to and willing to give up its most radical plank of decentralization.

4.2 Reform of Financial Relations

The second area of “competitive federalism” – the reform of financial relations among states themselves and among states and the federal government – was still left on the agenda in December 1999. This section of the paper will discuss three issues: the origins of the plans to regionalize public finance, the proposals that emerged in 1998–1999, and the course of the negotiations through to Summer 2001. The aim is to make the case that once again, the specific political structures in Germany that allow regional redistribution to be discussed in an island fashion at the highest of political levels have constrained the success of fiscal decentralization.

The origins of the proposals to reform inter-governmental financial relations lie with a tension at the heart of Germany’s system of public finance. Germany has a highly decentralized political structure but a highly centralised tax system (Gedde/Ves
per 1999; Renzsch 1991; Bundesministerium der Finanzen 1999). More conceptually, in contrast to other federal systems like the United States and Switzerland, states have almost no power to set their own taxes in Germany. Rather, single uniform tax rates are set at the federal level with the participation of the states in the process of setting tax rates not "individually" but rather "as a collective" at the national level via the Bundesrat.27 Nevertheless, the German constitution stipulates that every level of government must be able to finance its own expenditures. To manage this tension three complex mechanisms have been developed in the world of German public finance. First, states and the federal government in post-war Germany have co-financed most of their own activities through a system of "tax sharing" of the most significant German taxes set at the national level (e.g., VAT, wage tax, assessed income tax, corporation tax, etc.) which are basically evenly shared between states and the federal government. These taxes constitute approximately 75% of all tax revenues in Germany (OECD 1998: 76). Since German unification, the federal government has granted states a greater share of these "shared taxes" because of the problems of including the once Eastern states. Second, despite the constitutional stipulation that states should finance all their own activities, the federal government has increasingly found reasons to unilaterally intervene in state economies and has found loopholes in the German constitution to justify its active part in funding a range of activities that were supposed to be funded exclusively by states (e.g. improvement of regional economic structure, improvement of agricultural structure, investment in universities, etc.). The justification for this increasing federal financial intervention was usually "to assure a single standard of living in Germany" and "to address regional problems of national importance" (Bundesministerium der Finanzen 1999: 3). This direct federal funding of areas traditionally reserved for states, called Gemeinschaftsaufgaben, has now been formally included in the constitution (Articles 91 and 104). In the 1970s, state governments including Bavaria and North Rhine-Westphalia faced their own economic problems and without the instruments to set their own tax rates, welcomed the federal government's willingness to help fund universities, declining industries, and other "regional" problems. It is only in recent years that this "centralised" solution to regional problems has come under criticism.

The third element of Germany's public finance system that addresses the tension at its heart is the system of "after-tax" financial equalization (Landesfinanzausgleich) that was briefly discussed earlier in this paper. Because states cannot set their own tax rates, when poorer states face a budget shortfall even after "shared" taxes have been granted to the states, a system in which the federal government and other wealthier state governments are forced to pass money on from their budgets has been established. This horizontal system has its origins in the lack of a federal government in the immediate years after World War II and the inequitable financial burden of German Pflichtsteuer from the Eastern territories in some states but not others (Renzsch 1991). The system has been in a process of negotiation since its creation. After German unification, as the

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27 Importantly, a distinctive feature of German federalism is its qualities that analysts have dubbed "functional federalism" - a pattern of federalism, with origins as far back as 1871, in which federal legislation is usually implemented by Land governments. For a discussion and bibliography, see Hübinger (1990).
Table 4: State Finances Before and After "Horizontal" and "Vertical" Redistribution, 1998

