INFORME

THE RECENT REFORM OF THE FISCAL EQUALIZATION SCHEME – AN UNPOPULAR REFORM WITH SERIOUS IMPACTS FOR GERMANY'S FEDERAL ARCHITECTURE

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ABSTRACT
After more than eight years of negotiations, the federal government ("Bund") and the states ("*Länder*") decided in July 2017 on the most recent reform of the fiscal equalization system. With the reform, far-reaching interventions were made in the existing fiscal equalization scheme. However, Bund and *Länder* missed an opportunity to strengthen the financial power of the states and municipalities in the long term. Therefore, many observers expect that the financial equalization scheme will be called into question again by the donor states shortly after its entry into force on 1 January 2020.

RESUMEN
Después de más de ocho años de negociaciones, el gobierno federal („*Bund*") y los estados („*Länder*") acordaron en julio de 2017 la reforma más reciente del sistema de nivelación fiscal. La reforma prevé cambios de gran alcance en el esquema de la nivelación fiscal existente. Sin embargo, el Bund y los *Länder* perdieron una oportunidad de fortalecer el poder financiero de los *Länder* y municipios a largo plazo. Por lo tanto, muchos observadores esperan que los *Länder* "donantes" vuelvan a cuestionar el plan de estabilización financiera poco después de su entrada en vigor el 1 de enero de 2020.

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I. INTRODUCTION

After more than eight years of negotiations, the federal government ("*Bund*") and the states ("*Länder*") decided in July 2017 on the most recent reform of the fiscal equalization system. Almost a year earlier, on 14 October 2016, the federal and states' governments had already agreed on a fundamental reform compromise. However, the corresponding legislative process could not be initiated until 14 December 2016, when a cabinet draft was submitted to parliament. A draft bill from the Federal Ministry of Finance (BMF) had previously led to massive objections from the states and the municipal umbrella associations with the effect that a further marathon of negotiations between the two jurisdictional levels of government was necessary. However, there were still considerable concerns from various *Länder* after that date. The legislative process in summer 2017 was therefore shaped by tough negotiations in which amendments to the draft bill have been made until the last minute. With the reform, the now deselected Grand Coalition under German Chancellor Angela Merkel (CDU) and Federal Finance Minister Schäuble (CDU) wanted to demonstrate their ability to act shortly before the federal elections in September 2017.

With the reform, far-reaching interventions were made in the existing fiscal equalization scheme. Both chambers of parliament, *Bundestag* and *Bundesrat*, approved 13 amendments to the Basic Law ("Grundgesetz") with the necessary two-thirds majority and 23 modifications of individual laws. The extent of these changes is one of the remarkable differences between the most recent reform and previous negotiation processes of this kind, which resulted only in the revision of the simple Fiscal Equalization Act ("Finanzausgleichsgesetz" – FAG) at the end. Without a "settlement amount" from the federal government of 9.52 billion euros (nominal) and 4.09 billion euros (real), however, the states would not have been able to agree on the reform. The compensatory and relief effects that have now been decided upon, to which the donor states in particular had pushed, can be interpreted essentially as a cementation of the current financial power relations between the *Länder*. In doing so, *Bund* and *Länder* missed an opportunity to strengthen the financial power of the states and municipalities in the long term. Therefore, many observers expect that the financial equalization scheme will be called into question again by the donor states shortly after its entry into force on 1 January 2020 (Scheller 2005). In addition, the federal government appears to be increasingly becoming a "guarantor of default" ("Ausfallbürge"), which has to balance the growing fiscal disparities at the level of the federal states and the municipalities with *additional* money (Korioth 2017). In return for the provision of additional funds, however, the Bund is increasingly securing competences from the *Länder's* original area of responsibility. The reason for this is – as it was already the case within the debates about the Federalism Reform I and II (2006 and 2009) – an alleged increase in the efficiency of task fulfilment and financial distribution in the Federal Republic. Instead of strengthening the general financial power of the states and municipalities, output-oriented impact management is becoming increasingly important for the finance and budgetary policy.

