

## TABLE OF CONTENTS

|                                                                                      |    |
|--------------------------------------------------------------------------------------|----|
| Introduction .....                                                                   | 4  |
| Inter-governmental relations: consensus and co-ordination.....                       | 5  |
| Expenditure responsibilities overlap .....                                           | 5  |
| Increasing reliance on tax sharing .....                                             | 8  |
| ... and declining tax autonomy .....                                                 | 10 |
| The fiscal equalisation system .....                                                 | 12 |
| Revenues are equalised across states.....                                            | 12 |
| Disincentive effects of high marginal effective tax rates on the Länder .....        | 13 |
| Reform requirements: ensuring support while reducing disincentives .....             | 16 |
| Implementing the Stability and Growth Pact: the need for a domestic equivalent ..... | 18 |
| Matching expenditures and revenues: the case for greater state autonomy .....        | 20 |
| Co-financing goes too far .....                                                      | 20 |
| Taxing powers need to be devolved .....                                              | 22 |
| Summing up .....                                                                     | 23 |
| Bibliography .....                                                                   | 25 |

### Box

|                                                      |   |
|------------------------------------------------------|---|
| Tax sharing and revenue equalisation in Germany..... | 8 |
|------------------------------------------------------|---|

### Tables

|                                                                                     |    |
|-------------------------------------------------------------------------------------|----|
| 1. Länder expenditures co-financed by the federal government .....                  | 6  |
| 2. Tax accruals by layer of government .....                                        | 10 |
| 3. Redistribution of tax revenues in the Länder financial equalisation system ..... | 13 |
| 4. Spending and deficits of the Länder .....                                        | 19 |

### Figures

|                                                                                                     |    |
|-----------------------------------------------------------------------------------------------------|----|
| 1. Federal co-financing of sub-central fiscal projects .....                                        | 7  |
| 2. Share of state and community spending financed by taxes.....                                     | 11 |
| 3. Variability of per capita income and unemployment between Länder.....                            | 14 |
| 4. Outflow of Länder tax revenues due to interaction of tax-sharing and financial equalisation..... | 15 |
| 5. Real per capita income and unemployment in the Länder .....                                      | 17 |