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Efficiency Problems of
Administrative Federalism

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Abstract:

In general, governments in federal systems have the competences of legislation and of administration in one hand. There are two countries where the rights of legislation and the competence to execute the laws of the superior federal tier are separated. These systems are called "administrative federalism". Beside Germany and Austria, the European Community shows the fundamental qualities of administrative federalism. Empirical evidence suggests important efficiency deficiencies of administrative federalism compared with the so-called not-interconnected federal systems. In the paper, after the elaboration of the constituent differences of both types of federalism, possible advantages and disadvantages are analysed from the theoretical point of view of fiscal federalism. They are then contrasted with empirical experiences in Germany, in Austria and in the European Union: the results show many arguments that the existing administrative federalism is much less efficient than the not-interconnected federal systems. An international comparison of government expenditures and tax revenues gives deeper and more precise information about the efficiency of different types of federal systems also compared with centralist systems. The paper is completed by an analysis of the reasons of the measured inefficiency of administrative federal governments: The rules of the fiscal constitution are focussed as the main source of federal inefficiency.

The paper was presented at the Annual Conference of the Research Committee "Comparative Federalism and Federation Research" of the International Political Science Association (IPSA), October 4th to 7th, 2001 in Javéa, Spain.

Zusammenfassung:

Das föderative System der Bundesrepublik Deutschland wird wegen der Verteilung von Gesetzgebungskompetenzen an den Bund und der korrespondierenden Verwaltungskompetenzen an die Länder als Verwaltungsföderalismus klassifiziert. Ähnlich ist die föderative Verfassung Österreichs konzipiert. Außerdem weist die Europäische Union diese Strukturmuster auf. Alle drei Systeme weisen empirisch nachweislich ähnlich gelagerte Effizienzprobleme auf, die sich in dieser

Form in den sogenannten unverflochtenen föderativen Verfassungen nicht finden lassen. Der Beitrag geht deshalb der Frage nach, ob es sich hier – gemessen an einem Zielsystem für föderative Systeme, das aus der Theorie des Fiskalföderalismus abgeleitet wird – um konzeptionelle Probleme des Verwaltungsföderalismus geht oder ob bestimmte Konstruktionsmängel die möglichen Stärken des Systems überdecken. Der Beitrag prüft, welche Stärken und Schwächen diese Konzeption gegenüber anderen föderativen Systemen aufweist und worauf seine Probleme zurückzuführen sind. Anhand eines internationalen Vergleichs verschiedener Staatsquoten werden die Effizienzprobleme des Verwaltungsföderalismus gegenüber anderen föderativen Staaten, aber auch gegenüber zentralistisch verfaßten Ländern quantifiziert. Abschließend werden die Regeln der Finanzverfassung und die ihnen innewohnenden Mängel als Ursache der vorliegenden Probleme des Verwaltungsföderalismus analysiert.

Der Beitrag wurde auf der Jahrestagung des IPSA-Research-Committees "Comparative Federalism and Federation Research" präsentiert, die vom 4. bis 7. Oktober 2001 in Javéa, Spanien, stattfand.

1. Administrative federalism – between a claim to efficiency and the balance of power

There are a few federative systems which have chosen the track of so-called administrative federalism. In these systems, legislative and administrative competences are separated in essential fields, whereby the first are assigned to a higher, the latter to a lower federal tier. As an example can serve the German federalism, in which according to Art. 84 GG (Basic Law = German constitution) the Länder carry out the laws of the federal government as their own responsibilities, whereby they often delegate the concrete execution to their municipalities. In Austria there are also areas, in which the federal government is in charge of the legislative power, the Länder of the administration.¹ Within the EU conditions are similar, where there is almost no European administration of its own. Instead it falls back upon the administrative systems of its member states which have to introduce European law into national law and then to execute and administer it².

The decisive factors for these constructions probably are and have been power-political constellations: In Germany it was above all Prussia, who had secured a majority of votes in the Bundesrat of the newly founded German Reich in 1871 and had wanted to hold another counterpoise of power towards the Reich through the executive competence.³ When the Federal Republic of Germany was founded after World War II there was 'sufficient' experience with respect to the centralized administration of the third Reich to guarantee an effective restriction to the power of the Federal Government by way of a general competence of execution within the system of vertical separation of

1 See *Thöni, Erich*: Fiscal federalism in Austria: facts and new developments; *Fossati, Amadeo/ Panella, Giorgio* (Ed.): Fiscal Federalism in the European Union, London/ New York 1999, p. 108; and *Gamper, Anna*: Österreich – Das Paradoxon des zentralistischen Bundesstaates, in: Europäisches Zentrum für Föderalismus-Forschung Tübingen (Hrsg.): Jahrbuch des Föderalismus 2000, Baden-Baden 2000, p. 251 ff.

2 See e.g. *Streinz, Rudolf*: Europarecht, 5th ed., Heidelberg 2001; and *Arndt, Hans-Wolfgang*: Europarecht, 4th ed., Heidelberg 1999.

3 See *Fisch, Stefan*: Von der Föderation der Fürsten zum Bundesrat des Grundgesetzes, in: von Arnim, Hans Herbert/Färber, Gisela/Fisch, Stefan (eds.): Föderalismus: Hält er noch, was er verspricht? Seine Vergangenheit, Gegenwart und Zukunft, auch im Lichte ausländischer Erfahrungen, Baden-Baden 2000, p. 37.

powers. Finally in the EU which was founded as a custom and economic union in the first place an autonomous and supranational influence of Europe by way of administrative execution was neither necessary nor desired. Furthermore it seemed to be the more efficient solution than to install an administration covering the whole area of the European Community for the relatively few tasks it had in the beginning.

The efficiency advantages of administrative federalism are probably located in the regional differentiation in the execution of the laws of a higher federal tier towards the subordinated jurisdictions which differ not only geographically but also with respect to the structure of their administrations and the related costs of administrative performances. To what extent this "prejudice" is true and, above all, under which conditions administrative federalism can unfold its strength shall be examined below. The comparison with other federal systems in which legislative and administrative powers are fundamentally in the hands of one and the same jurisdiction, which means they are equally "centralized", will help to work out the respective empirical problems which can – due to the complex realities of the federative systems in practice – be modelled only to a certain, limited extent. Due to their quite similar system of values with respect to the distribution of public goods within the whole area of the national state Canada and Australia promise to be the most suitable countries for a comparison. A comparison of the problems of Germany and the EU allows insights in the systems of administrative federalism which are at the margin diversified to varying extents.

