

**Financing Counties in Germany with specific regards to the situation in
Rhineland-Palatinate
Gunnar Schwarting
Association of cities Rhineland-Palatinate
and
German University of Administrative Sciences Speyer**

Counties are part of the local sector¹ in Germany.² Their institutional setting (not each single county) is guaranteed by the German Constitution (Grundgesetz, article 28, 2, 2), with each county consisting of several municipalities. There are counties in each Bundesland (except the city-states of Berlin, Hamburg and Bremen), with the smallest number being the 6 counties in the Saarland. The populations of the counties vary widely – from 60,000 up to 600,000 inhabitants. The tasks of counties differ between the Länder, though this topic is beyond the scope of this section. In any case, basic public services (e.g. registration) are done by the municipalities; their town hall can be called a sort of “front desk for the citizen”, but they are still far from having developed into a “one-stop-government”.

The counterpart of counties is the city (the so-called county-free city). Roughly speaking the (county-free) city has the same position as the county and its municipalities combined. Cities may have subdivisions, with different terms used in the different Länder. These form a kind of district, but often have very limited rights. In bigger cities they can act as a sort of decentralized administration (“district town hall”).

Counties have the typical rights of local self-government: their own employees, own budgets, the right to issue by-laws and the right to determine the organisation of the district administration. However, their spatial rights, a prominent right of local self-government, are limited. For example zoning-laws are determined by the municipalities. As in municipalities, the head of the county (Landrat) is directly elected by the population for a term of 8 years (Rhineland-Palatinate). Each county has its own assembly, which is also directly elected (county council) but for a term of only 5 years (Rhineland-Palatinate). The general county elections in a Land are held at the same time as those for municipalities. The rights and duties of the elected officials are the same for both institutions. So at first glance counties seem to be very similar to municipalities.

However, there are some important differences. Counties have specific tasks but these are not

¹ In this paper the terms local entities, local sector or local level are used if all levels of local government (Cities, counties and municipalities) are included.

² As the sizes of the counties vary to a great extent between the Länder, their tasks and position in the system of local governments differ greatly. Thus this article can give only a very rough picture of the situation.

established in the constitution (in contrast to the municipalities, which are responsible for “all tasks of the local sphere”); instead the tasks of counties are defined by ordinary law. In addition, county tasks must be seen in the context of the tasks of the municipalities within the county. According to the principle of subsidiarity, tasks shall be fulfilled by the lowest level as possible.³ Naturally the same is true for county development planning (schools, public transport, streets ...), which has to respect the plans set by the municipalities. Therefore, counties are limited to some extent in their activities.

The functions of counties in Germany are mainly described as the following (Henneke 2008a, p. 66):

- to fulfil tasks which exceed the capabilities of municipalities but which must not be given to the state level (the counties as an intermediary level between the state and municipalities, see Henneke 2008b)
- to assist the municipalities if they cannot fulfil their tasks on their own due to a lack of administrative or fiscal capacity⁴
- to ensure equivalent living conditions within the county (mainly by means of the contribution from the municipalities)⁵

Generally the budget of counties in Germany is financed from very similar sources as the budget of municipalities – but with one great exception: **Counties do not levy their own taxes or take part in national tax sharing** as do municipalities.⁶ Instead they are financed by contributions given by (the paying municipalities would rather say: taken from) the municipalities within the county. Thus this is a bottom-up system of financing. This is much the same for other regional entities we find in some Länder, as for instance the region of Palatina in Rhineland-Palatinate or specific Provinces in North Rhine-Westphalia.