<table>
<thead>
<tr>
<th></th>
<th>Pre-Redistribution</th>
<th>Post-Redistribution</th>
<th>Difference Between Pre and Post Redistribution (DM)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>State Finances as Percentage of Average</td>
<td>State Finances as Percentage of Average</td>
<td></td>
</tr>
<tr>
<td>North Rhine-Westphalia</td>
<td>106.5</td>
<td>102.5</td>
<td>-3,955,000,000</td>
</tr>
<tr>
<td>Bavaria</td>
<td>108.5</td>
<td>103.0</td>
<td>-2,901,000,000</td>
</tr>
<tr>
<td>Baden-Württemberg</td>
<td>111.3</td>
<td>105.3</td>
<td>-6,473,000,000</td>
</tr>
<tr>
<td>Hesse</td>
<td>117.6</td>
<td>114.5</td>
<td>-3,155,000,000</td>
</tr>
<tr>
<td>Schleswig-Holstein</td>
<td>100.3</td>
<td>100.2</td>
<td>0</td>
</tr>
<tr>
<td>Hamburg</td>
<td>109.8</td>
<td>103.5</td>
<td>-6,315,000,000</td>
</tr>
<tr>
<td>Lower Saxony</td>
<td>93.8</td>
<td>99.6</td>
<td>+1,967,000,000</td>
</tr>
<tr>
<td>Rhineland-Palatinate</td>
<td>93.4</td>
<td>99.6</td>
<td>+1,078,000,000</td>
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<tr>
<td>Saarland</td>
<td>90.1</td>
<td>99.5</td>
<td>+437,000,000</td>
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<td>Bremen</td>
<td>71.8</td>
<td>99.6</td>
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<tr>
<td>Saxony</td>
<td>84.7</td>
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<td>Saxony-Anhalt</td>
<td>84.6</td>
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<td>+1,725,000,000</td>
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<td>Thuringia</td>
<td>84.1</td>
<td>99.5</td>
<td>+1,637,000,000</td>
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<tr>
<td>Brandenburg</td>
<td>85.6</td>
<td>99.5</td>
<td>+1,539,000,000</td>
</tr>
<tr>
<td>Meck.-Western Pomerania</td>
<td>83.7</td>
<td>99.5</td>
<td>+1,224,000,000</td>
</tr>
<tr>
<td>Berlin</td>
<td>79.1</td>
<td>99.5</td>
<td>+5,770,000,000</td>
</tr>
</tbody>
</table>

gap between rich and poor states increased (with the inclusion of the EastEast states), the amount of redistribution increased.

As Table 4 shows, the division of interests between the four "contributor" states to the horizontal redistribution system (North Rhine-Westphalia, Bavaria, Baden-Württemberg, and Hesse) and the twelve "recipient" states is unmistakable. In the face of an economic slowdown where tax revenues in the rich states started to diminish and in the face of a regional economic divide that demands increased regional redistribution from those same rich states, it would be unrealistic to think that the political leaders of rich states would not react. As one CSU official admitted, "It utopia, we (Bavaria) would like to not have to contribute to the equalization system at all" (Interview, CSU Landgruppe, February 2000). Or, put in even harsher terms by an official in the Hesse Finance Ministry, "When it comes right down to it, when we trade (in Hesse) as much as we do with Italy, France, and the United States, we really do not need Mecklenburg-Western Pomerania" (Interview, Hesse Finanzministerium, November 1, 1999). In short, an economically compelling but politically divisive logic underpins the effort to regionalize public finance.

But in the context of careful and delicate negotiations between state elites such proposals to decentralize are viewed as "unnecessary" and in fact, according to officials in the Staatskanzlei of North Rhine-Westphalia, counter-productive (Interview, North Rhine-Westphalia Staatskanzlei, May 16, 2000). As can be seen with the main three proposals up for discussion in the late 1990s negotiations are more cautious in tone: 1) the elimination of the Gemeinschaftsaufgaben, 2) the granting of state's ability to set

their own taxes. 3) the reduction in the amount that states are forced to contribute to the system of Ländersolidarität. Yet, along all these dimensions state interests were drawn clearly: the four states that contributed to the system of financial equalisation (SPD-governed North Rhine-Westphalia, CDU-governed Baden-Württemberg, CDU-governed Bavaria, and SPD-governed Hessia) favored reducing financial equalisation and all other states were opposed. With regards to tax autonomy, the richest states were in favor of it and the poorest states were against it. And with regards to the last issue – the elimination of the Gemeinschaftsaufgaben (Federal intervention in areas of state jurisdiction), the rich states favor it and the poor states are at best ambivalent, afraid that the curbing of federal funding means leaving poor states to fend for themselves. 29

In the face of this constellation of interests, the first efforts at change were made through the regional elite negotiations of the Minister-President Conference. In December of 1998 at their meeting with the Federal Chancellor, the Minister Presidents agreed to begin doing preparatory work on the three public finance issues. The negotiations remained relatively secretive and away from public scrutiny. But achieving their goals of reform looked slim given the fact that twelve states were opposed to the main concepts of reform.