For this purpose first of all some structure parameters are worked out in which both types of federalism differ. The two different constructions show through as far as their financial constitutions. Afterwards possible advantages of administrative federalism are discussed by means of aims and criteria for judgement. In the 4th section I want to analyse the problems of administrative federalism to see if and to what extent they can be traced back to the basic conception or to a faulty but possibly reparable design especially in the field of their financial constitutions. While doing this the question should be kept in mind how federative systems, which are not interlinked, react to certain problems and if they show more efficient solutions resp. social problem solution patterns.

2. Organizational dimensions of the so-called administrative federalism

The systems of the so-called administrative federalism differ in some fundamental elements from federative systems which are not inter-linked. These differences are elementary for the ways of functioning of these systems and at least to a certain extent not interchangeable because they guarantee the respective organizational consistence. Individually these differences refer to the following features:

1. According to its definition in administrative federalism the legislative power is in essential parts of the public sector separated from the administrative power. Subordinate federative tiers execute laws of the superior tier under their own responsibility. With respect to the way they fulfill their tasks they either can be free to administer or they have more or less instructions imposed on them. In the other – as I call them – non-interlinked federative systems legislative and administrative powers are "in one hand", which means the jurisdiction, which is in charge of the legislation – according to the distribution of responsibilities laid down in the constitution – also organizes the execution using her own authorities and institutions. In non-interlinked federative systems a regulation of administrative procedures this high is not necessary because the jurisdictions can also control their executing bodies directly on the institutional way.
2. In the financial constitutions of the federative systems the regulations correspond to the a.m. basic patterns of general legislation. The non-interlinked systems carry on their pronounced autonomy of their competences within the financial framework, which means that all tiers are equipped with autonomously exhaustible tax resources. The financial constitution of administrative federalism in contrast includes a high degree of financial interlinking.

For one part this refers to the distribution of spending competences according to the so-called principle of connexion, which does not refer to the legislative power but to the administrative competence.⁴ This means the subordinate jurisdictions which execute federal laws as their own responsibility have to carry the

4 See in detail *Kirchhof, Ferdinand*: Gutachten D zum Deutschen Juristentag 1996, München 1996.

costs of administration. They also pay for the costs of executing European regulations in all cases in which they are responsible for execution according to the usual national division of responsibilities. Only if the Länder carry out tasks on behalf of federal government the latter pays for the so-called "program expenditures", but not for the administration costs. The German districts and to a lower extent cities and municipalities also only receive genuine refunds of administration costs (however in most cases a lump sum) when they carry out tasks which – in earlier days – were transferred to them as a formerly subordinate authority of a Land and where they act "on behalf" of a Land.

3. For another part also the revenue side of the financial constitutions is interlinked. In all administrative federalisms there is a genuine lack of autonomously exhaustible tax resources. In Germany and Austria, for subordinate tiers there are (if any at all) only rights of (determining) tax rates to homogeneous bases of assessment resp. multipliers to homogeneously determined federal rates or rights of surcharges on tax resources of the superior federal tier. For reasons which are probably historical municipalities still have the right to levy some meanwhile quite restricted local expenditure and excise taxes. Finally, the European Union may have by now the revenue power for dedicated shares of national taxes and some special agricultural duties. However it is otherwise dependent on the financing decisions of the council of ministers⁵ whereby especially decisions concerning VAT-based own resources must be considered as some type of revenue-sharing of certain taxes of the member states.⁶ These regulations for revenue division are furthermore the most outstanding common feature of the financial constitutions of administrative federalisms on the revenue side.
4. With regard to the financial equalization there seems to be very little difference between the two types of federalism. Both systems are compatible – as the examples of Canada and Austria show – with a financial equalization which is at the same time thoroughly marked and formalized. A horizontal financial equali-

5 Decision of the council dd 31.10.1994 on the system of capital resources of the EG (94/728/Euratom), Abl. Nr. L 293, p. 9.

6 See *Kraff, Manfred*: Der Finanzausgleich in der Europäischen Union, Bonn 1997, p. 337.

zation however should turn out to be only compatible with administrative federalism, because due to the lack of autonomy and the closely connected high intensity of intervention from the side of the tax law the part that can be identified as the "own" of the state tax revenues is forced into the background. In the non-interlinked systems the financial equalization is carried out only by vertical assignments which however have a horizontal equalization effect. Further to that in all types of federalism there is a high level of specific purpose assignments which can already be explained by the fact that federalism cannot – unlike centrally organized systems – force a government or an administration e.g. of a region without restriction to act according to the best interests of the superior tier. On the contrary in federalism money must be used as a "lubricant agent" in order to motivate other jurisdictions to an agreement or to act in a certain way if this is not in their own best interest anyway.

3. Advantages of administrative federalism?

The division of powers in federative systems is to be seen in a functional context. It has to meet certain requirements. It is equally at the service of an optimal and efficient supply of public goods with regards to the preferences of the voters, which from a normative point of view and considering the findings of the economic theories of democracy and federalism can be operationalized by the following five targets:

1. optimal consideration of regional preferences for public goods,
2. production of a certain public goods supply at minimal costs,
3. innovative competition in the public sector which will enhance efficiency,
4. adaptability of the federative system to changes in the societal environment with respect to way and extent of public task performance, and
5. optimal political control.

3.1 Optimal consideration of regional preferences for public goods

Also exclusively with respect to a decentralized administrative power there are advantages conceivable for a higher correspondence to preference in the provision of public goods⁷. Especially in the case where a higher federal tier – the federal government or Europe, but also Länder for their municipalities – determines only certain features for public goods and leaves others to the administering lower governments for a free and regionally diversified organization, solutions according to preference in public performance become conceivable. If legislative and administrative power were in the hand of one regional corporation the performance would have to be uniform throughout the whole territory at least as far as the important principle of equality of citizens for access to public services is concerned. But if the higher level only determines the characteristics which have to be absolutely uniform, e.g. to avoid restraints of competition and to guarantee free trade, as it was already determined in the EU contract in the times of its foundation as European Economic Community (EEC) then even considering large regional differences in kind and extent of public service supplies according to preference can be organized throughout the entire territory.

There are different ways to influence the decentralized performances of centrally regulated public tasks: the logically most simple possibility is the determination of the extent of supply with public goods as it was carried out in Germany in the case of guarantee of a kindergarten facility. But further-going regulations are conceivable with respect to the organization of public output and responsibilities as well as to the ways of administrative procedures up to the type of financing which includes amount and rates of fees. As far as central regulations are necessary to guarantee an optimum supply of public goods – which means e.g. to internalise external effects and to avoid or minimize transportation costs at crossing over from one decentralized local government to the next, which have not been caused by different preferences –, they serve to avoid losses in welfare. In these

7 See regarding general requirement: *Tiebout, Charles*: A Pure Theory of Local Expenditures, in: *Journal of Political Economy*, 1956, p. 416 ff.; as well as *Peffekoven, Rolf*: Finanzausgleich I: Wirtschaftstheoretische Grundlagen, in: *Albers, Willi u.a. (eds.): Handwörterbuch der Wirtschaftswissenschaft*, Stuttgart u.a. 1980, p. 611 ff.

cases central regulations cause gains in efficiency. In principle however there mostly remain sufficient parameters relevant to the organization of the executing jurisdictions to consider the respective regional or local preferences in the more or less individual organization of the execution.