Figure 1 outlines the the other sources of current county revenues, which are then further

³ This principle is also part of the Lisbon Treaty. The problem was the object of a judgement by the High Court in 1988 concerning waste disposal. In its judgement the High Court clearly defined the conditions for state legislation in which a specific task shall not be given to the municipalities but to the district. See Henneke 2008a, p. 32

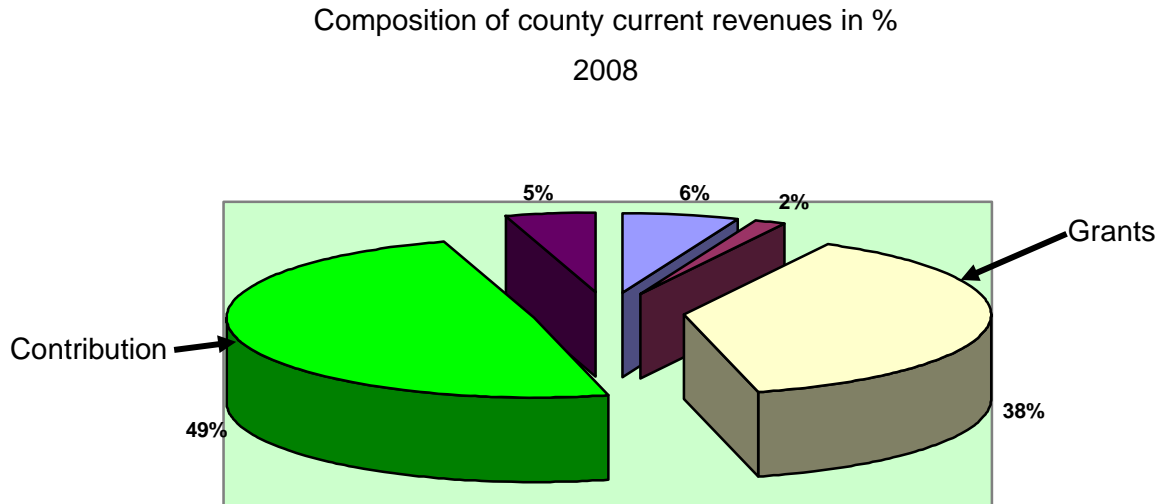
⁴ This is a very crucial point. The municipalities within the county are often not of equivalent size and capacity. Bigger municipalities (or municipalities with a different status like in Hessen or Rhineland-Palatinate) claim the right to fulfil duties on their own. The conflict arises when the contribution to the county budget nonetheless remains the same as for the other municipalities.

⁵ This is another crucial point, as the equalization policy within a relatively rich county might conflict with national or regional development policy.

⁶ Counties have the right to levy only chase and fishing taxes – a very minor tax revenue of 30 million Euro in 2008 (Wohltmann 2009a, p. 273). Therefore, the Association of Counties (German County Association) advocates at the

discussed below:

Figure 1



Source: Wohltmann (2009a), p. 273

User charges are quite an important revenue source in county budgets, amounting to 6% of total revenue, mainly due to the counties responsibilities for waste disposal (with some differences between the Länder). Generally these revenues cover the costs of the service so that it is not a burden on the county budget. This is possible because the county itself sets the rate of the charge (just high enough to cover the costs). A second quite important **fee** is levied for vehicle registration, another service done by counties. However, in contrast to user charges, this is an administered price set by the national government. Whether these fees cover the costs of the service or not is determined by the number of newly registered cars and the efficiency of the service provision.

Surpluses from **local enterprises** are more common on the municipal level, accounting for less than 2% of total county revenue. Most counties have only minor enterprises – however, in some regions counties are shareholders in regional energy suppliers, so in some cases the dividends might be a substantial source of revenue for the county budget.

Within every Land there are economic disparities; among the counties of Rhineland-Palatinate the GNP per capita ranges from 20% above the average to 18% below. Therefore, counties take part

national level for the right of counties to have their own district taxes or for the counties to have a share in the system of tax-sharing.

in a **fiscal equalization scheme** among the local entities.⁷ These payments amounted to 38% of total county revenues in 2008. As is pointed out in other articles in this book, each Land has its own equalization scheme, but generally there are five decisions to make:

