German States Plunge Into Budget Emergency

by Rainer Apel

The daily *Frankfurter Allgemeine Zeitung* sounded the alarm on its front page on June 1, that the majority of the 16 German states have been forced to declare a budget freeze, and some of them are in a budget emergency. Not that the crisis had just been discovered. The state governments have made their situation known repeatedly, appealing to the national government—in vain, so far—for relief from certain financial burdens. But the fact that Germany's leading establishment mouthpiece finally made it a prominent issue, tells how bad the states' budget situation has become. *EIR*'s assessment has, therefore, been prominently corroborated by the *Frankfurter Allgemeine* story—which only covered the facts, not the causes of that development.

The proximate cause of this fiscal crisis is the depression-related shrinkage of industrial output and employment, which is leading to a continuous drop in tax payments by firms and workers. The situation is most dramatic in the three city-states of Berlin, Hamburg, and Bremen, which are suffering more than other states from the outsourcing of industrial production into the countryside, where taxation levels are lower. For the city-states, the loss of productive industrial firms has created a big hole in the tax revenue base. Berlin's tax revenue, for example, will meet only 40% of its current fiscal year budget—an austerity budget, at that. The other 60% has to be financed by borrowing from private banks, or by revenues from privatizing state property.

The situation is similar in Hamburg and Bremen, but Berlin, as the capital of Germany, has special obligations which add to the burdens of the public services sector: Some 90% of the taxes that Berlin collects, are spent on the city-state's public services sector.

The national government has contributed to worsening the states' fiscal situation, with its loyalty to the European Monetary Union "Maastricht criteria," which represent an illusory attempt to reach a "balanced budget" by no later than fiscal year 2004. The criteria imply that the public sector debt will be paid despite deep budget cuts by the euro-zone member governments, and that public sector investments designed to increase the production base or employment level in substantial terms, are banned. Coming more and more under fiscal pressure itself, the national government has shifted budgetary burdens onto the states and municipalities—for example, social welfare payments, to ease pressure on the national budget in an attempt to meet the Maastricht criteria.

Ill-Fated 'Tax Reform'

The national government has also contributed to the problem by its "tax reform" of 1999, which brought substantial tax cuts for big, multinational corporations, to an extent that most of them no longer pay any taxes. Many corporations also apply for additional tax rebates, as their local or regional daughter corporations report losses due to dropping output and sales. Reduced consumer spending affects the sales and value-added taxes. The drop in the corporate tax revenues hit the municipalities especially hard, whereas losses in the sales and income taxes hit the states and national government.

With the current fiscal year just half over, 11 out of 16 states have been forced to impose a budget freeze—ranging from a partial one (Baden-Württemberg) to a total freeze (Berlin). The 11 states are: Schleswig-Holstein, North Rhine-Westphalia, Rhineland-Palatinate, Baden-Württemberg, Hesse, Thuringia, Saxonia, Saarland, Brandenburg, Lower Saxony, and Berlin. Only because state elections were held a few weeks ago, Saxe-Anhalt has not yet declared a budget freeze, even though the situation there, as in Berlin, is so grave that an all-out budgetary emergency—in which even legally mandated payments (such as for social welfare and related budgets) can be suspended—might be declared soon. Two other states are overdue to declare a budget freeze: Bremen and Hamburg, which also held elections a few weeks ago, allowing them to postpone the issue.

Only Bavaria has avoided a budget freeze, but it is only a matter of time before it, too, has to declare special budgetary consolidation measures, because rising corporate defaults and unemployment have haunted the Bavarian economy increasingly in recent weeks. With the defaults of the Kirch Media Group, with more than several billion euros of uncovered debt, and of the Maxhuette steel plant, two of the biggest Bavarian enterprises are putting a burden on the state government—a prominent creditor in both cases—of additional requirements for financial guarantees. All of that will add to the fiscal pressure that the state government has already been exposed to.

The worsening situation in Bavaria, which has ranked among the "rich" German states for about 20 years, affects the other states. The special inter-state compensation fund, which arranges transfers from the richer to the poorer states, will run into trouble as the richer states' tax revenues decline. The case of Thuringia, one of the "poor" states, illustrates the point: Already this fiscal year, it has received 15% fewer transfers from the special inter-state compensation fund. Bavaria, one of the few states that pays into that fund, has contributed considerably less this year. Next fiscal year, the situation of Thuringia and other recipients of such transfer payments will be worse.