

Municipal Finances for Urban Governance

Empowering local government with
fiscal decentralisation *plus* strong vertical ties

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Session 2 of the

URBAN CONFERENCE AND LAUNCH OF COMMUNITIES OF PRACTICE (CoP)

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Good practises - My contribution “in a nutshell”

German
example

“Best practices” are not
best for everyone

- Autonomy-focused decentralisation narrative may not suffice for rapidly changing cities and urbanisations
- Strong vertical ties bind both sides, central and decentral level

Money doesn't come first

- In municipal and regional finance, money should, where the task can be accomplished best - not vice versa

Slides
3-4

Fees and contributions
form the basis

- Local public services that can be priced should not tax-financed
- No cross-subsidies: Necessary subsidies come from the budget

Slide
5

Several local taxes with
"moderate autonomy"

- Property tax, local business tax, tourist tax, sales tax, sin taxes
- Uniform tax law and tax base; individual tax rates (if sensible)

Slides
6-8

Backed by fixed shares of
joint taxes

- Joint taxes foster the concordance of interests among levels
- Personal income tax, VAT, possibly energy and eco-taxes

Slide
6

Embedded in a strong
equalisation system

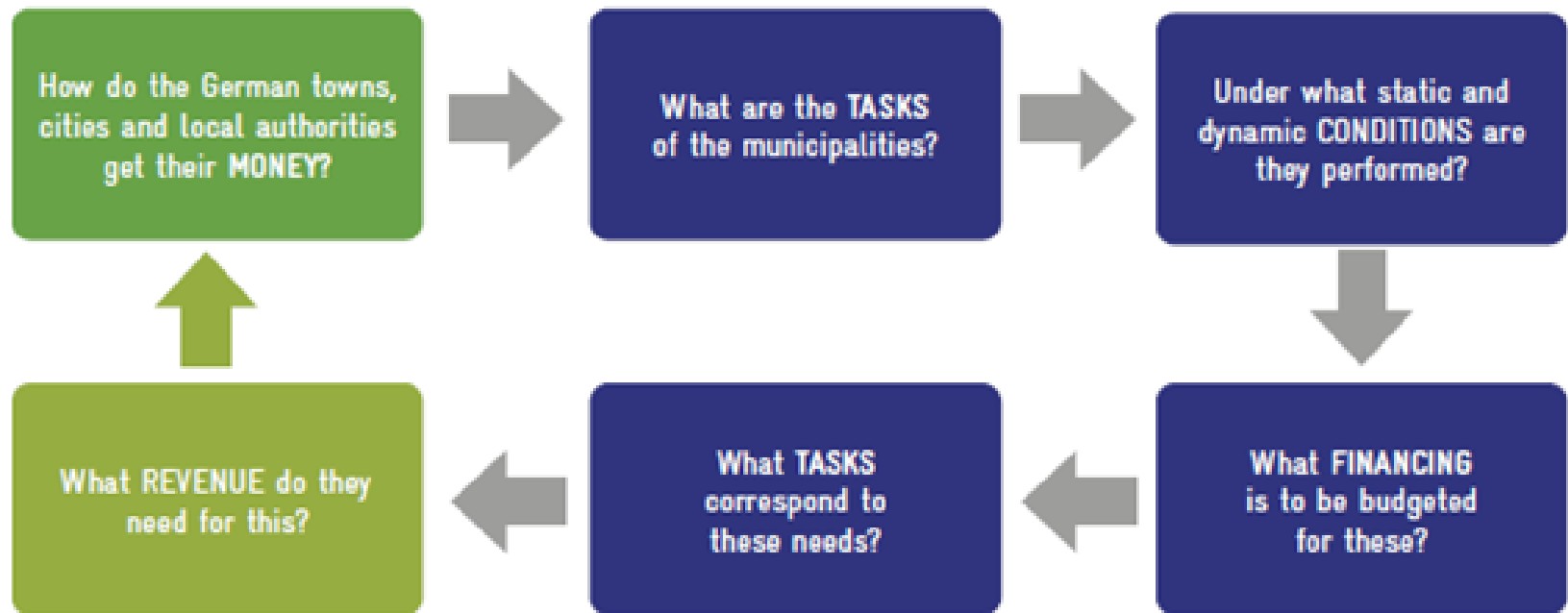
- Fiscal equalisation ensures that the money follows the tasks.
- Vertical equalisation with horizontal effects are best suited