3.2 Production of a certain supply of public services at minimum costs

The "classical" line of reasoning for the basic pattern of the administrative federalism is in the field of the (more) efficient production of public goods. Thus basically the long-postulated principle of a distinction between a state guarantee function on one hand and the concrete production of public goods on the other hand⁸ has been realised as principle of federal state organization. Although in administrative federalism the executive function has not been privatised but transferred to a decentralized federative tier (which can in principle also decide on its own whether to pass the realization on to a private enterprise) the advantages of the organizational principle for the costs of the provision of public goods can be systematized in a similar way.

Efficiency can here be achieved in a quadruple way: In the first place the decentralization of administrative competences actually only opens in the face of the law-giving federal tier the possibility of regionally different "production structures", by which – in spite of different regional and local circumstances – in each case efficient production methods can be achieved. Regionally differing prices for production factors can just lead to different, each individually efficient ways of execution. In the second place the executive body has concrete information at its disposal at far lower costs than the central body, which is necessary to plan the required realization alternatives.⁹ In the

8 See *Jann, Werner*: Verwaltungsreformen auf der Ebene des Bundes: Binnenmodernisierung der Bundesverwaltung und Beendigung des Kombinationsmodells, in: RWI-Mitteilungen 3-4/1998, p. 193 f.

9 Strangely the economic theory of federalism restricts itself practically exclusively to this efficiency advantage of administrative federalism (see e.g. *Schwager, Robert*: The Theory of Administrative Federalism: An Alternative to Fiscal Centralization and Decentralization, in: *Public Finance Review*, Vol. 27, 1999 Nr. 3, S. 282 ff.), which however does not only exist in federative systems but also in systems organized as centralist states, which also have

third place different regional structures (such as distances, density of population, historical orientation) equally bring about that – should necessity arise – different forms of execution can be in individual cases efficient solutions with respect to the desired degree of supply in the population.

While the first three advantages could also be realized through different forms of supply and execution in non-interlinked federative systems, e.g. by transferring certain autonomous executive powers to public institutions to generate efficient solutions, the advantages of a general delegation of the execution to independent lower jurisdictions can only be reached in administrative federalism. In non-interlinked federative systems each regional corporation has to organize an administration for the entire territory of its jurisdiction. The same way as an economy without any territorial dimensions only exists in economic models there are hardly any public goods which do not show territorial dimensions. Although here the new media for information and communication will cause dramatic changes to the supply of an area with administrative performances (e.g. residents registration via internet) in the years to come, most of the public goods have to be organized throughout the whole territory.

Theoretically, for every public performance there is a special optimal size of jurisdiction. The fixed costs of whatever bureaucratic organization and the immeasurably growing costs of the political decision making process are points in favour of a bundling of several public goods in a jurisdiction. In the German administrative federalism the federation e.g. runs only federal authorities which can carry out their tasks in one or a few locations. All other tasks are carried out by the Länder and or even by the municipalities which are more spread across the whole territory. The only federal administrative organization in Germany, which is regionally differentiated, are the labour offices owing to their character as a self-administrated social security fund. By the way: as long as the federation had to pay children's allowance entirely out of its budget, it was paid exactly for this reason of a coun-

to solve the problem to establish efficient administrative structures all over the area of the national territory to supply their population with public goods. With regard to the different approaches to regionalization see the country reports in *Färber, Gisela/Murray Forsyth: The Regions – Factors of Integration or Disintegration in Europe? Föderalismus-Studien Bd. 8*, hrsg. von Hans-Peter Schneider, Baden-Baden 1996.

try-wide representation by the labour offices, who had otherwise nothing to do with this task.

So it is the decentralization of an administration which creates the possibilities for a nearly efficient and optimally supplied concentration of public performances. Depending on transportation costs and urgency of local supply many federal tasks such as administration of passports and identity cards are even organized on a municipal level. Instead of three or possibly four authorities on the spot if Europe is included, which carry out the tasks of the levels separately there are furthermore "bundling authorities" at the state level which administer similar tasks of the federation, of the Land and – should the occasion arise – also of the EU. This bundling of administrative functions minimizes equally the costs of management of the authorities as well as transport costs for the citizens because otherwise the instalment of authorities would only have been economically possible in a much wider geographical context. Furthermore this organization minimizes costs for regular provision and maintenance of services when by fulfilling different tasks "under one roof" a better utilization of regularly maintained capacities is reached.

3.3 Competition for innovative production of public goods

Under this keyword a general advantage of federative state organization is summarized, which results from the fact that novel solutions for the fulfilment of public tasks, which promise improvement faced with the status quo, do not need to be introduced immediately over the whole territory of the national state but more or less experimentally in one or only few member states to begin with.¹⁰ Only if the innovation has proved to be satisfactory the other Länder will follow. Thus costs of failure are minimized because they only concern one part of the country. In addition there is a stimulus to solicit votes through a genuine competition of better performance of public tasks, if politicians can

10 See *Oates, Wallace E.*: Ein ökonomischer Ansatz zum Föderalismusproblem, in: Guy Kirsch (Hrsg.): *Föderalismus*, Stuttgart/New York 1977, p. 20 ff.; *Bretton, Albert*: *Competitive Government: An Economic Theory of Politics and Public Finance*, Cambridge 1996, p. 30 ff.; see also *Tarr, Alan G.*: *Laboratories of Democracy? Brandeis, Federalism, and Scientific Management*; in: *Publius*, Winter 2001, pp. 37.

prove that they have enforced better and more efficient forms of public goods than other parts of the federation.

Even more than to the way and extent of public goods this argument refers to the production process itself. Supposing there were uniform preferences for a public good within the commuter belt of a jurisdiction – and this would c.p. justify that this government had legislative power – there are still different forms of execution resp. its innovation or improvement conceivable which would on their part be subjected to a performance competition through administrative federalism. Here a prerequisite for a functioning competition is however that the executing decentralized local governments dispose of sufficient liberty to develop innovation and to carry it out.