The changes to the constitution and the revision of different individual laws that have now been made contain various legal and semantic inconsistencies and contradictions. It is not for nothing that many academics voiced sharp criticism of the emerging reform considerations throughout the entire negotiation process as well as in several public hearings in the *Bundestag* (for an overview: Junkernheinrich; Korioth; Lenk; Scheller; Woisin 2016; Henneke 2017). What is even more remarkable, however, is that the politically involved actors themselves are in some cases very critical of the reform. Besides, to the members of the *Bundestag*, the Finance Committee of the Federal Council ("Bundesrat"), the Federal Minister of Finance and high-ranking officials of the ministry also expressed a lack of understanding of how the states acted throughout the reform process. Even the Federal President expressed fundamental doubts about a central point

of the reform in the formal engrossment of the law. Many observers are concerned about the increasing self-disempowerment of the *Länder*. In the medium and long term, the increase of the Bund's competences could lead to a further centralization and erosion of German federalism.

II. THE SYSTEM IN PLACE UNTIL 2019

The fiscal equalisation system has to be understood as a part of a three-pillar architecture of the German fiscal constitution. The first pillar is formed by the rules for the tax distribution, which were stated in Article 106 and 107 of the Basic Law. They serve to guarantee the basic financial equipment of the *Bund* and the *Länder*. Further, the fiscal equalisation system (second pillar) serves to adjust the extreme disparities between the states. Both pillars together are supposed to guarantee "a finance equipment which is suitable to fulfil the legally standardized tasks" ("aufgabengerechte Finanzausstattung") of the *Bund* and the *Länder*. The third pillar provides in Article 109 and 115 of the Basic Law the possibility that the *Bund* and the *Länder* could go into debt under specific conditions.

The fiscal equalisation system itself is a four-stage system that is build up by two vertical and two horizontal components. The Basic Law makes clear, that the equalisation system is intrinsically tied to the tax system: In the first stage, the entire tax revenue is distributed between the *Bund* and the *Länder*. The municipalities also receive a defined share of some particular tax revenues. This process has some vertical distribution effects. In the second stage, a part of the VAT-*Länder*-share is distributed among the *Länder*, which has a horizontal distribution effect ("Umsatzsteuervorwegausgleich"). The third stage serves as an equalisation between the financially weaker and stronger states. This component is the primary horizontal equalisation mechanism among the *Länder* or the "fiscal equalization in the narrow sense" ("Länderfinanzausgleich im engeren Sinne") and it seems to be unique from an international comparative perspective (Jeffery 2003). After these first three stages of equalization, poor *Länder* can receive additional funds from the *Bund* – the so-called supplementary federal grants ("Bundesergänzungszuweisungen"). In sum the federal fiscal equalisation system ensures that fiscally weak states get adequate financial resources to fulfil their legal obligations. The adjustment of the revenues of the *Länder* is intended to create and maintain "comparable living conditions" ("Einheitlichkeit der Lebensverhältnisse") for the entire population in all German *Länder* – as stipulated in Article 106 para. 3 BL.

The Federal Constitutional Court ("Bundesverfassungsgericht") has pointed out in the past, that the fiscal equalisation system cannot be understood merely as a "soft law", which can easily be changed by the legislator. The constitutional rank of the regulations actually demands a majority of two-thirds of the *Bundestag* and the *Bundesrat*. In addition, it is not feasible to change the order of the stages. The fiscal equalisation among the *Länder* is legally not allowed to undermine the fiscal autonomy and sovereignty of the *Länder*.

The Basic Law jointly allocates the income tax, the corporate tax and the VAT to the *Bund*, the *Länder* and, to a degree, to the municipalities. Therefore, these taxes are referred to as "joint taxes" ("Gemeinschaftssteuern"). These types of taxes generate by far the largest share of the complete tax revenues in Germany – in 2016 around 79.7 % or 516.4 billion euros (from around 648.3 billion euro totally) (Bundesministerium der Finanzen 2017(a): 40). According to the Constitution, neither the *Bund* nor the states or the municipalities are entitled to the full amount of the entire revenue of these single taxes types. The *Bund* receives 42.5% of the income tax, 50% of the corporate tax and around 55% of the VAT. The *Länder* are entitled to receive 42.5% of the income tax,