Slides
9-10

Infrastructure investment:
Debt plus central subsidies

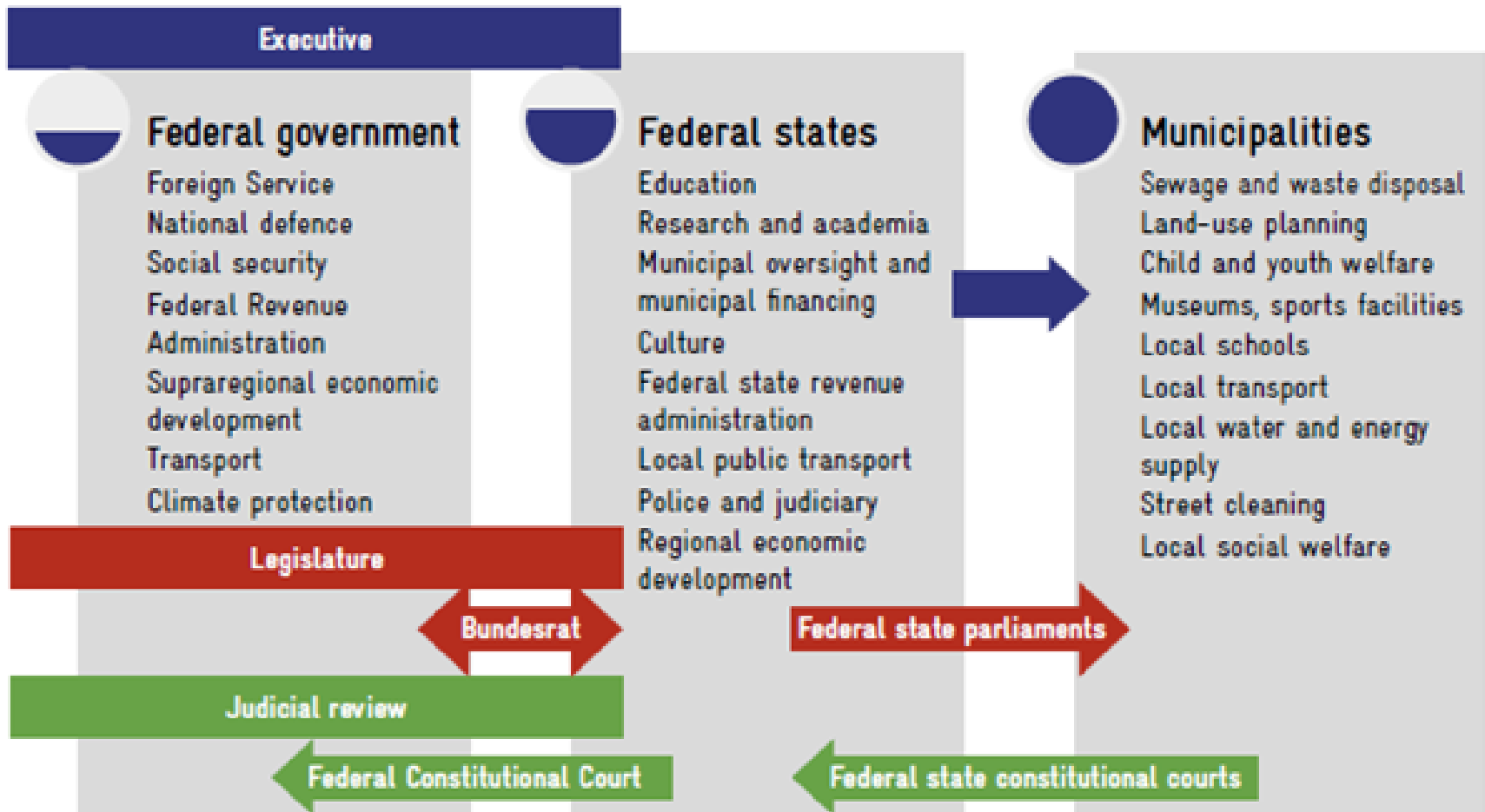
- Golden rule for investment spending. Decent accounting, no bailout
- Bailout for centrally approved investments (possibly subsidised)