- the proportion of the tax income of the Land that is given to the local sector (about 20% in Rhineland-Palatinate)
- the division of this sum between general and specific grants (for many years this has been 60:40 in Rhineland-Palatinate, but this is now changing slightly in favor of general non-specific grants)
- the division of general grants between counties and municipalities (in Rhineland-Palatinate this is done within the equalization scheme – “single-tier” – whereas in Hessen a specific “column” for the counties is defined by the Land before equalization - “multiple-tier”)
- the indicators used to determine the needs of the local entities. Aside from the number of inhabitants, the most important for the counties are (in Rhineland-Palatinate):
 - the costs of social aid and the number of pupils in secondary schools (as counties are responsible for these tasks)
 - the area - giving a higher weight the greater the area (this indicator shall reflect the costs of streets built and managed by the county)
- the ratio of equalization between fiscal needs and fiscal capacity (50% in Rhineland-Palatinate)

Generally the fiscal equalization scheme should be sufficient enough to enable local entities to meet minimum service requirements in relation to the average. The crucial point is the portion of tax income given to the equalization scheme by the Land, which ranges from 11% in Bavaria to 23% in North Rhine Westphalia. However, in many cases this is not the whole story. A high portion does not necessarily indicate that a Land is very friendly to the local level and vice versa. Interestingly, short term loans to districts are very high in North Rhine Westphalia but very low in Bavaria (see Fig. 4). It may be that in Bavaria money is given to the local level outside the fiscal equalization scheme or that some tasks done in other Länder by the local level are situated at the state level in Bavaria.

Another interesting question is: How are general grants divided between counties and municipalities within a single-tier equalization scheme as in Rhineland-Palatinate? The crucial determinants the number of inhabitants. To avoid double counting inhabitants the population is

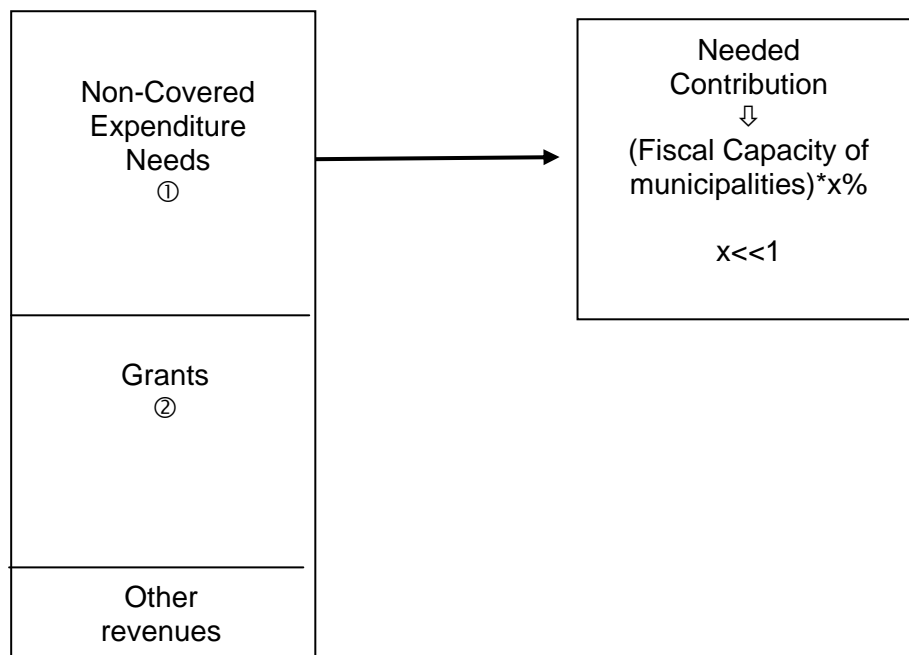
⁷ The Fiscal Equalization deals only with the budget (fiscal needs minus fiscal capacity, see the article by Gisela Färber); there are other instruments to close the gap between wealthier and poorer regions, such as development policy,

divided between the two levels (70% for the county, 30% for the municipalities). The same is done for fiscal capacity.

The **contribution of funds** to the county by the municipalities – the main revenue source for counties (Fig. 1) – is regulated by the fiscal equalization law. This shows the very close connection between the two systems. Contribution funds are always general revenues. They are paid to finance current and capital expenditures of the county (Figure 2). The contribution is based upon the fiscal capacity of each municipality within the county. Of course the system works only if the municipalities have their own revenues which are sufficient enough to pay the contribution to the county.