As a result of the apparent opposition from the twelve "receiver" states, during the course of 1998, Minister President Stoiber and his cabinet met in a series of "joint cabinet meetings" with the CDU-governed state governments of Baden-Württemberg, Saxony, and Thuringia with the aim of finding a wider coalition of "like-minded" politicians from poorer "Eastern" states. Unlike the broader Minister-President Conference where SPD and CDU governoes met, these meetings between CDU Minister-President were more clearly partisan in tone. In these informal "regional" meetings, that are also never open to the press or to the public, the leaders of each of the CDU/CSU governed states discuss common issues of concern and possible areas of cooperation (Interview, Bavarian Staatskanzlei, March 20, 2000). While the meetings are often symbolic affairs, in the Spring of 1998, the Bavarian government came to the table with a series of proposals in their meetings with the three CDU state governments. In each of these meetings, the Bavarian government proposed its agenda of "competitive federalism", discussed its plans of possibly filing a case before the Constitutional Court regarding the current system of Ländersolidarität, and outlined plans that the four "Southern" states release a joint statement calling for the reform of federalism. The Bavarian government surprisingly found sympathetic listeners in all three of the state governments — including the two "Eastern" states of Saxony and Thuringia.

29 This summary of positions on the three main issues in the public finance debate is based on interviews in the Staatskanzlei of North Rhine-Westphalia and Saxony-Anhalt and formalized positions in the Landtag/Parlaments of debates in 1999 in Thuringia, Hesse, and Hamburg. Additionally, the high profile March 2000 proposal of the "East Minister Presidents" for the extension of the Solidarity Pact that is to expire in 2003 was viewed by its authors as a strategic defensive response to the effort of rich states to cut funds to poor states. Interview, Staatskanzlei, Saxony-Anhalt, April 6, 2000.
For Stoder and his staff, the addition of two Eastern states to their side would have been a major strategic coup for two main reasons. First, to gain two extra states on the side of decentralization would strengthen the Bavarian hand in the Bundesrat by increasing the number of seats on their side for future legislative efforts. Second, and even more importantly, the joining of two Eastern states to its cause would help prove the Bavarian contention that "competitive federalism" was not a case of a Western backlash against the East (Interview, Bavarian Staatskanzlei, March 20, 2000). Additionally, a joint statement of intent to reform federalism by the four "Southern" CDU/CSU governed states (cutting across Eastern and Western Germany) would have had the potential of offering an alternative north-south conceptual map of regional politics in Germany so the dominant east-west post-unification vision of German politics. Indeed, since 1990, political leaders in Saxony, Thuringia, and to a greater extent Bavaria have pointed to a small regional economic inequality along the north-south dimension within Eastern Germany to try to make the case that a new "North-South" divide now cuts across and will soon replace the cold-war created "East-West" divide in German politics. A commitment from two of the five Eastern states to cut public finance money to poorer states would represent a serious conceptual shift in post-unification German politics.

The inconvenience, however, of real economic and political interest interfered with these plans. After a series of negotiations, the shadow of the upcoming 1999 regional elections in Saxony and Thuringia began to appear and the CDU-led governments in both states gained in pragmatism and lost enthusiasm. According to two different participants in the negotiations, the CDU-led Eastern governments feared, above all, election-time recriminations from the FDP that the Eastern CDU governments had "sold out" Eastern interests to the rich Bavarians (Interview, Bavarian Staatskanzlei, March 20, 2000; Sazonov, Staatskanzlei, November 23, 1999). As a critical test of the strength of the east-west divide, it was clear in 1998-1999 that even the most well-off Eastern state governments still, in the end, identified themselves as "Eastern". On their own, the Bavarian and Baden-Wuerttemberg governments wish no hope of finding a consensus to even push the discussion along in the wider Minister President Conference, finally filed a petition before the Constitutional Court in 1999. Their aim was to have the constitutionality of the current system examined: after presentations before the Court in the Fall of 1999 a decision was made and all the Minister Presidents are currently back at the table seeking, in short of course, to hammer out a consensus on the three public finance issues.