Money doesn't come first



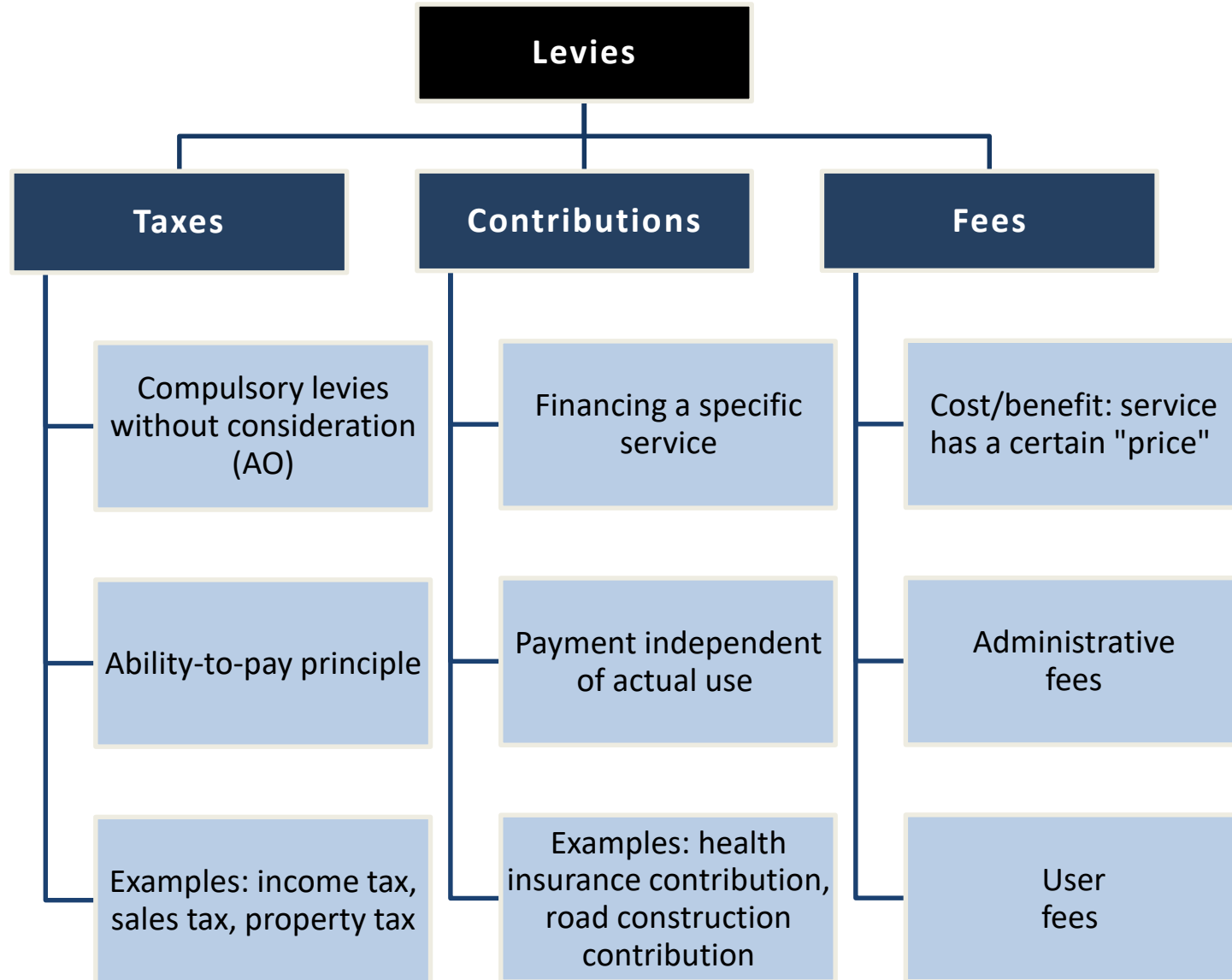
Authors' own graphic.

Allocation of tasks between federation - Länder - municipalities



Authors' own graphic.

Fees and contributions form the basis of local finances



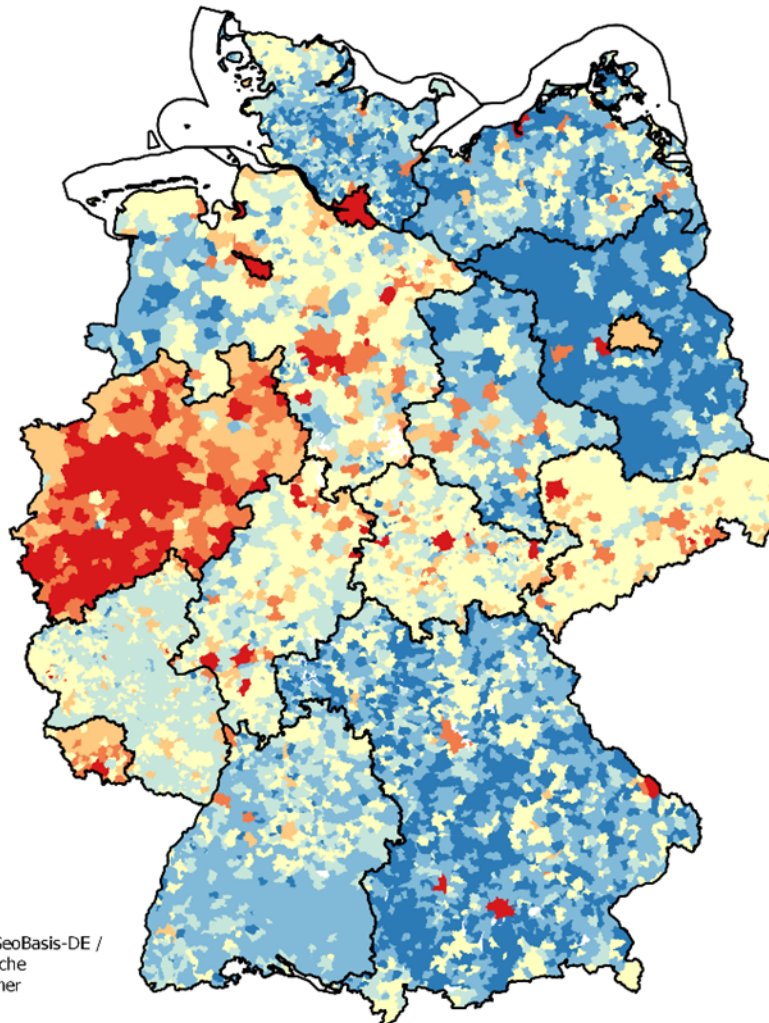
Local and joint taxes in the German tax system