Figure 2

Calculation of the contribution rate



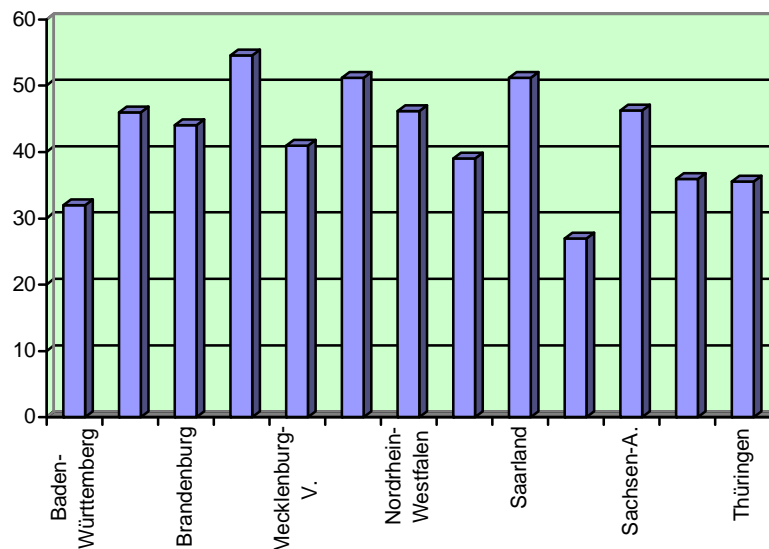
Municipalities are obliged to pay. They cannot hold back the money for any reason even if they disagree with the height of the contribution rate. Counties in two of thirteen Länder require approval for the rate of contribution if the rate exceeds a critical borderline, while in another four Länder approval is needed if the rate is to be raised. In Niedersachsen approval has to be given in any and every case (for more specific information see Wohltmann 2009b, p. 277). Moreover in four

the positioning of public institutions such as universities, and etc.

Länder the municipalities have the explicit right to give their opinion on the county budget, especially on the rate of contribution. If they disagree with the rate their arguments must be discussed by the county council.

Figure 3

Different rates of contribution by Länder in % of municipal fiscal capacity
2009



Source: Wohltmann (2009b), p. 287

Fiscal capacity of the municipalities is determined in accordance to the fiscal equalization scheme. Generally speaking the municipal revenues consist of:

- the local property tax
- the local commercial tax
- the local share of the national income tax
- the local share of the national VAT
- the general grants

These are the basis for defining fiscal capacity and thus determining the county contribution (occasionally with different rates between the Länder).

The county determines a rate defined as a percentage of the total fiscal capacity of the municipality. This rate amounts to nearly 40% in Rhineland-Palatinate, while there are even higher

rates in, for instance, Hessen. Moreover, Rhineland-Palatinate allows a progressive setting of this rate. The contribution of funds to the county sets a small-sized equalization scheme on the county level, very clearly seen if the rate is set in a progressive way.

As is seen in Fig. 3 the contribution rate differs widely between the Länder. The lowest rate is found in Saxony, the highest in Hessen; the difference amounts to almost 30 percentage-points. Possible explanations for the differences are:

- a different division of tasks between counties and municipalities
- a different position of counties in the fiscal equalization scheme
- a different level of specific transfers from the Land outside the fiscal equalization scheme
- deficits on the county level which are not balanced by a rise in the contribution rate (“holding deficits at the county level”)

A unique aspect in the one-tier equalization scheme of Rhineland-Palatinate is the effect of the division of inhabitants between county and municipalities. The higher the rate in favor of the counties, the lower should be the contribution rate demanded from the municipalities. This does not change the overall level of the budgets of the municipalities (less grants on the revenue side, less contribution on the expenditure side) – but it looks better!

County capital expenditures are mainly funded by

- surpluses in the current account or earnings from selling local assets
- specific (matching) grants by the regional government
- borrowing

Nowadays surpluses are mostly small, and in many counties even negative. Thus this source is not really important. Earnings from the sale of assets are also of minor importance because counties do not have real estate that is not in use for public services. Furthermore, as pointed out earlier, in most cases counties do not have at their disposal public enterprises that could be privatized.