50% of the corporation tax and around 43% of the VAT. At present, the municipalities get 15% of the income tax and around 2% of the VAT. The *Bund* receives all of the revenue from the federal taxes, the majority of the excise taxes (on mineral oil, tobacco, coffee, electricity and the insurance tax). The states get all revenues from the *Länder* taxes, the inheritance tax, most types of transactions taxes (particular, the real property transfer tax) and some other types of taxes that generate small amounts of revenue. The municipalities receive the revenue from the trade tax, the real property tax and the local excise taxes. The tax revenue belonging to the *Länder* as a whole is distributed among the individual *Länder*. Apart from the VAT, the individual *Länder* are entitled, in principle, to the tax revenue, which is collected by the tax authorities on their territory ("principle of local revenue"). By contrast, 75% of the *Länder*-share of the VAT is distributed according to the number of inhabitants. The other part of the *Länder*-share of the VAT, but not more than 25%, is used as a supplementary portion for those *Länder* whose revenues from the income tax, the corporation tax and the *Länder* taxes per capita are lower than the per capita average of all *Länder*. Thus, the distribution of the VAT is the second stage of the fiscal equalisation system, because the purpose and effect of this horizontal equalisation is to adjust the disparities in the tax receipts of the different *Länder*. It considerably increases the amount of tax revenue that financially weaker *Länder* like the Eastern German states receive. The significance of this stage of the fiscal equalisation system is obvious in so far that this mechanism already guaranteed the redistribution of around 8.3 billion euros between the financially stronger and weaker states in 2016. These are more than one third of the about 28.8 billion euros altogether, which are redistributed within the whole transfer and compensation system (Bundesministerium der Finanzen 2017: 40).

The third stage of the transfer system, the system of horizontal fiscal equalisation in the narrow sense, should further reduce the fiscal disparities among the *Länder*. Therefore, the fiscally weaker states receive adjustments of the stronger ones. These payments have to be funded from the income overhead, which lies above the per capita average of the financial power of these *Länder*. The Federal Constitutional Court has emphasized that the income differences among the states should only be reduced, not completely compensated (BVerfGE 72, 330 (398); BVerfGE 1, 117 (131) and BVerfGE 101, 158 (222)). The starting point for the financial equalisation among the states is a comparison of the fiscal power per capita of all 16 *Länder*. The fiscal power of a Land is the sum of its own income and 64% of the revenue of its municipalities. In principle, the system of horizontal fiscal equalisation assumes that the financial requirements per inhabitant are the same in all the states. Only the *Länder* Berlin, Bremen and Hamburg, the so called "city-states", make an exception, because they are simultaneously both cities and states in their own right. All statistics show that they have much higher financial requirements per inhabitant than the other *Länder*. Therefore, their populations are notionally up-graded by 35%. The *Länder* Brandenburg, Mecklenburg-Western Pomerania and Saxony-Anhalt, which are populated very sparsely, also have a slightly higher financial requirement per inhabitant. Their populations are therefore slightly increased for financial equalisation purposes. The concrete sum of the transfers to the fiscally weaker *Länder* depends on the amount by which their financial power per (fictitious) inhabitant lies below the average financial capacity per inhabitant. The difference from the average is aligned partially, but not completely. With the horizontal equalisation, the poor *Länder* should align on a level around 95% of the per capita average of all *Länder*. Yet, the regulations are designed in a way that should maintain the order of the *Länder*, in terms of financial power per inhabitant.. The Federal Constitutional Court forbade a change of the states' order of financial power explicitly. In 2016 there were be in sum about 10.6 billion euro redistributed between the financially stronger and weaker states in the third stage of the fiscal equalisation system – the fiscal equalization in the narrow sense (Bundesministerium der Finanzen 2009: 40).

In the fourth stage of the fiscal equalisation system the *Bund* provides so called supplementary federal grants ("Bundesergänzungszuweisungen") to the poor states to complement the fiscal equalisation among the *Länder*. There are two different kinds': general supplementary federal grants without any conditions and supplementary federal grants for special needs. General supplementary federal grants serve to further reduce the gap between the average financial power per (fictitious) inhabitant of the financially weaker and stronger *Länder*, which still remains after the fiscal equalisation among the *Länder*. General supplementary federal grants are supporting the states whose financial power per inhabitant, after financial equalisation among the *Länder*, is less than 99.5% of average financial power per inhabitant. The shortfall is made up proportionally. In 2016 the *Bund* granted about 4.3 billion euros to eleven *Länder* (ibid: 40).

Besides, supplementary federal grants for special needs to the *Länder* ("Sonderbedarfs-Bundesergänzungszuweisungen") compensate the special burdens, which individual poor states have to bear. They form a part of the "Solidarity Pact II" ("Solidarpakt II"), which is intended to rectify the consequences of Germany's division. Currently, the Eastern German *Länder* and Berlin receive special-need supplementary federal grants to build up their infrastructure, which is still comparatively underdeveloped: a remnant of the German division. Additionally, they compensate for the disproportionately weak financial power of their municipalities. In 2016, these funds amounted to a total of 5.6 billion euros annually and were therefore extremely important to the *Länder* receiving them. These supplementary federal grants for special needs will gradually be phased out by 2019. In addition, the Eastern German *Länder* receive supplementary federal grants to compensate for the special burdens placed on them by structural unemployment. And last but not least, small, poor *Länder* receive special-need supplementary grants, amounting to around 517 million euros annually, to make up for their above-average administrative costs (Bundesministerium der Finanzen 2016: 40).