The fate of these negotiations finally became clear in the Summer 2001 Minister President Conference. After the Minister Presidents met in Wiesbaden in March, and after having defeated legislation from the Federal government at the end of April, the Minister Presidents met again in Berlin, June 21-23, 2001 where a consensus had to be found. Without a consensus, the three "coasting" states of Germany's South, Bavaria, Baden-Wuerttemberg, and Hesse had discussed the possibility of filing another case before the Constitutional Court (Interview, Bavarian Staatskanzlei, June 12, 2001). But such a move was not necessary. In the June meeting, the negotiations proceeded in the following manner: the three Southern states who had originally entered the negotiations with a proposal for a much larger reduction in "horizontal" redistribut...
The previous discussion of the political fate of the policy ideas of "competitive federalism" as they were translated into concrete policy proposals highlights the moderating influence of political structure in Germany on the idea of fiscal decentralization. But how, precisely, do the institutions of German federalism constrain efforts at fiscal decentralization? Isn’t it possible, as some have argued, that efforts at fiscal decentralization fail not because of state institutions but because of the configuration of interests in Germany? If a majority of states are “receiver” states and only a minority are “donor” states, then the argument runs, aren’t structural preconditions and not institutions, the determinants of the success or failure of policy reform? The following section disputes such interests-based accounts by pulling together the lessons of the previous section to argue that it is only because of the institutions of the Bundesrat, which gives the states a “seat” at the table of national legislation, that the constitution of regional interests can constrain all proposals and all legislation that in the short-term leaves poorer states worse off than they presently are. This last section offers a systematic presentation of three formal and institutional features of German federalism – centered around the institution of the Bundesrat – that have made the adoption of fiscal decentralization so difficult in Germany since 1990.

First, at the most formal level of institutional organization, in historical and comparative terms, German federalism distinguishes itself from all other unitary and federal systems in Europe with an unprecedented and highly unusual institutional anomaly: the member states or regional governments of the nation state have an officially sanctioned “seat” at the table in all legislative decisions of the central state (Scharpf 30).

30 It should of course be noted that most proposed changes are on the way. The Bavarian government, along with the more Southern German CDU allies, has filed a new case in July 2001 before the Constitutional Court calling for the reform of the public health (VOG) redistribution system between states. Also, according to officials in the Bavarian Staatskanzlei, they plan to pursue the issue of the decentralization of competencies in Fall of 2001 (Interview, Bavarian Staatskanzlei, June 12, 2001).
1989). In other words, in all political decisions of the federal government the member states or "regional interests" sit along side and compete for their own agendas along-side the political parties and interest groups that normally participate in the decision-making process of all other countries.

In more concrete terms, the "territorial interest" of member state governments is represented in the second national parliamentary chamber. Each state's Minister President and several other officials from the each state's governor's office constitute the sixty-nine members of the Bundesrat (Lauffer/Münch 1998: 143-158). This is an important contrast to the structures of second parliamentary chambers in all other European states that are constituted according to the "Senate principle" of either direct election by the population, the selection according to the level of party-support in member-state assemblies or direct selection by regional assemblies. In these three latter structures, party competition dominates the legislative debates while in the German system the interests of state governments -- often cutting across party lines -- structure debate in the second parliamentary body (Schäfer 1989: 128). In contrast to upper houses in countries such as Austria and Belgium, in Germany there is a higher degree of representation for small states, and a lower degree of representation for more populous states. Smaller states have more of a say than they might in other countries. All large states have six seats, intermediate size states have four seats, and all small states have three seats. As a consequence, the four large states that are "dono" states in the "horizontal" fiscal equalization system -- Hesse, Baden-Württemberg, Bavaria, and North Rhine-Westphalia -- have together only 23 of the 69 seats in the Bundesrat, making the possibility of reaching a majority for a dramatic policy change quite limited.31 When one assesses the element of party competition into the equation, which cut across the rich and poor states, the possibility of finding a majority coalition of states to cut back on regional redistribution looks even more bleak. Though some political scientists who begin with a majoritarian conception of democracy have criticized such "territorialized" federal systems as "demons-constraining", this "territorial" representation allows the regional voice to be heard in Germany, gives regional political elites a stake in the national level, and can explain why issues of regional redistribution become subject to careful compromise in the Bundesrat (Strojan 1999). In order to pursue a legislative agenda at the national level, the Bavarian government and the governments of other rich states frequently must take part in bargaining, compromise, and "log-rolling" between the states within the Bundesrat. All of this, at purely the formal level, requires a cautiousness that can explain why members of the CSU began in 1998-1999 to regard the plan of "regionalizing" social insurance as "politically too costly". In short, the formal institutionalization of territorial interests at the central level of decision -- in stark contrast to Italy for example -- takes us a first step in explaining why proposals of fiscal decentralization find such political trouble in Germany.