Contrary to that in non-interlinked federative systems the competition of innovation is only possible in an integral way. This means it always includes the public good itself and its ways of production or execution. Thus the innovation competition is excluded, when for whatever reasons tasks have been assigned more centrally than it would have been necessary for the executive process. Therefore administrative federalism can only provide a high level of administrative innovation and efficiency if the lower jurisdictions have sufficient free competences to decide about the way of production of public goods. Insofar the administrative federalism offers due to its conception the possibility to run innovation at a higher speed but lower risk of costs and failure than in other federative states.

3.4 Adaptability to changes of the social and global environment

Since economy and society are not static systems, since they are continuously changing, another important criterion to assess the efficiency of the organization of a national state is its adaptability to these changes, precisely: its capacity to modify ways and extent of public task fulfillment according to possible changes. In a centrally constituted state the respective responsibility is in the hands of the central government, in federative states it lies with the corresponding federal tiers, which hold the respective responsibilities for the production of the public goods involved. Problems always come up when social and economic change requires a revision of competence assignment among the different federative tiers. The necessary shifts can head either towards centralization when e.g. regional spill-overs increase and

can no longer be internalised under decentralized competences. They can however also come in the shape of necessary decentralization, e.g. when new technologies cause economies of scale to decrease or turn into diseconomies of scale or when regional preferences lose uniformity and the voters desire a more differentiated supply of public services.

Competence shifts in federative systems are in most cases connected to changes of the constitution and thus to qualified majorities in all jurisdictions concerned. For this reason federative systems are per se more sluggish than centralist ones in which these competence shifts do not exist. Systems of administrative federalism however are – faced with changes in competences – less sluggish than non-interlinked systems in spite of high costs of reaching consent because they mostly have a movable functional competence assignment. These make at least a centralization of legislative powers possible without a change of constitution, provided that certain conditions are fulfilled. In Germany there exists the institution of concurrent legislative power (art. 72 Basic Law), which transfers the right to legislate to the federation, if certain conditions such as equal living conditions or legal and economic unity are of supra-regional interest and make this seem necessary. Many fields of activities of the EU are only explicitly and exclusively legitimised by their functional targets e.g. to ensure the free trade within the European Common Market.

Non-interlinked federative systems do not know these comparably easy competence shifts which require flexible handling.¹¹ In these the federation as well as the member states have to agree to constitutional competence shifts. For changes of the constitution often referenda have to be carried out, which – as is well known – always show a bias in favour of the status quo. So if a matter of state power is – from the federation's point of view – in need of federal regulation, the federation can at most offer financial means from its own tax revenues in order to convince the provinces or states to do what it thinks is right. Exactly with regard to the asymmetries and pathological states of empirically existing political systems the resulting political solutions do not necessarily need to be optimal. Apart from that the costs of a possibly non-

11 See the analysis of Australian federalism by *Martin Painter*, who interestingly adopts for Australia which from its basic type has non-interlinked structures the term "collaborative federalism" (see *Painter, Martin: Collaborative Federalism*, Canberra 1998, esp. P. 121 ff.).

transparent jumble of multi- and bilateral agreements on specific purpose grants or the corresponding charges on the financial equalization system have to be lamented. The welfare losses resulting from such negotiations should furthermore depend on how far the federative constitution has equipped the federal tiers with balanced powers or if the distribution of power is biased in favour of one tier.

In necessary processes of adjustment and reform, which do not require shifts in competence between the federative tiers the interlinked systems of administrative federalism could turn out to react a lot more sluggishly than the non-interlinked ones. In general, there are several institutions involved in the formation of political intentions, which in most cases not only pursue different interests if governments and parliamentary majorities are inducted by different political parties. Here usually diverging interests of the different tiers are virulent. This becomes evident again and again in the political decisions of the Bundesrat forms in financial concerns and also among other aspects in the quite unusual harmony of the Länder Bavaria and Northrhine-Westfalia in these matters. It is not possible to say whether this complex situations of political negotiation will in the end turn out to be advantageous or disadvantageous for political reforms. Both ways are conceivable, both can be proved. For the quick responsiveness of the federative systems however the interlinked structures might present a definite disadvantage in an international competition.

3.5 Optimal intensity of political control

The theory of public choice has taught economists that it is not the decisions of "wise dictators" to shape reality but those of elected politicians. Correspondence of provided public goods to voters' preferences can among other conditions be reached by means of a short political span of control as voters in democratic elections not only uncover their preferences but also assess the activities of the government in office¹². Furthermore majorities come up by weighing carefully be-

12 See *Blankart; Charles B.*: Öffentliche Finanzen in der Demokratie, 3rd edition, München 1998, p. 69 ff.; as well as *Eichenberger, Reiner*: Föderalismus: Eine politisch-ökonomische Analyse, in: von Arnim, Hans Herbert/Färber, Gisela/ Fisch, Stefan (Hrsg.): Föderalismus: Hält er noch, was er verspricht? Seine Vergangenheit, Gegenwart und Zukunft, auch im Lichte ausländischer Erfahrungen, Baden-Baden 2000, p. 111 ff.

tween supply of public goods and the "tax prices" which are necessary to finance them. Political systems also have to be assessed whether they effectively guarantee the political control of public activities.

In non-interlinked federative systems it should not be difficult to fulfil these conditions. Since legislative and administrative power are in one hand and furthermore the federative tiers have at least the possibility to determine tax prices "at the margin" the voters can carry out a complete assessment before voting. A financial equalization should grant to realize certain ideas concerning the distribution of income over the entire territory without an excess of national and uniform intervention, which can be influenced by monetary and real public transfers. Apart from remaining external effects, on every federative tier then coincide deciders, users and payers for the respective public good provided. The fiscal equivalence – as it was elaborated by Olsen in 1969 as criterion of optimality¹³ – is here fulfilled – apart from a few curtailments which economists have to accept when observing real worlds.

It is at this point that severe problems come up in administrative federalism. For the voters the separation of legislative power and execution of federal laws is neither conceivable nor can they arrive at a rational judgement about public expenditures and corresponding tax payments. The distinction between legislative and administrative powers on the federal tiers is probably only known to a minority of voters to an extent that they understand it. Therefore in many cases they won't be able to realize if the noticeable shortcomings in the administrative execution are caused by e.g. the municipal administration or by absurd federal laws. In the integrated systems a "tax price" for the public goods of the respective federative tiers can neither be determined on the whole nor at the margine. Parliamentary elections of a Land e.g. can only be carried out with limited rationality in the sense of public choice assumptions since the state parliaments only decide on part of the matters which are carried out by the administrations of the Länder. Even the budgetary mechanism, by which every year the parliaments control the extent and the composition of the respective public services is in the administrative federalism with regard to the principle of connexion no longer in working order for the lower juris-

13 See *Olson, Mancur Jr.*: The Principle of "Fiscal Equivalence": The Division of Responsibilities Among Different Levels of Government; in: *The American Economic Review*, Vol. LIX (1969), p. 479 ff.

dictions because the superior tier determines a more or less large proportion of their budgets but does not have to book any costs of opportunity for vote-attracting political measures into its own budget. So administrative federalism can always run into problems of an effective political control because voters cannot clearly conceive who is finally responsible for the supply of public goods. In any case this incongruence has consequences for the efficiency of the entire general government sector.