III. KEY ELEMENTS OF THE RECENT REFORM

In future, the "new" fiscal equalisation scheme is to be implemented in only three – rather than four – stages: (1.) the general tax distribution between the *Bund* and the *Länder*; (2.) the revenue distribution of the *Länder*'s VAT share, which will be calculated by means of surcharges and deductions from the respective financial power in order to ensure appropriate compensation, and (3.) the supplementary federal grants ("Bundesergänzungszuweisungen"). The previous revenue distribution of the *Länder*'s VAT share as well as the "fiscal equalization in the narrow sense" – and thus the two horizontal elements, which belonged to the special features of the German system – will be abolished. The distribution of the VAT is now to be based entirely on the number of inhabitants. When calculating the financial power of the *Länder*, 75 percent of municipalities' financial power is taken into account from 2020 onwards – so far only 64 percent have been taken into account, since the donor states have always opposed the complete inclusion of their cities' and municipalities' financial power. Since the municipalities in southern Germany (Bavaria, Baden-Württemberg and Hesse) usually have significantly higher tax revenues, including their full financial power in the calculation of the financial equalisation system would place an even greater burden on the donor states. The increased inclusion of municipal financial power and the distribution of the VAT according to the number of inhabitants will have an impact on the municipalities, as the federal fiscal equalisation scheme has always been closely linked to the municipal fiscal equalisation systems of the *Länder* (KFA). The ratio of allocations from the "compulsory" and "optional tax revenue sharing system" ("fakultativer" und "optionaler Steuerverbund") in the municipal fiscal equalisation systems will change. How this actually affects the individual municipalities depends on the specific design of the KFA in the respective *Länder*.

The abolition of the fiscal equalisation in the narrow sense strengthens the vertical compensation mechanisms in the system. The upgrading of the supplementary federal grants, which is now being sought, will thus favour the "verticalization" of the entire system. This is because the degree of compensation for the general supplementary federal grants (formerly § 11 para. 2 FAG) will be increased. The federal states, whose financial power is still below the average after fiscal equalization, will then reach 99.75 percent (previously 99.5 percent). It is true that the "Solidarity Pact II" ("Solidarpakt II") will no longer be continued for the eastern German states and their municipalities ("Supplementary federal grants for special needs due to the German division") from 2020 onwards. However, two new compensatory measures will be introduced at the same time, in order to equalise the still considerable disparities in financial power between the *Länder*.

Financially weak *Länder* whose municipalities have a particularly low financial power can thus receive "municipal tax power allocations" ("Gemeindesteuerkraftzuweisungen") (BR-Drucksache 969/16). This would be the first time that an instrument would be anchored in the financial equalisation system, which is based on the municipal tax power and which will primarily take account of Eastern German municipalities. The municipalities will not benefit directly from these provisions, since there cannot be direct financial relations between the federal government and municipalities in the German federal state. These allocations will therefore be channelled to the *Länder*, which have to decide autonomously how they pass them on to the municipalities. However, this new type of supplementary federal grants recognises that there is a fiscal imbalance not only in the "family of municipalities", but also in the German multi-level system as a whole: since some of the federal states are apparently no longer able to provide sufficient financial resources for their own municipalities, the *Bund* must step in. However, concrete financial needs of the municipalities are not taken into account.

