

The Economist

Germany's local finances

Hundreds of mini-Greeces

The economy booms, but many municipalities are strapped for cash

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THE heart of Wuppertal is the Schwebebahn, a trolley dangling from a rail above the Wupper river. It is the lifeline of this river-hugging city of 350,000, Germany's 17th-largest. Perhaps because it is unique, it is also expensive. The 110-year-old contraption is undergoing a €500m (\$715m) modernisation; it drains €27m a year from the city's budget. "Wuppertal is unthinkable without the Schwebebahn," says the mayor, Peter Jung. "Nobody talks about whether it makes economic sense."

Wuppertal has other glories, including an orchestra and a dance troupe. It embodies the belief that high culture belongs in the provinces as much as in bigger cities. But Wuppertal is poor. Textile production shrivelled by the 1970s. High earners left; needy immigrants arrived. Wuppertal now has a debt stock of €2 billion and pays its way with an overdraft. If it were a company, "it would have to file for bankruptcy", wrote its treasurer recently.

Germany's 11,000-odd municipalities had a deficit of €7.7 billion last year, the second-highest ever. The pain is uneven. Towns in the rich south were hit by recession. In other regions, including parts of North Rhine-Westphalia (NRW), the slump came on top of long industrial decline and years of fiscal rot. Municipalities face a "debt spiral" as interest rates start rising, says Martin Junkernheinrich of the University of Kaiserslautern.

Mayors think of municipalities as cradles of democracy where citizens meet government close up. They build and maintain schools, repair streets and help the jobless and the elderly. They account for almost two-thirds of public investment. Most of what the 16 states decide localities are forced to execute, notes Torsten Albig, mayor of Kiel. Yet though a mayor may matter more to citizens than a state premier, voter turnout is higher in state elections. Towns have financial and political autonomy but no "state quality" (except for indebted Berlin, Bremen and Hamburg, which are states). They are like branches of a head office that dictates most spending and provides or regulates most revenue. "Our problem is that we can decide very little ourselves," says Monika Kuban of the German Association of Cities.



This saps vitality from public life. Citizens have little local influence; politicians set their sights on state capitals or Berlin. City halls no longer launch political careers, "a problem for the political culture as a whole", says Mr Junkernheinrich. Federal, state and local authorities tap the same sources of revenue, which makes tax reform harder. Citizens see no connection between local services and tax bills. The government's upper echelons have squeezed municipalities. They dream up new benefits and then oblige towns to provide them. In NRW local social spending rose by 274% between 1980 and 2006, whereas revenue went up only by 104%. Little is left for discretionary spending. NRW towns spend €707 per person on social services and invest just €165. In richer Baden-Württemberg social spending is €403 per head and investment is €359.

This inequality may widen. Trade tax, a corporate tax that is the biggest source of local revenue, is rebounding with the economy. That helps towns with thriving enterprises more than those with fewer firms and harder social problems. Frankfurt has three times the population of Kiel, but 12 times the trade-tax revenue, notes Mr Albig. Profligate municipalities make things worse. The Ruhr is spangled with swimming pools. Wuppertal's orchestra has a rival that plays in nearby Solingen and Remscheid. A merger might save cash, but musicians are municipal employees who cannot be sacked. It would be cheaper to modernise the Schwebebahn with driverless cars, but Wuppertalers will not hear of it. Self-denial is not easy, especially when the federal constitution endorses "equal living conditions".

Some of the excess is pure fat. Municipal councils are "self-service cafeterias for political parties," snarls Magnus Staehler, who as mayor paid off Langenfeld's debt. Senior jobs at city-owned enterprises come with lavish perks. State watchdogs should police local finances. When they are tough, as in Bavaria and Saxony, towns have no overdraft problem. In NRW and Rhineland-Palatinate they are weak.

The federal government is willing to offer help in return for self-help. A commission set up by the finance minister, Wolfgang Schäuble, offered the prospect of relief from social spending and suffocating quality "standards" for local services. In return, Mr Schäuble wanted to scrap the trade tax and replace it in part with a municipal right to vary income tax. But mayors would prefer to annoy companies than voters. Even so, in February the federal government agreed to assume payment of basic pensions to the old and infirm, saving municipalities €12 billion by 2015.

Three states have set up funds to lower debt repayments in exchange for spending reforms. NRW may follow suit. If richer towns help, says Mr Jung, Wuppertal can balance its budget by 2015. Reformers dream of bolder measures: towns raising and spending their own revenues, fewer states, more responsibilities transferred down. "Real reform would require dramatic changes in federal structures," says Mr Albig. Yet this looks unlikely.

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