A second and informal feature of Germany's federal system additionally contributes to the pattern of regional compromise in Germany. All formal institutions, as students

31 It is interesting to note that just the five former East German states together also have 23 seats, the same number as the four Southern "rich" states. This discussion of the Bundesrat comes from Bundestag (1999).
of organization theory have taught us, contain informal features. The critical question is whether these informal patterns of behavior—that is, patterns of behavior that are not governed by strict, written rules—reinforce or undercut the aims of the formal institutions. In the case of the formal institution of the Bundesrat, a set of informal Fach ("expert") conferences have developed around the Bundesrat that serve to reinforce the cooperative and pragmatic problem-solving aims of the Bundesrat. Since significant German federal legislation often has its roots in the Bundesrat (the upper house of the German parliament that is constituted by the heads of the state governments), such conferences of Minister Presidents and their governments are often the earliest site of legislative proposals. The bi-annual meetings of the Minister Presidents of the sixteen states, the Finance Ministers of the sixteen states, and the Cultural Ministers of the sixteen states have a long tradition of self-organization in German history going back as far as the Bismarckian Reich. In that period the central aim was to guarantee a consensus of the regional political elites before they entered the formal legislative arena of the Bundesrat and in order to allow the states to speak "with one voice" vis-à-vis the national government.32

Today, the motivations are similar. But more importantly, the aim of the Minister President Conference is to allow for an insulated and thoughtful discussion among political elites away from the broad and divisive social pressures that in a regionally-divided society lead to political "polarizing" and symbolism when legislative debate is carried out in an exposed environment. In short, the underlying idea today is that deliberation and debate on sensitive issues is more effectively carried out in a secretive political arena, all of which results in the fact that a premium is placed on cooperation and compromise.

A third "cultural" feature of German federalism anchored in the institutions of the Bundesrat and the Minister President Conference is what Fritz Scharpf (1989) has called the "consensus-seeking" culture of the Bundesrat. Likewise, Gerhard Lehmbrock (1998) has identified the "behavioral norm" of "cooperation" that dominates political negotiations in the "arena" of the Bundesrat. Lehmbrock identifies this cultural attribute of German democracy as a historically-based outcome of German experiences with negotiation and compromise going back as far as the Peace of Westphalia. The historical accuracy of this claim is beyond the scope of this paper. But, what is critical for my argument is Lehmbrock's claim that an unwritten rule of conflict resolution dominates political life in Bundesrat; all decisions must be acceptable to all participants. In the context of discussions over the redistribution of resources via social insurance and public finance from rich to poor such an unwritten rule serves as an important constraint on the revolt of rich regions.

Taken together, these formal, informal, and cultural features of German federalism have created an institutional framework in which regional political elites, despite a wide range of interests, can negotiate the terms of regional redistribution among themselves, out of the limelight of media attention, political pressure groups, and voters. In short, the existence of the Bundesrat and its institutional organization in which all

32 For a historical account of the "self-organization" of the Minister President going back to the Bismarckian period as well as a thorough bibliographical listing, see Lehmbrock (1998).
states have a "vest" at the table of national legislation allows for the articulation of regional interests in national legislation and has generated a mode of (1) elite negotiated territorial integration that (2) places a premium on consensus, cooperation, and compromise, (3) that requires a consensus among the state Minister President for any important legislation, and (4) which prevents the emergence of legislation that leaves any poor state worse than it is under the current system.