Specific grants are of course a means by which the state influences local preferences in order to further state policy aims. This happens also on the municipal as well as on the county level. Generally specific grants cover only part of the total investment, leaving the rest to local co-financing. Therefore it can be said that this amount on the local level is absorbed from other projects. The main objects of specific grants to counties are (secondary) schools, streets or – if run

by the county – hospitals. Theoretically specific grants should follow a clear development strategy set by the Land but in many cases specific grants can be said to be a result of political negotiations.

Counties as well as municipalities have the right to take out **loans** for investment purposes. They even can decide which financial institute shall provide the loan (according to the best effective interest rate), limited only in that local governments should avoid borrowing in foreign currencies. There is no need for specific guarantees for local borrowing. The right to collect taxes (or in the case of a county: contribution) is a sufficient collateral for the loan. Therefore, to date there has been no obligation for the financial sector to hold a specific ratio of equity in relation to loans to the local sector. Defaults on loans to cities, municipalities or counties did not occur in the past. Moreover, in Germany (in contrast to other nations, e.g. Switzerland) a rating procedure for local entities is not common or even necessary.

Great attention should be paid to the **burden of local borrowing**. Because interest payments diminish the future fiscal capacity of the local entity, theoretically borrowing is permitted only if the excess of revenues over expenditures is high enough to cover additional interest payments (and, of course, the running costs of the investment project). Thus local entities need to get approval from the supervisory institution, which for municipalities is the county. Counties, therefore, are Janus-faced; as a supervisory institution they act in place of the state, but as a local entity counties themselves need the approval of a state institution, such as the Ministry of Interior or (in most cases) one of its subdivisions.

Though not necessary for every single loan, such **permission** is needed for total borrowing planned for a given fiscal year. Permission should be denied if the budget of the local entity is not balanced. However, in reality this is often not the case. In order to ensure sufficient investment for fundamental services at least some debt financing will mostly likely be approved. This was a crucial condition for allowing the public investment (national investment program 2009/2010) needed to help overcome the difficulties caused by the financial and economic crisis of the last few years.

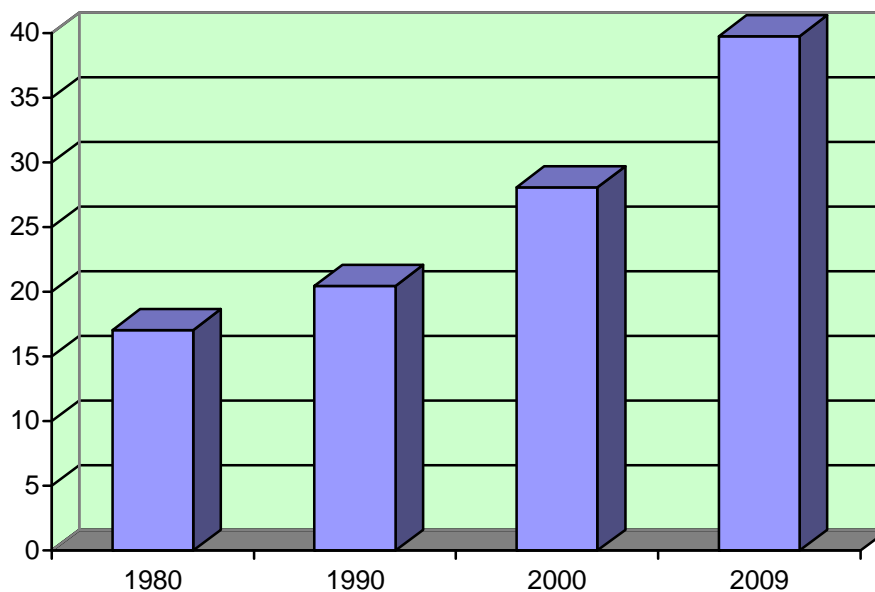
Now, what are the main (fiscal) problems of counties?