In addition, financially weak *Länder* may receive further supplementary federal grants "whose shares of the subsidies under Article 91b are less than their population shares" (own translation). This extremely questionable new regulation links two systems of rules of the German financial constitution, which have been kept strictly separate from each other up to now – partly because of their constitutional status. On the one hand, there has always been a financial equalisation scheme between the *Bund* and the *Länder* in order to strengthen the financial power of the *Länder* in a general and demand-independent way (Article 106 and 107 BL). On the other hand, the constitution contains mixed financing instruments – particularly the so-called "joint tasks" ("Gemeinschaftsaufgaben") for the targeted and strictly limited promotion of investments by the *Länder*, which were of supraregional importance (Article 91a – c BL). For example, Article 91b BL is stipulating: "(1) The Federation and the *Länder* may cooperate on the basis of agreements in cases of supraregional importance in the promotion of sciences, research and teaching. Agreements primarily affecting institutions of higher education shall require the consent of all the *Länder*. This provision shall not apply to agreements regarding the construction of research facilities, including large scientific installations." For years, the "joint tasks" of the Basic Law have been controversial. The new regulation now provides a questionable link between two systems of rules of the financial constitution, which contradict the different intentions of the respective mechanisms. By the new regulation of Article 107 (2) of the Basic Law the objectives of these two instruments of the fiscal constitution, which were clearly separated conceived by the Basic Law-Makers, are now being counteracted and led ad absurdum. In order to avoid a financial disadvantage of individual states in the annual calculations of the financial equalisation, it is assumed that there is a general funding need for research institutions in the individual *Länder* based on their inhabitants. This created a questionable state of affairs in the otherwise demand-neutral financial equalisation

scheme. The compensation system is thus reduced to the correction mechanism of the earmarked allocation system for research funding.

In the future, none of the supplementary federal grants will be distributed on a diminishing scale, as it is envisaged in the existing system with a phasing-out until the end of 2019. This is simply necessary because of the fundamental decision to abolish the distribution of the *Länder*'s VAT share and the fiscal equalization in the narrow sense, which requires that, in future, a considerably higher proportion of the compensation has to be settled via the vertical instrument of supplementary federal grants. This is the only way to maintain the current level of equalization from 2020 onwards – an inescapable demand that the recipient states had formulated from the beginning of the negotiations. The fiscal principle on a diminishing scale had been introduced in the last negotiations about a reform of the financial equalisation system as a concession to the donor states. The background were demands from the academia to avoid alleged false incentives through "permanent financial assistance" for the financially weaker *Länder*.

IV. SUPPLEMENTARY REFORM ELEMENTS WITH SERIOUS IMPACTS

The most recent reform of the fiscal equalisation system consists of thirteen amendments to the Basic Law and the modification of 23 federal laws. Only a small part of these concerns the financial equalisation system itself. The new regulations beyond the relevant constitutional provisions on the fiscal equalisation system (Articles 106 and 107 BL) are even more significant in their impact on the overall federal architecture of the German multi-level system. In this context, for example, the newly inserted Article 104c BL is of particular relevance. According to this new constitutional assignment, the federal government can "grant financial funds to the *Länder* for state-important investments by financially weak municipalities (municipal associations) in the field of municipal education infrastructure" (own translation). For the concrete implementation, the "Municipal Investment Promotion Fund" ("Kommunalinvestitionsförderungsfonds") is to be increased – a special fund ("Sondervermögen") that was set up as early as 2015 under the "Municipal Investment Promotion Act" ("Kommunalinvestitionsförderungsgesetz" – KInvFG). The Federal Government will double the original capital endowment of the fund amounting to 3.5 billion euros for municipal infrastructure investments – including the education sector – by the same amount to 7 billion euros. The funds should be used exclusively for investments in the educational infrastructure of cities and municipalities. A corresponding administrative agreement on the distribution of the funds between the *Bund* and the *Länder* has now been reached. Two of the three central municipal umbrella associations welcomed this new regulation in the wake of the legislative process, although it is another example of how the federal government is advancing into the *Länder*'s and municipalities' sphere of competence.

The new Article 104 c BL does not establish any direct financial relations between the federal government and the municipalities. However, the dictum of the "modified two-level structure" ("modifizierte Zweistufigkeit"), which the Federal Constitutional Court had already formulated in a decision of 2013, gains new significance. For the first time, the Basic Law confers on the federal government an obligation to provide assistance or guarantee obligation for financially weak municipalities (Korioth 2017). This means that the *Länder*'s own sphere of competence is affected in two ways: on the one hand, it is incumbent upon them to guarantee local self-government, including the "the bases of financial autonomy" (Article 28 (2) BL). On the other hand, structural investments in school infrastructure fall within the scope of education policy and thus under the "cultural sovereignty" ("Kulturhoheit") of the *Länder* and municipalities. The so-called "cooperation ban" ("Kooperationsverbot"), which the Bundestag institutionalised with the Federalism Reform I of 2006, was intended to additionally protect this

cultural sovereignty of the *Länder*. According to this, the *Bund* should actually be prohibited from intervening in any areas of activity that fall within the exclusive legislative competence of the *Länder*. This shows how inconsistent the legislator acted within a few years of reforming the federal system (Benz; Sonnicksen 2017). The far-reaching interference with the overall federal architecture can only be compensated to a limited extent through the "discretionary clause" of Article 104 c BL and the fact that concrete needs of the municipalities cannot be compensated directly. As the Bundestag and Bundesrat have waived the formal abolition of the "cooperation ban", the corresponding provision of Article 104 b BL has in the meantime mutated into a fuselage right or a meaningless formula without protective effect.