To summarize my argument: Given the current state of German federalism, the constellation of interests and institutions in the German federal system works on two levels to constrain the impact of the ideas of fiscal decentralization: First, German political institutions contain within them formal and informal "veils" that constrain policy proposals from being adopted that would leave the poorer states worse off than they presently are. Second, more profoundly, the constellation of interests and institutions in Germany constrain some more decentralizing proposals — e.g., regionalizing social insurance — from even being seriously made because of the "political unfeasibility" of such proposals. Both of these arguments make clear that in the German context the agenda of fiscal decentralization itself has come to be viewed by political leaders in poorer states in Germany as a profound challenge to political stability, as an instance of rich regions seeking to "steal" or at least "punish" from the redistributive underpinnings of the nation state (Interview Saxony-Anhalt Staatskanzlei, April 6, 2000). If such a view is correct, this sheds new light on the criticisms that have been leveled against German federalism in recent years — e.g., that it is a system that generates an "inefficient" redistribution of resources, that it creates overlapping and inflexible bureaucracies, and that it results in a set of institutional "joint-decision making traps" that prevent economic and political "modernization". Perhaps it is precisely these criticized institutions that have so effectively kept the rich in the national bargain in the face of the challenges of German unification. Germany's federal institutions may often rightly or wrongly be blamed for economic problems in Germany in the 1990s, but they should also be given their due credit for facilitating and easing Germany's improbable and historically unprecedented post-Cold War project of national unification.


Despite the broad rhetoric of reform, the critical juncture of German unification in 1990 did not provide an opportunity for a fundamental rectifying of German federalism. Instead, national political institutions continue to constrain efforts at reform of Germany's federal institutions. But, does this mean that all reform efforts will continue to confront the nationally-embedded formal, informal, and cultural restraints outlined in this paper? Do German political institutions persist without ever "softening up"? Isn't it possible future decentralizing reform efforts might be easier as a result of past reform efforts?

In fact, a new set of unexpected external forces have emerged since European Monetary Unification (EMU) in 1999 that may in fact provide a new critical juncture that

could result in a fundamental reshuffling of German federalism. But, instead of guaranteeing further decentralization, two possible but alternative future scenarios for German federalism exist. Both scenarios are rooted in requirements of the "convergence criteria" that form the cornerstone of the European Union’s Stability and Growth Pact, passed at the Amsterdam Summit of June 1997. Since no EMU member may exceed a total annual public deficit greater than 3% of national GDP or total public debt greater than 60% of national GDP, a new restraint exerts itself on Germany’s federal system. In the winter of 2001-2002, Germany confronted expanding budget deficits, at all levels of government, leading Germany precariously close to the 3% threshold set by the Stability Pact. Though German Federal Finance Minister Hans Eichel guaranteed his European partners in early 2002 that Germany will achieve a balanced budget in 2004, this is only possible if the federal government is able to exert some control over budget deficits at the Land level of government. Put in other terms, the European Monetary Union has provided an impetus for a transformation of German federalism in which the federal government can maintain greater control over expenditures at all levels of government. But, how is this to be achieved in Germany where German Land governments possess a constitutionally-protected right to set their own expenditures (Article 109, Federal Constitution)? It is precisely out of this tension between the requirements of the EMU and the German Grundgesetz that two alternative scenarios emerge: a scenario of increased competition or a scenario of renewed cooperation. The first scenario involves the unleashing of a renewed decentralization impulse onto German fiscal federalism. Such a future would be likely if the only way to assure budgetary discipline at all levels of government were the negotiation of a set of agreements with the state governments of Germany that would involve the passing of greater taxing and spending autonomy onto the German states in exchange for greater fiscal discipline. If this scenario were to come to pass, then the advocates of "competitive federalism" might find themselves with a rapid victory of their vision from an unlikely and unexpected source: the requirements imposed by the European Monetary Union. Alternatively, a second, and more likely institutionally-grounded scenario for the future, is one that focuses on the means by which a Bund-Land settlement would be achieved to assure budgetary discipline in Germany. From this perspective, any negotiation between Bund and state governments would inevitably involve increased federal and state coordination and cooperation to assure that Germany not exceed the 3% budget deficit threshold. Any such coordination would require a vigorous recommitment to cooperative federalism resulting in a push to re-centralize fiscal policy away from the regional level to the national level. In this scenario, the only way in which state spending autonomy remains viable is through a continuation of the traditions of cooperative federalism in which direct federal fiscal intervention is used to sustain German federalism. The future contours of German federalism have survived German unification, yet now confront the challenge of European Monetary Unification. Whichever path of reform German federalism takes, the decisive point for analysis is the discussion of German federalism must now move away from a singular focus on domestic political dynamics and towards a frame of reference that incorporates the intersection of European-level and domestic economic and political considerations. It is out of the cross
pressures of European Union fiscal requirements and the historically-embedded national institutions and practices of contemporary German federalism that a future German federalism will be negotiated and begin to take its shape.

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