1. In many parts of western Germany the budgets of local entities – including counties – are **not balanced**. The costs for local public services are insufficiently covered by revenues. The biggest part of the deficit, which nationwide is estimated at a level of about 15 billion

Euros (160 Euros per capita) for the year of 2010, generally arises from the social aid sector. As social aid accounts for about 40% of county expenditures (Fig. 4) this problem is existential for them, even more so as these expenditures have risen extraordinarily in the past years.⁸

Figure 4

Share of Social Transfers in relation to current expenditures (in %)
1980 – 2009



Source: Wohltmann (2009a), p. 255

2. Counties face a variety of changes in legislation, especially in the field of **social security**. They have to adapt new or changed regulations for their services. As is the case for child care (children under 3 years old), more and more costly tasks are coming. Therefore counties and their respective associations have to negotiate with the state ministries about compensation payments (principle of connectivity).
3. On the other hand, **rapid changes** are occurring in the market for public services. This is for instance the case with hospitals. While traditionally a typical task for the county, now an increasing number of private hospitals are being established. Sometimes counties even

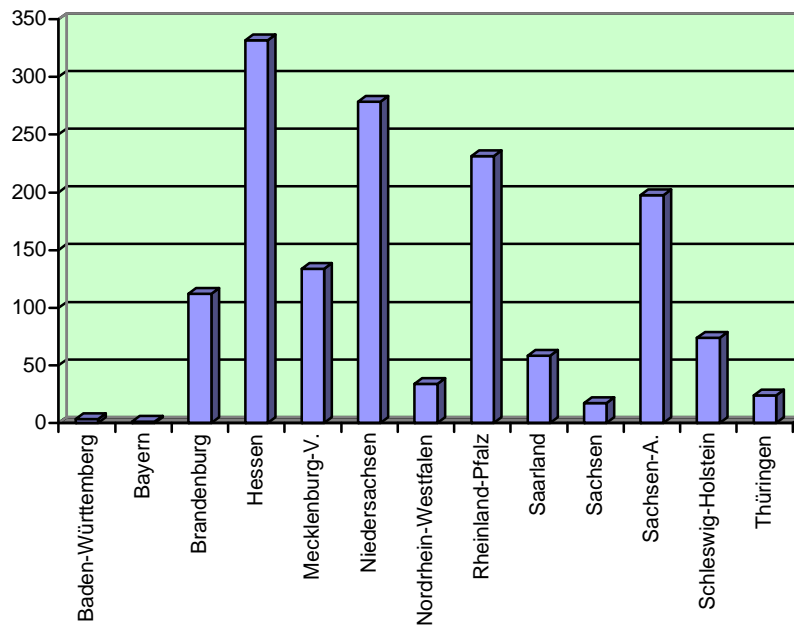
⁸ Additionally, the costs of social administration have to be taken into account. In some Länder specific social services are done by higher level organisations, such as the provinces in North Rhine-Westphalia. The contribution of districts to

- privatize their hospitals.
4. A great part of the revenues of counties comes from the **contribution** by the municipalities. This affects the fiscal capacity of the municipalities. If – as in some cases such as Hessen – more than 50% of local tax revenues and grants are absorbed by the county then conflict between the two levels is inevitable.
 5. A very real conflict is related to using the level of county costs as basis for setting the contribution rate (⊕ in Fig. 2). In Germany the local sector will implement **accrual accounting** by 2016, meaning that depreciation has to be taken into account which was not the case before. Municipalities claim that they will now be paying for depreciation of county infrastructure that were once financed by them through earlier contributions.
 6. The implementation of accrual accounting is accompanied by the introduction of more tools of **new public management, such** as governing by goals and numbers, benchmarking or (financial) risk management.
 7. The members of the county council are often members of a council in a municipality within the county. Thus they face an **inherent conflict** regarding whether to support the county or the municipality. Consequently, many counties do not raise the contribution rate to the level necessary to cover all expenditures.
 8. Therefore counties have to take out **short-term loans** to fill the gap between expenditures and revenues (Fig. 5). In the counties of Rhineland-Palatinate this debt amounts to about more than 230 Euros per capita (2008). This short-term debt adds to the long-term liabilities, it has risen in 2010 to nearly 350 Euros per capita.