Irrespective of this, the question arises, if basic maintenance and replacement investments in the educational infrastructure of individual municipalities are of "national significance". It is true that such investments can have, in total, a positive effect on the Federal Republic as a whole. However, the 3.5 billion euros that have now been made available for the years 2017 to 2022 by the *Bund* will fall short of estimates of the total state infrastructure investment requirements in this area. Studies show that in Germany as a whole, an extrapolated backlog of 32.8 billion euros exists in the area of schools, including adult education (Scheller; Schneider 2017: 12). In addition, there are the sports and swimming facilities as well as childcare infrastructure of the municipalities, with an estimated need of 9.7 and 4.6 billion euros respectively.

The new Article104 c BL is subject to various constitutional difficulties (Henneke 2017(a)). This is particularly true with regard to the abstract definition of the term "financial weakness" of municipalities, which has to be established as a precondition for granting such investment funds. There is indeed a long running constitutional and political debate about this issue. However, a generally accepted consensus on which indicators and thresholds constitute such a status has not yet emerged. In the past, this question has been discussed above all with regard to the states. However, the much more difficult question of which criteria are suitable for the municipal level is arising. Against this background, a definition of nationwide uniform criteria seemed to make little sense to the legislator as well. This would have become problematic if only because of the large number and (fiscal) heterogeneity of the approximately 11,000 counties, cities and municipalities in the Federal Republic. Contrary to an earlier version, the *Bund* and the *Länder* have therefore agreed with the modification of Article 104 b (2) BL that "the definition of the criteria for setting up the states' programmes [...] shall be carried out in a mutual agreement with the states concerned" (own translation). This has reduced the scope for the *Bund* to exert influence. However, a bilateral agreement has now to be reached between the federal government and each state in order to fix which indicators will be used to determine the financially weak municipalities in the individual states. This approach leaves the states their autonomy, since the final binding decision on the criteria remains with them formally. However, the *Bund*, which provides the funds, has a veto right in case of doubt. A further consequence of this regulation is that there will in fact be sixteen different benchmarks for determining "municipal financial weakness". For the Federal Audit Office ("Bundesrechnungshof") and the States' Audit Offices ("Landesrechnungshöfe"), this should result in additional auditing requirements – especially since the question of which indicators and data sets are recognised as statistically valid by the federal government as well as the states is omitted in the corresponding administrative agreement.

An important issue in the debates and negotiations on the reform was the question, which kind of consideration the states would provide the *Bund* for pumping more money into the system in order to reach a final reform compromise. In addition to a transfer of administrative powers for the federal highways, the *Länder* also agreed to strengthen the audit and control rights of the Federal Audit Office. This regulation was strongly

promoted by the Bundestag and was directly related to the constitutional anchoring of the new Article 104 c BL. A former version of the *Bund*'s draft bill for the amendment of Article 114 (2) BL, which had not been approved in the end, stipulated:

> "In order to examine the appropriate use of the funds allocated by the Federal Government to the *Länder* in the area of mixed financing transactions and to ensure that the general objectives associated with the allocations are met, the Federal Audit Office may, in consultation with the responsible state audit offices of the *Länder*, conduct surveys at the departments of the Land's administrations charged with managing the funds" (own translation).

This would have made it possible for the *Bund* to exercise far-reaching powers of intervention, leading to a massive shift in the overall federal structure between the different jurisdictional levels of government. However, the *Bund* was unable to assert itself with this proposal. In the end, the amendment of Article 114 (2) BL, was much more moderate since it now only stipulates:

> "For the purpose of audit in accordance with sentence 1, the Federal Audit Office may also carry out surveys of bodies outside the federal administration; this shall also apply in cases where the Federal Government allocates earmarked financial resources to the *Länder* for the fulfilment of *Länder* tasks [...]" (own translation).