4. Problems of administrative federalism

Although the existing systems of administrative federalism were hardly created out of the exclusive rationality of an efficient administration – much rather aspects of power control were decisive factors a superiority of non-interlinked systems over interlinked ones cannot ex ante be expected. Much rather do both types of federative systems display advantages and disadvantages which should balance each other in consistent constructions. A clear disadvantage for administrative federalism comes up in the field of political control which can hardly be compensated since it is an imperfection of the basic model.

Real worlds have in contrast to the world of economic models always the disadvantage that in them there are always more parameters than in the model which come into force and that they never present ideal worlds. In order to judge existing systems it is always more fruitful to check them for existing pathologies, compare them if applicable with the basic model and to ask if the problems result from the basic model or its faulty design and thus if they are "curable" by more or less far-reaching reforms or if the basic type is completely "misconceived". In the latter case a change of system should be the consequence.

Therefore the following paragraphs deal with the typical problems of the existing administrative federalism which can be summed up with the following four keywords:

1. Centralization and self-coordination,
2. dominance of specialists as opposed to generalists,
3. high resistance to change and finally
4. – as already expected from the above mentioned theoretical considerations – problems of political control.

4.1 Centralization and self-coordination

Critics of German federalism complain that from the 1950s onwards an extraordinary centralization of competences has taken place.¹⁴ They connect this with the fact that the federation has by now practically exhausted all matters of the so-called concurrent legislation. In the field of the so-called framework legislation a framework has been worked out which does not only contain general basic rules but often prescribes many details. Where the Länder have powers of their own, e.g. police or education such as schools and universities, and in the field of environmental policy, they would display a high, even exaggerated amount of self-coordination. In Germany there is nowadays de facto a uniform right in practically all important areas of legal regulation.

From an economic point of view one has to agree with these critics. It may be in individual cases rationally understandable how the utilization of concurrent legislation by the federation came about. The grown mobility of production factors and consumers has surely created a considerable need for federal regulation. Many of the harmonization efforts on the level of the EU are understandably necessary to eliminate transaction costs and to ensure a functioning competition between the member states. The clause in art. 72 paragraph 2 no. 3 Basic Law "the maintenance of legal and economic unity" which safeguards the utilization of concurrent legislative power has in the past surely contributed a lot to the fact that in the post-war period high growth rates could be realized. The growth effects of the Common European Market is by now also undisputed. Similar effects are expected once the Euro has been introduced and the costs of the circulation of money within Europe will decrease.

Centralization would not by far be the strain it is if the regulations did not refer to a considerable extent to the administrative execution. This means instead of a general regulation of a matter of the federal

14 See *Wendt, Rudolf*: Finanzverfassung im Spannungsfeld zwischen Zentralstaat und Gliedstaaten, in: Pommerehne, Werner W./Ress, Georg (ed.): Finanzverfassung im Spannungsfeld zwischen Zentralstaat und Gliedstaaten, Baden-Baden 1996, p. 20 f.; *Brenner, Michael*: Der unitarische Bundesstaat in der Europäischen Union, in: Die Öffentliche Verwaltung 1992, p. 903 ff.; as well as *Lehmbruch, Gerhard*: Parteienwettbewerb im Bundesstaat, 3rd edition, Opladen 2000, p. 104 ff.

law – within the framework of the respective laws or decrees – also the details of the execution to be carried out by the Länder or their municipalities are determined. The best indicator for this fact is the constant complaint that by way of the Bundesrat the Länder governments influence the federal policy too much. As a matter of fact the majority of federal laws require the consent of the Bundesrat. This leads to quite difficult political situations and produces decisions which do not necessarily promote efficiency in the negotiations preceding legislation or in the formalized procedure in the Federal mediation Committee.

However considering that federal laws only require the consent of the Bundesrat if their regulations also refer to the execution, it becomes clear that the lamented phenomenon – apart from an admittedly restricted interpretation of the regulations, which count for a regulation of the execution¹⁵ – results from the fact that the federation interferes more and more in the administration of the Länder with regulations of its own.¹⁶ The more detailed the regulations are the less latitude there is for the Länder to elaborate administrative solutions of their own, which can be guided by the preferences of their citizens or by the peculiarities of a Land or by the special costs of the regional production factors of the administrative services. "Long-standing experience shows that none of the pertinent ordinances issued so far was really necessary to keep the Länder from committing foolery or from dodging federal law."¹⁷ Therefore one can conclude from the participation of the Bundesrat in the federal legislation, which is criticized as being too extensive, that the organizational latitude of the Länder execution in Germany, which is necessary to attain correspondence to voters' preference and to the efficiency of the administration, is obviously no longer available to a sufficient extent.

This critical finding aggravates if one considers that the self-coordination of the Länder¹⁸ apart from its high costs also jeopardizes the innovation competition. There are too many and too detailed regu-

15 See *Herzog, Roman: Strukturmängel der Verfassung?* Stuttgart/München 2000, p. 112 ff.

16 See *Laufer, Heinz/Münch, Ursula: Das föderative System der BRD*, 7th edition, Bonn 1997, p. 129 f. and 137 f.

17 *Herzog, Roman: ibid.*, p. 113.

18 See *ibid.*, p. 187 f.

lations and in many cases they are copied from each other. In cases where ordinances and promulgations can no longer be issued, standards of synchronization of administrative action are programmed. These are then immediately applied in liability law and thus unfold genuine exterior effects. Even regular efforts in the course of administrative reforms which occur every ten years cannot change this. Low cost and innovative regulations are properly suffocated in this climate.

Finally a construction defect in the federative distribution of tasks in the German federation is to be pointed out: There are possibilities to centralize powers within the framework of concurrent legislation in the federation, provided the conditions of Art. 72, paragraph 2 BL are valid. A decentralization clause, which will transfer powers back to the Länder when the general conditions change, does not exist. This always requires an explicit passing of a resolution by the Bundestag, the Federal Parliament. However the interests of the latter to transfer powers back have to be considered as extremely weak from a public choice point of view: Why indeed should the federation hand competences back to the Länder, if the (respective) majority in Parliament, the government in office can use them in the competition for voters but does not have to pay for the execution costs? Facing this the German Basic Law lacks regulations for those cases in which the Länder or even only some of them want to have their own legislation powers transferred back to them and the necessity of harmonized federal regulations is no longer given. The federal legislation competence is therefore comparable to an incontestable monopoly market. Economists know the amount of welfare losses from this structure.