2018 (EUR million)	Fed. govt	Fed. states	Municipalities	Totals	Share
Joint taxes	262 022	256 350	48 666	567 038	74 %
Income tax (incl. wage tax)	117 208	117 208	41 182	275 598	36 %
VAT	116 513	110 841	7 484	234 838	30 %
Corporation and withholding tax	28 301	28 301		56 602	7 %
Federal taxes	108 586			108 586	14 %
Energy tax	40 882			40 882	5 %
Vehicle tax	9 047			9 047	1 %
Tobacco tax	14 339			14 339	2 %
Electricity tax	6 858			6 858	1 %
Insurance tax	13 779			13 779	2 %
Solidarity surcharge	18 327			18 327	2 %
Others	5 354			5 354	1 %
Fed. state taxes		23 913		23 913	3 %
Real estate transfer tax		14 084		14 084	2 %
Inheritance tax	9 047	6 813		6 813	1 %
Beer tax	14 339	655		655	0 %
Others	6 858	2 361		2 361	0 %
Joint taxes	2 058	7 020	62 707	71 785	9 %
Property tax			14 202	14 202	2 %
Local business tax	2 058	7 020	46 795	55 873	7 %
Others			1 710	1 710	0 %
Totals by level	372 666	287 283	111 373	771 322	100 %

Local Business tax (“trade tax”): Local tax rates (2017)

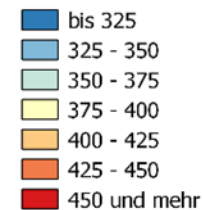
Backbone of local finances in many municipalities

The right to determine the local tax rate on company profits (“business tax”) in each municipality has a long tradition, but is economically very controversial because of tax competition.



Local tax rate

Collection rate points (2017)

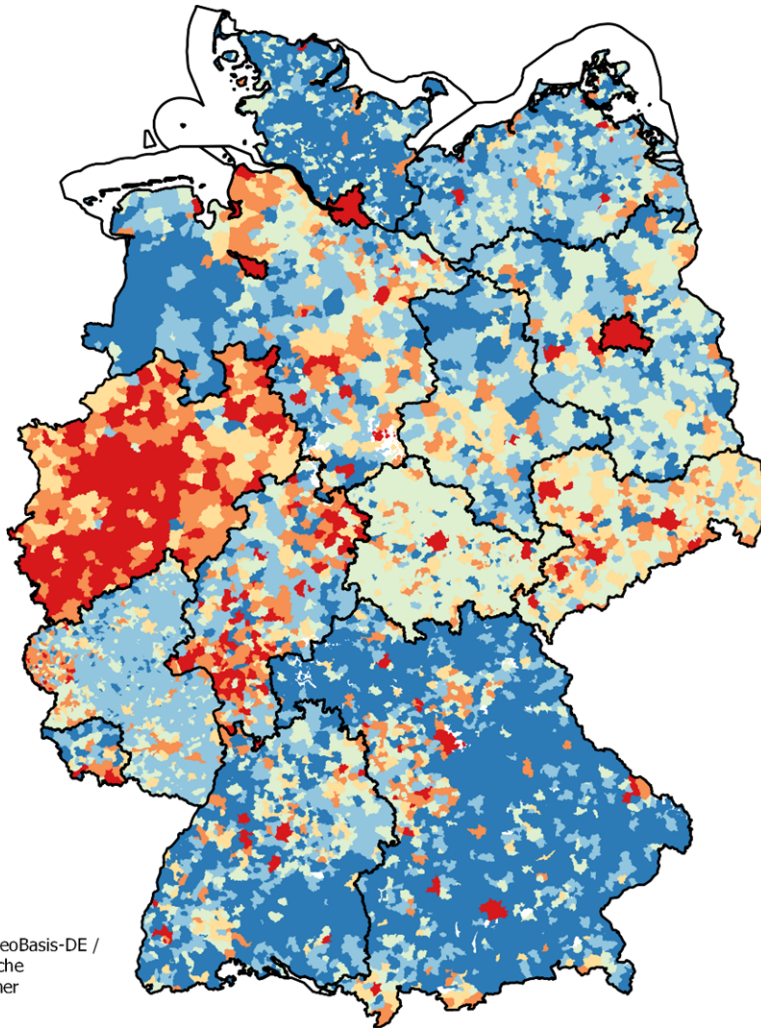


□ Länder borders

The map shows how strongly the state finances also affect the collection rates:

- Strong municipalities do not need high rates (BY, BW)
- Economically weak municipalities do not allow high rates (MV, BB, ST...)
- Underfunding of municipalities forces high rates (NW)

Land Property tax: Local tax rates (2017)



Quellen: Geobasisdaten © GeoBasis-DE /
BKG 2018; Hebesätze Deutsche
Industrie- und Handelskammer

The right to determine the amount of local land and property tax in each municipality has a long tradition and, unlike business tax, is not economically controversial.