However, despite the weakening of Article 114 BL, the intention and logic of an intensified budgetary control, which have shaped the fiscal policy discourse between the *Bund* and the *Länder* since the negotiations on the Federalism Reform II, remain unmistakable. For example, the recommendation for a resolution report on the *Bund*'s draft bill by the Budget Committee states:

> "For effective audits, the option to inspect will be extended to all bodies outside the federal administration (states, municipalities and legal entities under public and private law)" (BT-Drucksache 18/12589 – own translation).

In addition to strengthening the Federal Audit Office, the so-called "Stability Council" ("Stabilitätsrat") is also being upgraded. In the past the Council was essentially responsible for examining the budgetary situation of the federal government and the states on a yearly basis with a view to possible "budget emergencies" ("Haushaltsnotlagen"). From 2020, however, the Council will have the responsibility of checking compliance with the "debt brake" ("Schuldenbremse") – stipulated in the new § 5a of the Stability Council Act:

> 1. The Stability Council shall periodically review, in the autumn of each year, compliance with the debt rule of Article 109 (3) BL by the *Bund* and each individual state for the respective the current and the following year.
>
> 2. The monitoring referred to in paragraph 1 shall be based on the provisions and procedures laid down in the Treaty on the Functioning of the European Union in respect of budgetary discipline."

This new regulation also reflects the "control logic" that became more and more dominant in the financial discourse of the Federal Republic at the latest since the Federalism Reform II (Scheller 2015): *Bund* and *Länder* voluntarily give up their budgetary autonomy and submit themselves to a debt regime that is gradually being tightened.

The *Bund* has also gained competence in another area: up to now, the administrative responsibility for the federal highways and motorways has rested with the *Länder* as "contract administration" ("Auftragsverwaltung") (Article 90 (2) sentence 2 BL). With

the fiscal equalisation reform, this competence is not only transferred back to the federal government. As the sole owner and operator of the federal motorways it is rather given the right to establish a new "infrastructure company" ("Infrastrukturgesellschaft"), to which maintenance is transferred. A company under private law can be established for this purpose. Especially in the Bundestag and in the media debate, massive resistance to these considerations arose. There was great mistrust about the possible privatisation of public property and the introduction/extension of toll systems. The final solution, which was reached in the Bundestag in the night before the decisive vote, is now intended to ensure that the federal motorways remain in public ownership. The Federal President has at least expressed doubts about this part of the law in the formal engrossment. It remains to be seen whether the federal government or a corresponding company will actually work more efficiently. However, the formerly responsible employees of the road construction administrations of the states and municipalities must now be taken over by the federal government by 2021 at the latest.

V. CONCLUSION AND OUTLOOK

The recent reform of the German fiscal equalisation system is a mystery. After the parliamentary adoption in summer 2017, many observers are perplexed and amazed. A classification of this reform, or even an explanation in using relevant federalism theories, does not seem to be possible at this point in time. Even though a "decline in German federalism" has long been deplored, it is unmistakable that the recent reform will accelerate the trend towards centralization and verticalization in favour of the *Bund*. In addition, various elements of the reform aim to foster a "control federalism" (Scheller 2015). The status of the Stability Council will be enhanced, the budget system of the *Bund* and the *Länder* will be further harmonised and the auditing rights of the Federal Audit Office extended. The federal government will only fund "restructuring grants" ("Sanierungshilfen") for the most indebted states of Bremen and Saarland in return for strict consolidation obligations. The general financial autonomy of the *Länder* and municipalities was not strengthened by an adjustment of their shares of the total tax revenues. Instead, federal transfers like "block grants" in the USA – limited in time and for specific purposes – are gaining more weight. At the same time, new obligations to provide evidence and audit rights of the *Bund* are laid down by law. In this way, the *Länder* will continue to reduce their last remaining leeway. Though, the municipalities might benefit from this development in the long term. They could possibly position themselves more and more strongly as direct partners of the *Bund*.

The price that the *Länder* are paying for this fiscal equalisation reform is high. Various calculations have been made to show that the result achieved so far could easily have been reached in the existing structures of the fiscal equalisation system, which will remain in force until the end of 2019 (Lenk; Glinka 2016). Such a far-reaching constitutional reform would therefore not have been necessary. In a way, the reform also demonstrates a reckless handling of the constitution. This has been cultivated under the grand coalition of CDU/CSU and SPD. The Basic Law is supposed to provide a stable framework for everyday political business. The massive encroachments on the constitution and the existing financial equalisation system are also problematic for another reason: if the new Fiscal Equalisation Act should – as in the past – again become the subject of political disputes, including proceedings before the Federal Constitutional Court, it is not yet possible to foresee how the Supreme Court will behave. Since the institutionalization of the fiscal equalisation system in the Basic Law 60 years ago, the Constitutional Court has established a consistent jurisprudence with four fundamental judgments. It is unlikely that the legal principles formulated this way will be applied in the same way of the interpretation of the new fiscal equalisation system. This creates new uncertainties for the *Länder*.