4.2 Dominance of Specialists over Generalists

Federative systems initially possess a high degree of achieving voters' preferences among the variety of public goods by using the different possibilities of the extent of public goods and its production among the jurisdictions of the same tier. The existing systems of administrative federalism show in contrast a high degree uniformity of the fulfillment of public tasks which is not supposed to follow the voters' preferences. The reason for that undesired uniformity lies in the predominance of vertical rails in the intergovernmental relations. Many years ago, Frido Wagener has already coined the term "vertical specialist

brotherhoods" for this phenomenon.¹⁹ Fritz Scharpf et.al. found still valid facts about their so-called "trap of political entanglement"²⁰ and meanwhile extended the statements to the relationship between European Union and its member states²¹.

The studies investigate the consequences of the vertical coordination processes which are necessary in administrative federalism for the outcomes of the political process. All agents working in one political field on different federative tiers then form a kind of cartel which prevents that the horizontal coordination of weight and ways of public goods within a jurisdiction can no longer be carried out independently but gets dominated through the results of vertical cooperation. Additionally, a costly organizational network has to be established for the horizontal coordination among the jurisdictions of the same federative tier in each policy field which also protects the once established special regulations against undesired change. The consequences of this dominance of vertical coordination within the policy fields are over-regulation, programmed inefficiency and immobilism. So-called "rent-seekers" profit from this, because this kind of networks positively suggests itself for the intervention of lobbyists. There have already been cases on the European level where the commission – for lack of expert understanding among their own ranks – had guidelines drafted for themselves by the lobby.²²

Along with this structure of actors comes a dominance of expert policies as opposed to cross section aspects such as they are represented in the policies of budget and finance. The expert brotherhoods

19 See *Wagener, Frido*: Vom Neubau zur Pflege – wohin entwickelt sich unser Verwaltungssystem, in: ders. (ed.): *Zukunftsaspekte der Verwaltung*, Berlin 1980, p. 21 ff.

20 See *Scharpf, Fritz W./Reissert, Bernd/Schnabel, Fritz*: *Politikverflechtung: Theorie und Empirie des kooperativen Föderalismus in der Bundesrepublik*, Kronberg/Ts. 1977.

21 See *Scharpf, Fritz W.*: *Die Politikverflechtungs-Fälle: Europäische Integration und deutscher Föderalismus im Vergleich*, in: *Politische Vierteljahresschrift* 1985, p. 323 ff.; as well as *Scharpf, Fritz W.*: *Optionen des Föderalismus in Deutschland und Europa*, Frankfurt/Main, 1994.

22 See *Grote, Rolf Jürgen*: *Steuerungsprobleme in transnationalen Beratungsgremien: Über soziale Kosten unkoordinierter Regulierung in der EG*, in: *Ellwein, Thomas et al. (ed.): Jahrbuch zur Staats- und Verwaltungswissenschaft*, Bd. 4, Baden-Baden 1990, p. 227 (247 f.).

establish blockade cartels which complicate every cut in resources. Especially when in the past matched grants were established, the curtailment of these vertically interlinked programmes for every individual federative level seems to be irrational compared with reductions of programmes financed from their own resources, because this way they would additionally lose grants from other regional corporations involved. So in Germany many programs which are quite dubious with respect to effectiveness and efficiency are only kept going because one wants to attract the means of other governmental budgets into one's own budget and territory. The result is a dubious "rat race" between jurisdictions which is to a high degree inefficient and due to the differing financial capacities even burdened with unequal revenue chances.

The welfare losses due to the formation of cartels in the vertical specialist brotherhoods are aggravated through the enforced transfer of burdens to lower executing federative tiers in the context of consolidation efforts.²³ Under the pressure of cutting back public budgets there is no more effective saving strategy than to replace programs, which require one's own resources, with those which are carried out by lower tiers and thus have to be financed by them. Here again the dominance of special policies turns into a burden to the whole structure of actions. For the vertically predominated budgetary means have been withdrawn from the general weighing between the increase of benefits from the different expenditure programs of a jurisdiction and the losses of benefit from the corresponding tax burdens. An inevitable consequence of this bias is a distortion of the resource utilization within the entire economy, whereby it has to be assumed that altogether too many resources are absorbed for public means.

A lamentable reflection of the dominance of the vertical specialist brotherhoods is the failure of the budget mechanism. The idea is that the elaboration of the yearly budget of a jurisdiction serves for political control of its programs and of the taxes necessary to finance it. Marginal costs and utilities of expenditure programs are not only compared against each other but usually also the effects of marginal expenditures with the withdrawal of benefits resp. the losses of votes caused by the marginal raise in taxes. Important parts of the budget

23 See *Färber, Gisela*: Sparen in der deutschen Finanzverfassung: Sparen ja – aber beim anderen, in: dies. (ed.): *Schlanker Staat – Zwischen Paradigmen und Pragmatismus*, Werkstattbericht Nr. 18 der Gesellschaft für Programmforschung, Köln 1996, p. 135 ff.

items are de facto not available for change and a rational choice after the intervention of specialists through central legal regulation. So it can only to an extremely restricted extent be subject to reductions. In the case of matched grants only a share of the respective program expenditures needs to be financed by the executing government. Therefore from the point of view of politicians who have to decide on a budget it seems to be more reasonable to maintain the programs. Financial means granted by a third party cause – due to their revenue effects – that even a program, which is entirely inefficient from the aggregate perspective does promise more positive effects in the competition of gaining votes than a program which has to be financed completely by own resources.

4.3 High costs and thus high resistance to change

Also with respect to adaptability to necessary changes of public activities the empirical systems of administrative federalism show large deficits. Already due to the involvement of more than one federative tier in the formation of political will, the interlinked federations are above all more sluggish than the non-interlinked ones when no explicit shifts in federative competences are necessary, which means in all cases of "normal" political reforms. But not only is the time needed for the formation of consent higher in administrative federalism. Also the results are not optimal due to the different interests involved as well as to the different consequences for the actors on the legislating and the executing level. An extreme case is represented by the reform blockade where necessary reforms of programs and even in the basic structures of the public sector find no majorities because the reform would provide are – apart from gains for the general public – only losers among the actors of the political-administrative systems and the interest groups concerned. In the worst case it comes to a "decline of nation" as Olsen analysed in his book²⁴, namely when the distortions through the "rent-seeking-society" cause such extensive losses in welfare, that a national economy loses its global competitive ability and its growth potentials.