Property tax is currently being reformed.

Local tax rate tax B

Collection rate points (2017)



Länder borders

The map shows how strongly the state finances also affect the collection rates:

- Strong municipalities do not need high rates (BY, BW)
- Economically weak municipalities do not allow high rates (MV, BB, ST...)
- Underfunding of municipalities forces high rates (NW)
- Financial equalization laws of the Länder have additional influence (hetero- / homogeneous)

Structure of municipal financial equalisation schemes

Allocations to municipalities		
Within the financial equalisation system (association volume)		Outside the financial equalisation volume
Key allocations	Earmarked allocations	Reimbursement for administration of orders and other allocations from the Land
	Demand-based allocations	Forwarded reimbursements from federation or EU

Requirements

- **Subsidiarity:** Exploiting your own revenue potential first.
- **Appropriate determination of needs:** Appropriate standards for determining financial needs and financial strength.
- **No levelling out:** financial strength sequence not to be changed by equalization.
- **Transparency requirement:** In order to ensure acceptance of the results of equalization, it must be as comprehensible as possible for the municipalities.

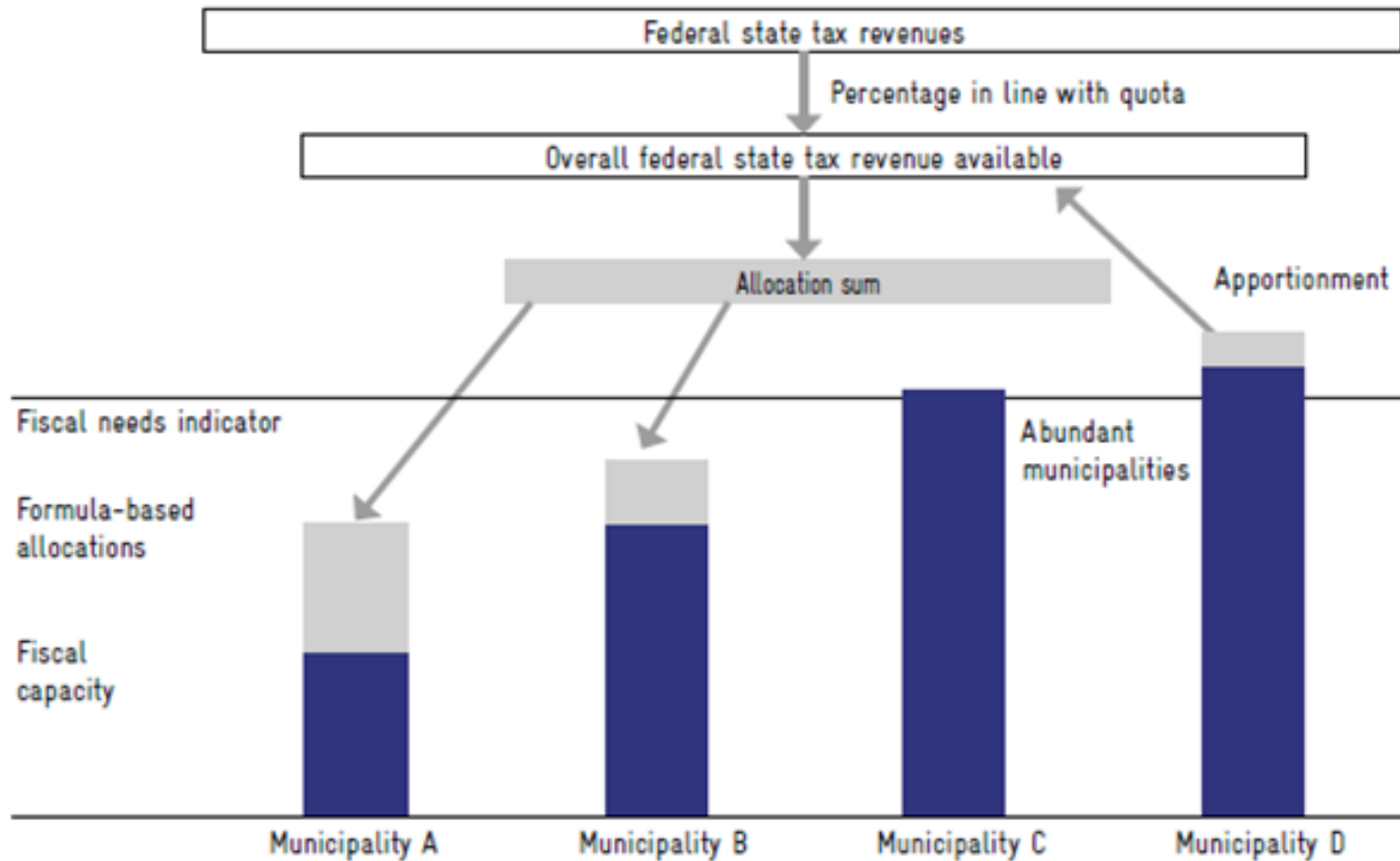
Local financial equalisation in a narrow sense

- Flat-rate **financial requirements** > flat-rate **fiscal capacity** -> key allocations
- Financial requirements are calculated on the basis of independent **indicators**.