Figure 5

Short term loans by counties in Euro per capita
31.12. 2008

these institutions is also part of social costs on the district level.



Source: Wohltmann (2009a), p. 239

9. Hence the counties are demanding, through specific associations (German County Association), their **own taxes or a portion in tax-sharing** – a system found in other countries such as France (communautés urbaines)
10. As the municipalities have to pay the contribution, they try to limit the **activities of the county** (① in Fig. 2) while districts are interested in getting more duties, e.g. by decentralising former state duties.⁹
11. The **distribution of grants** is another field of conflict (② in Fig. 2). As the sum of grants is limited, the division between the two levels is crucial. Some Länder try to solve the problem by dividing the grant total into a part for the counties and another one for the municipalities (multiple-tier). However, this division itself can be a point of conflict and is open to political debates.
12. The local sector overall (but with great regional differences) faces a substantial gap between investment needed and real **investment expenditures** made. Most of this investment is not necessary for new infrastructure but for renovating and modernizing the existing one. This is true also for the counties. So unfortunately, many streets, schools and other parts of infrastructure are not in good condition.
13. A challenge for the counties is the development of **regions** (somewhat higher level local entities). For example, the city of Hanover and the county of the same name now form the

⁹ A very creeping decentralization is found in street classification. The national level tries to shift the responsibility for national roads to the Länder as they try to shift the responsibility for their regional roads to the districts.

region of Hanover. Similarly, the city and the county of Aachen merged two years ago. Both regions were not initiated by the Land and the idea was instead born at the local level. They are thus a result of a bottom-up process. Furthermore, metropolitan areas are becoming more and more important. A very old one is the Ruhr region in North Rhine-Westphalia, but more interesting is the Rhine Neckar region (Mannheim-Heidelberg-Ludwigshafen), whose local entities belong to three different Länder.

14. Are regions an answer to territorial reform through amalgamation of counties (and county-free cities)? Might regions in the long run become something like a “super county”? What happens to areas at the periphery where no nucleus for forming a region exists? There are many questions about such issues but any prediction is nothing but speculation.

Some relevant books and articles on the issue:

Especially for the financial situation of counties

H.G. Henneke (2006), Besonderheiten der Einnahmen der Kreise und anderer kommunaler Gebietskörperschaften im Überblick, in: H.G.Henneke/H.Pünder/C.Waldhoff (ed.), Recht der Kommunalfinanzen, München, p.230 – 255

M. Wohltmann (2009 a), Kreisfinanzen 2008/2009 – Kreishaushalte vor den Auswirkungen der Konjunkturkrise, Der Landkreis 6/2009, p. 238 -273

M. Wohltmann (2009b), Die Kreisumlage 2008/2009, Rechtliche Grundlagen und finanzielle Entwicklung, Der Landkreis 6/2009, p. 274 – 289

More generally on Local Finance

Deutscher Städtetag, Gemeindefinanzbericht 20..., der städtetag 5/20.. (yearly publication)

Gunnar Schwarting (2010), Der Kommunalhaushalt, 4th ed., Berlin

Horst Zimmermann (2009), Kommunalfinanzen, 2nd. ed., Berlin

A very profound description and analysis concerning the position of counties within the German Public Fiscal System is found in:

H.G. Henneke (2008a), Die Kommunen in der Finanzverfassung des Bundes und der Länder, 4th ed., Wiesbaden

H.G. Henneke (2008b), Die Kreise – Bindeglied zwischen Staat und Gemeinden, in: S. Magiera/K.-P. Sommermann/J. Ziller (eds.), Verwaltungswissenschaft und Verwaltungspraxis in nationaler und transnationaler Perspektive, Berlin 2008, p. 429 – 449

For the specific questions of Fiscal Decentralization see my lecture at the DHV Speyer www.dhv-speyer.de/lba/schwarting/Mitschnitte.htm