24 See *Olson, Mancour Jr.: The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities*, New Haven 1982.

According to this it is difficult to succeed with reforms in Germany in a way that in the end all the courageous ideas of change have been modified and cut to an extent that the outcome could no longer be called a reform. The problems are still comparably small if Bundestag and Bundesrat present the majority of votes for the same parties. In this case a consent is looked for, whereby the Länder governments in the Bundesrat can altogether pursue interests of their own which they do often enough. Länder governments are however frequently in the dilemma to support the intentions of the federal government in order to support a re-election of the government on the superior level instead of pursuing their own interests. Whenever federal reforms lead to considerable increases in costs of administration, resistance also comes up in those Länder the governments of which are formed by the same party as in the federal government.

If both government levels show different majorities the situation often becomes hopeless: reforms are blocked, even if both positions were basically able to reach consent, with the sole purpose of proving failure against the government. Even if this opposition strategy bears risks for the chances of the opposition to get elected it might even be understood by the voting citizens as a position of improper refusal. This way it seems to be most success-promising because the government in office cannot use realized reforms for the political competition in its election-campaign.

The phenomenon of blockade is often branded as failure of the Bundesrat. One has to consider however that – with the exception of a few explicitly determined areas in the Basic Law such as the tax laws – the consent of the Bundesrat is only necessary if the law also regulates the procedures of the Länder administration. It is true that in the last few years this clause was interpreted more and more restrictively, which means the obligation of approval affects already quite general regulations of the execution. Therefore it is only the political will for a more or less uniform execution of federal laws that causes a compulsion for political agreement. Under this perspective a reform blockade is not the fault of the Bundesrat but the fact that on the side of the federation the administrative processes of the Länder are regulated all too often in too much details.

Similarly as in non-interlinked federative systems there is also in administrative federalism the possibility of "vote-purchase". Here the federal government "buys" among the opposing Länder governments the votes necessary for a majority in the Bundesrat by promising cer-

tain special financial benefits in favour of the Land as compensation. This method of reaching consent is nothing new. There are lots of examples. However only those cases stand out as spectacular where the opposition in the Bundesrat noisily announced hard resistance. This kind of political negotiation becomes particularly meaningful when tax reforms or grants for the Länder are concerned as in the law on structural aid in 1988. After all the Länder are here directly called upon to take part in the financial policy of the federation at the charge of their own budgets.

From an economic point of view the instrument of "vote-purchase" is preferable to immobilism. In most cases the benefits of reforms is by far bigger than the comparably low sums paid for the agreement of a Land in the Bundesrat. According to the criteria of Kaldor and Hicks²⁵, the losers of a reform can be efficiently "bought out" as long as the marginal benefits of a political measure exceed losers of welfare by the payment necessary to compensate the loss. Especially in the case of tax reforms, which provide shortfalls in tax revenues also for state and local budgets as a result of the complete centralisation of legislation competences in the field of taxation and of the tax sharing arrangements of administrative federalism it is mainly the oppositionally governed Länder who turn out as double losers of the reform because they have to go without the revenues and also have no political share in the reform success.

4.4 Problems of Political Control

With respect to the functioning of political responsibility and an effective control through the voting citizens the inferiority of administrative federalism has already been deduced from the theoretical point of view. It is confirmed by the empirical situations. There are mainly two phenomena which emphasize the weak points of interlinked federative systems:

1. the audit courts have only a limited validity of power of control;

25 See *Kaldor, Nicolas*: Welfare Propositions in Economics; in: *Economic Journal* Vol. 49, 1939, p. 549 ff.; und *Hicks, John R.*: The Foundation of Welfare Economics, in: *Economic Journal* Vol. 49, 1939, p. 696 ff.

2. a general loss of power of the parliaments and a weakening of the political control not only of the Länder Parliaments but also the Bundestag.

Ad 1: In all democratic systems audit courts have the task to control public budgets with respect to a legally correct and efficient use of public money. In the last 30 years, in many industrial countries audit courts were entrusted with the task of evaluation of political programs²⁶. Beside the classical budgetary control they were hereby instructed to examine the effectiveness of political programs with respect to their goals and thus to carry out a far more comprehensive efficiency analysis. Thus the audit courts are in all the countries elementary components in the structure of democratic separation of powers and political control.

As the competences of legislation and administration are under two different independent federative tiers the audit courts of both tiers would have to examine the efficiency of the chosen political measures at the federal tier and of the respective administrative procedures at the state level. It is easily understood that both efficiency controls have to remain incomplete because the effective efficiency of one of them cannot be established without that of the other. Before this background the controversy in Germany if and to what extent the audit courts are allowed to carry out program evaluations at all²⁷ appears from a different angle again. This is due to the fact that the issues in question are the political competences of other federative tiers and therefore the control of budgetary means would be concerned of the use of means from other public budgets different to that of the controlling level.

Apart from that the rights of control are not effectively organized even if the subordinate level administers – within the framework of programs – financial transfers from superior budgets. So the federal audit court of Germany still holds a right of control as far as federal means are used in the context of matched grants. The European audit

26 See *Derlien Hans-Ulrich*: Der Rechnungshof zwischen Finanzkontrolle und Programmevaluation, in: Hartwich, Hans-Hermann/Wewer, Göttrik (ed.): *Regieren in der Bundesrepublik IV*, Opladen 1992, p. 81 ff.; *Rist, Ray* (ed.): *Program Evaluation and the Management of Government – Patterns and Prospects Across Eight Nations*, New Brunswick/London 1990.

27 See *Derlien, Hans-Ulrich*: *ibid.*, p. 86.

court however depends on the agreement of the respective member state to examine the correct and efficient use of means from the European budget. It is not difficult to understand that it is exactly those countries where one would rather presume that means are wasted or even far reaching fraud with European money takes place that controls are refused because such statements would result in a repayment from the respective national budget.