Often:

- **Main approach:** number of inhabitants x size of town ("inhabitant scaling")
- **Secondary approaches:** Surface area, pupils, centrality, social charges ...

Basic horizontal financial equalisation mechanism



Graphic: Wolfgang Pohl (2015), CC-Lizenz.

Thank you!

Continue the dialogue: thoene@fifo-koeln.de

Jens Bullerjahn / Michael Thöne:

English:

Municipal Finances and Municipal Financial Equalisation in Germany

<https://www.reformgestaltung.de/infothek/publikationen/publikationen-details/municipal-finance-and-financial-equalisation-in-germany>

Deutsch: **Gemeindefinanzen und kommunaler Finanzausgleich in Deutschland**

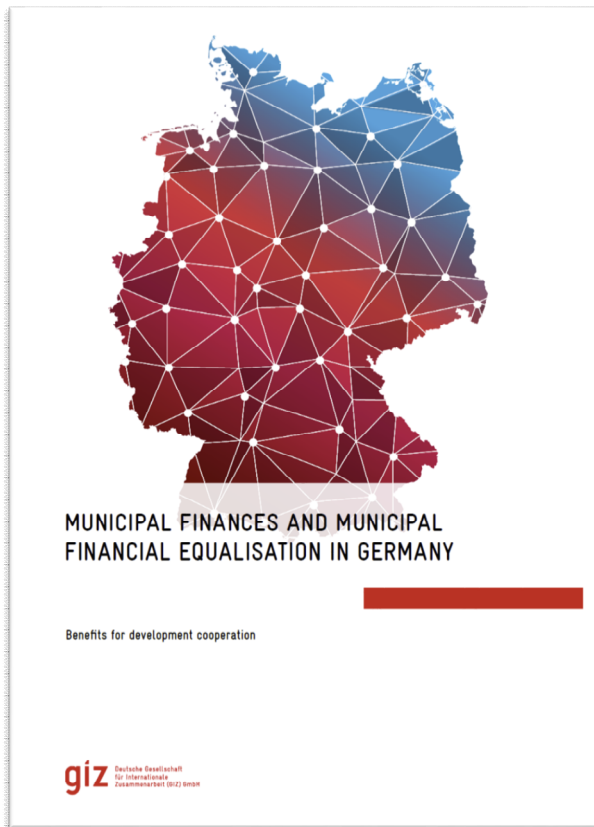
https://www.reformgestaltung.de/fileadmin/user_upload/Dokumente/GIZ_kommunaler_Finanzausgleich.pdf

Französisch: **Finances communales et péréquation financière communale en Allemagne**

https://www.reformgestaltung.de/fileadmin/user_upload/Dokumente/KFA_FRA-sm.pdf

Spanisch: **Finanzas municipales y compensación financiera municipal en Alemania**

https://www.reformgestaltung.de/fileadmin/user_upload/Dokumente/GIZ_Standard_A4_hoch_ES_kommunalerFinanzausgleich_web.pdf



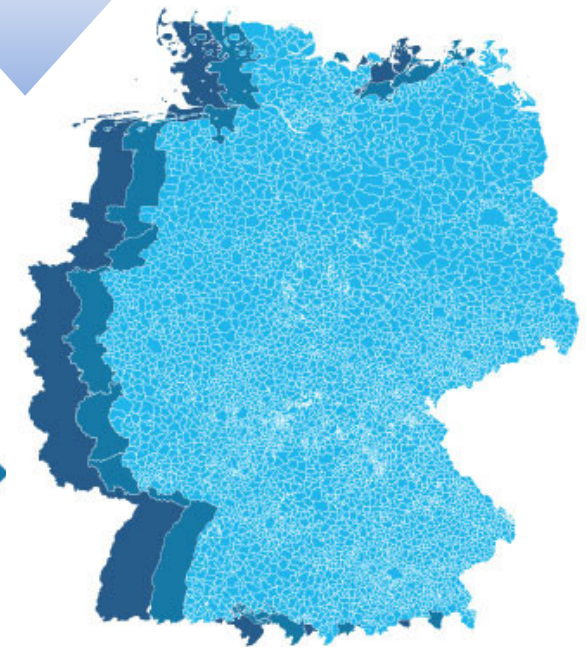
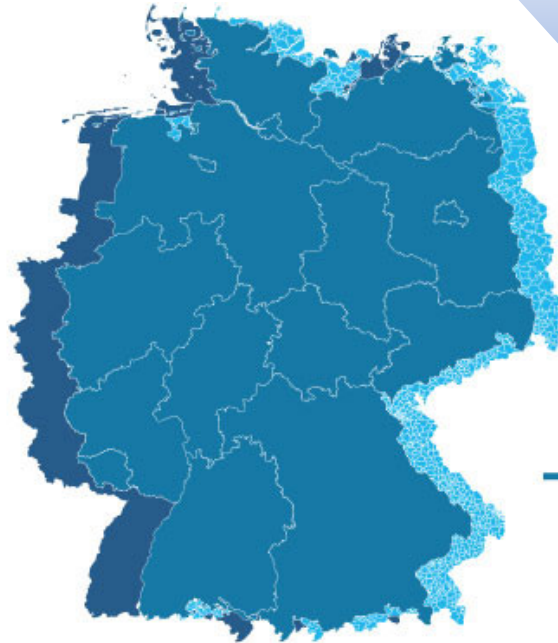
Annex: Additional information on the German example