The new Article 143f BL shows how much the constitution has become overburdened with detailed regulations that would have been previously laid down in simple federal laws. It stipulates that the "financial equalisation between the *Bund* and the *Länder*" shall cease to apply "if, after 31 December 2030, the Federal Government or at least three *Länder* together have called for negotiations on a reorganisation of the federal financial relations" (own translation). In addition, another condition must be fulfilled: "no legal reorganization of the federal financial relations must have entered into force" until "five years after notification of the federal government's request for negotiation or the request of the states to the Federal President". In fact, this means that a new reform of the fiscal equalisation system would not be possible again until 2031 at the earliest. The states – including the donor states – thus commit themselves to a form of "federal-self-restraint". If they take this self-commitment seriously, they would actually have to exercise restraint in terms of both, procedural policy and verbal reluctance in the sense of a "pacta-sunt-servanda" logic.

However, federal fiscal equalization arrangements are always temporary rules that have to be renegotiated periodically by the federal partners. The new regulation that has now been found establishes a static structure that is contrary to the natural dynamics of federal systems. Apparently, however, the new Article 143f BL shall shield a further system of rules of the financial constitution from politically motivated access by the *Bund* and the *Länder*. As in other controversies, the *Länder*'s prime ministers have opted for a "de-politicization strategy" with which – completely unusual and without precedent – the otherwise unpolitical office of the Federal President becomes involved to reconcile possible conflicts between the *Bund* and the *Länder*. It seems like this way the almost ritualized negotiation practice of mutual accusations between donor and recipient states as well as the time-consuming appeals to the Federal Constitutional Court shall be left behind.

Ultimately, the new Article 143f BL is a response to the complaint about the alleged susceptibility of the system to disputes, which is repeatedly brought forward not only in the academic but also in the political discourse. However, the constitutional safeguarding of detailed financial policy regulations of this kind is also an expression of mutual political mistrust between the federal partners. The fact that negotiations of this kind are becoming increasingly protracted and tying up the respective capacities of the *Länder* is based not least on the political constellation of interests, which has become considerably more heterogenous in recent years due to the increased fiscal disparities and an increase in the party-political heterogeneity of government coalitions at the states level.

Past experience has shown that a ten-year period of validity of the equalization system does not seem very realistic since it cannot adequately take into account the dynamic adjustment requirements of federal financial distribution systems (Adelberger 2001). On the one hand, the sequences in reforming the fiscal equalisation system have become ever shorter over the decades (1948, 1955, 1986, 1992, 1999, 2005, 2017) (Renzsch 1991). On the other hand, the donor states in particular have already voiced harsh criticism of the regulatory framework, which they themselves have negotiated, a few months after the last reform came into force on 1 January 2005. The fact that the federal financial relations were made to a subject of a Federalism Commission II in 2006, after the essential regulatory systems of the financial constitution had in fact already been reorganized to corresponding reforms beforehand, was not least due to this criticism – even if (for obvious reasons) the financial equalisation between the *Bund* and the *Länder* themselves was not finally made available again in the Commission's deliberations.

The reform of the fiscal equalization system, on which the federal and state governments have now been decided upon, appears once again symptomatic for an "exhausted federalism" – an increasingly technical debate in which the socio-political integration

functions that the federal system is actually supposed to fulfil are hardly ever explicitly discussed (Lehmbruch 2000: 71; Scheller 2015). Such a discourse may be difficult in the context of financial equalisation negotiations, which are naturally characterised by complex and technical issues. Despite all political opportunities, however, the material structure of the constitutional and simple legal provisions on fiscal equalisation should at least meet certain minimum requirements and legal principles. This includes the clarity of standards, transparency, systemic justice and consistency. A large number of the regulations that have now been found meet these principles only conditionally. The recent reform shows that Germany is missing a permanent exchange forum for self-assurance of the functions and the achievement of goals of federal equalization. It remains to be seen to what extent the new Bundestag, which was elected on 24 September 2017, will find the power to initiate a corresponding discussion.

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