The three levels of Germany

A large and multi-faceted federal state

Intermediate Levels

Regional associations, districts, counties....



1 federation

Population: 83 million

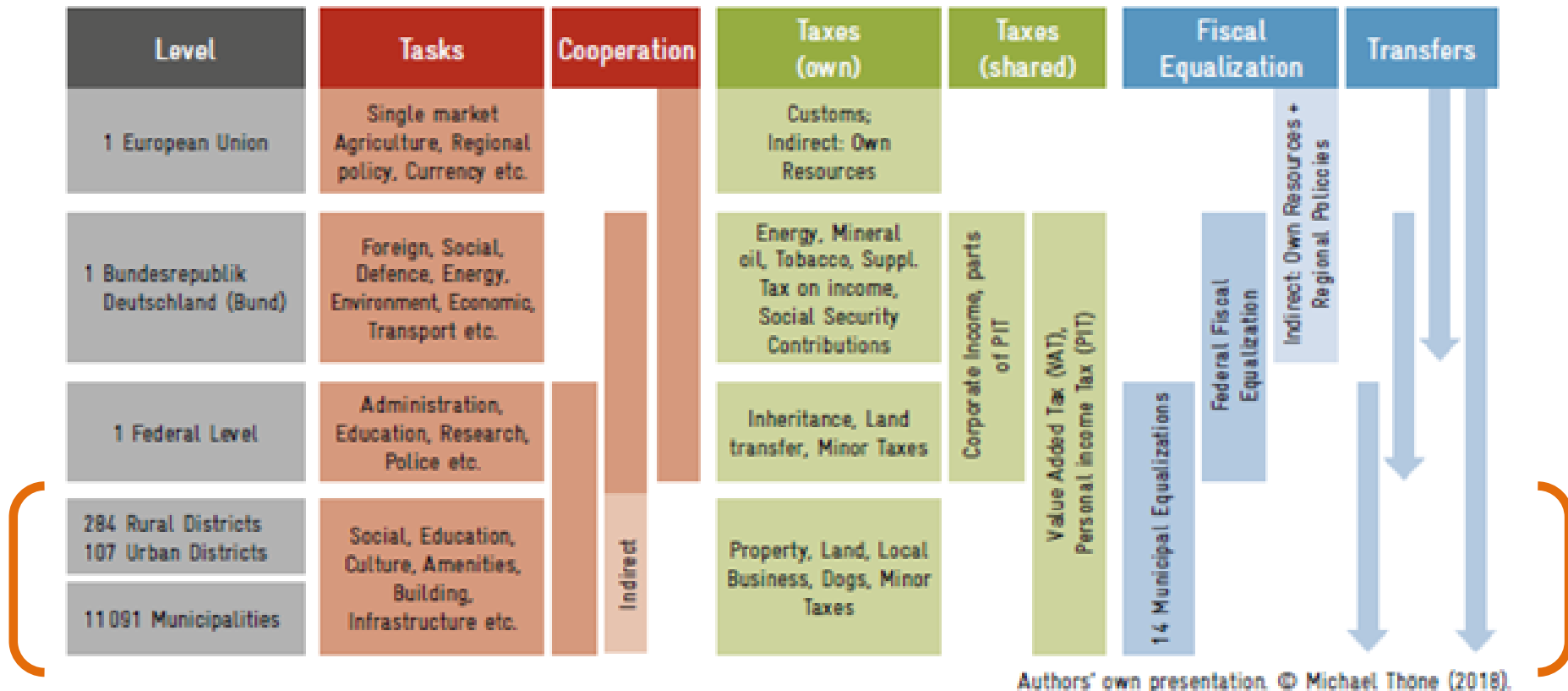
16 Länder

from 560,000 inhabitants (Bremen)
up to 17.9 million inhabitants (NRW)

approx. 11,000 municipalities

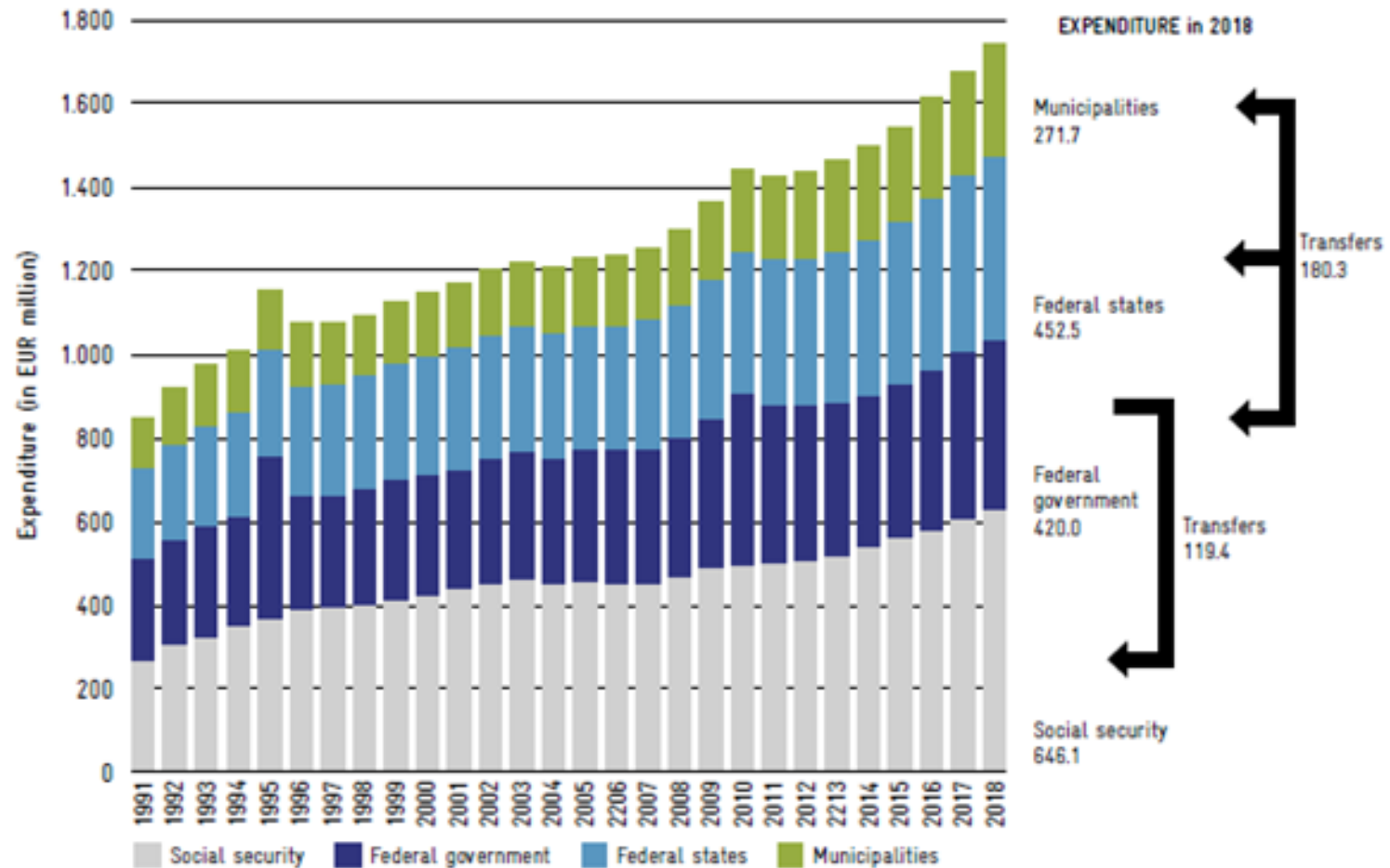
from 10 inh. (Hallig Gröde)
up to 3.6 million inh. (Berlin)

Municipalities in the German multi-level state



© Michael Thöne (2017).

Spending at the three levels is almost equal
(plus social security).



Authors' own graphic. Data: destatis (2019).

Principles of the municipal system and its finances

'Municipalities must be guaranteed the right to regulate all local affairs on their own responsibility within the limits prescribed by the laws.' (Article 28 II GG). The following principles must be borne in mind:

- Principle of subsidiarity

- Decisions to be as decentralised as possible. The higher level only intervenes if a uniform regulation is clearly advantageous.

- Principle of connexity

- 'He who orders, pays': centrally established tasks call for adequate central financing.

- Principle of equivalence

- Revenues must correspond to the locally provided services.

- Principle of solidarity

- Redistribution from financially strong to financially weak municipalities

- Uniformity of living standards

- Constitutional standard that justifies a centrally organised regional equalisation.

- Loyalty to the federal government

- Reciprocal commitment (in the last resort)

Authors' own graphic.

Review and evaluation

- Municipal finances in Germany are a **constant point of contention between the** municipalities and the Länder; now also involving the federation.
- The **numerous interests** and the **complexity of** the 13 different municipal fiscal equalisation scheme create a **network of actors and instruments**, also in the review and evaluation of fiscal equalisation laws and their financial resources.