Ad 2: In the interlinked federative systems of Germany, Austria and the European Union the hypothesis of loss of powers and control in parliaments is confirmed. The legislatives of the different federative tiers may be affected to different extents: The Länder parliaments are affected to the highest extent because of two regulating tiers above, the European Parliament even obviously due to its limited power of legislation and due to the in many areas genuine inferiority to the council of ministers. But even the Bundestag is in many cases no sovereign in the wider sense of the word when it has to vote retroactively on the results of a compromise negotiated with more partners, which often do no longer correspond to the interests of the majority of elected members of the Parliament.²⁸

It is exactly with decisions concerning financial policy that insufficient powers of parliaments become clearly visible: Länder parliaments can neither decide on all the expenditures of Länder budgets nor do they have the right to determine the amount of tax revenues necessary to finance a chosen expenditure level. Similar circumstances apply to the budget of the European Union. The basic idea to discover the preferences of voters by way of the vote mechanism can therefore work only insufficiently. Losses in welfare due to a supply of public goods which is insufficient in extent and structure are therefore prearranged on the side of jurisdictions holding the legislative power as well

28 It would be quite naive to believe that in the USA every member of parliament could vote independently. This means that there also processes of percolation of interests and formation of compromise take place. But these do not depend on so many different agents and are not affected to such a systematically considerable extent by political interests of other federative tiers. Also the different regional dimensions of the party systems indicate this: e.g. in Canada there are partly completely different parties for the tiers of the federation and the provinces. (for details see *Hrbek, Rudolf* (ed.): *Political Parties and Federalism – An International Comparison*, Baden-Baden (forthcoming).

as on the side of those holding the administrative power. Due to the also systematically mis-conducting institutions of financial control the power of ex-post-control of both parliaments is equally insufficient and thus partly responsible for the exceedingly high extent of waste, fraud and corruptive self-service in the area of the EU. The right of the European parliament to refuse the annual approval to the commission, may in this context be an instrument of considerably threatening potential – as one could see at the end of the last commission's tenure period. Finally however it is not sufficient with respect to the need of effectively working political instruments of a more extensive parliamentary control, which is exactly based on the direct responsibility of elected members of parliament towards their voters for what the money of the European tax payers is used for.

Some peculiarities in the area of tax legislation powers are noteworthy. These are in Germany and in Austria quasi monopolized on the federal level. But national governments also decide within the European Union in the council of ministers about the amount of European tax revenues or tax shares, and the member states have to transfer financial means to the European budget as well as they decide about the way and extent of a harmonization of the tax laws among the member states. So a special concentration of tax-political deciding powers on the level of the federation is to be observed, which is not exactly located in the Parliaments of the member states but de facto in the federal (and other central) governments, which are executive organs. Insofar one also has to note a deficiency in democracy here, which considerably affects the decisions on way and extent of public goods in the whole public sector in Europe.

5. Are the general government sectors in Germany and Austria too large, inefficient and suffering from adjustment-problems?

After noting quite considerable functional deficits in real systems of administrative federalism the question inevitably comes up whether these problems can be stressed in quantity and if significant differences to other federative states or states with unitarian constitution can be proved. As an ideal guideline the extent of divergence from the optimal supply of public goods according to the voters' preference and their efficient production, has to be taken into account. But the latter can turn out to differ due to varying preferences in the different Länder

as well as with respect to time. Insofar based on the present statistical data one can only run indirect comparisons with limited expressive value. However one can – in spite of the well known measuring problems of state activities – deduce certain tendencies from the volumes of public expenditures, of taxes and social security contributions (relative to GDP) as well as from the changes of the ratios.

Table 1 contains, apart from the ratio of government expenditure, also the taxation ratio, the ratio of compulsory charges (taxes plus contributions to social security) as well as the ratio of national debt (each in relation to the GDP) from selected prosperous industrial states with federative and unitarian constitutions for the years 1985 and 1998. Among the federatively constituted states Austria and Germany represent systems of administrative federalism, the others non-interlinked systems.

It is noteworthy that federative states in mean value show strikingly lower public expenditure ratios as well as on average equally lower taxation and compulsory charges ratios. Among the unitarian states Great Britain and Norway stand out. The public sector of the first had been considerably cut back under the government of Margaret Thatcher in the 1980's, while the low public expenditure ratio in Norway can be explained by the high proportion of oil in the economic real net output, which is part of the denominator and therefore declines the value of the ratio. France, Italy, the Netherlands and Sweden however showed in 1985 public expenditure ratios far above average. Countries, where – like in Italy the compulsory charges ratio is significantly lower than the expenditure ratio especially high amounts of public debt were built up. But altogether the compulsory charges ratio was also significantly higher in the centralist countries than in federatively constituted states.

In % of the GDP	Public expenditures / GDP		Tax revenues / GDP		Compulsory charges / GDP		Gross public debt / GDP	
	1985	1998	1985	1998	1985	1998	1985	1998
Federative States								
Austria	49,9	49,4	28,9	29,3	42,4	44,3	49,8	63,1
Germany	47,2	48,0	24,2	21,9	38,1	37,1	41,5	60,1
Australia	35,3	34,8**	30,0	30,3**	30,0	30,3**	11,0*	17,0
Canada	46,0	42,1	28,7	31,9**	33,1	36,8**	63,1	89,8
USA	33,8	32,8	19,5	22,5**	26,0	29,7**	49,4	56,7
Switzerland	n.v.	33,9**	20,9	22,4	30,8	34,8	n.v.	n.v.
Unitarian States								
France	52,1	54,3	25,2	28,7	44,5	45,2	38,6	58,2
UK	44,0	40,2	30,8	31,0	37,5	37,6	59,4	48,7
Italy	51,3	49,1	22,6	30,7	34,5	43,5	83,0	118,7
Netherlands	57,1	47,2	24,6	24,6	44,1	41,1	71,5	67,4
Norway	41,5	46,9	34,3	33,4	43,3	43,6	34,6	33,4
Sweden	63,3	60,8	37,5	37,9	50,0	53,0	66,7	75,4

* 1990, ** 1997

Tab. 1: Different financial indicators from selected industrial states with federative and unitarian constitutions for the years 1985 and 1998

Source: OECD, BMF.

In this latter group one can again find significant differences between the interlinked and the non-interlinked federative systems. Germany and Austria have in the area of the public expenditure ratio rather the level of unitarian states. In the years 1985 and 1998, Australia, the USA and Switzerland range far below Great Britain as far as expenditures and compulsory charges are concerned. In 1985, only Canada still had a level of public expenditures which was slightly above average and at the same time a low charges ratio, but a debt ratio which was growing fast. In 1998 however, Canada has to be counted among the group with lower public activity ratios, with a public expenditure ratio of only about 42%.

Noteworthy are by the way the differences in the dynamics of change among the different groups. While states with a non-interlinked constitution and a small public sector consolidated early on and have partly been stimulating the economic growth process for

some time, Austria and Germany show hardly any changes. Germany may have gone through her unification between both dates of survey which was mainly financed by social security contributions and debts. This result however does not explain the immobilism in the development of the state ratio but rather the rise in the ratios of social security charges and public debt. Also it should not be forgotten that beside the territorial change in Germany also the reform of the family allowances has contributed to a merely optical lowering of public expenditures and taxes because since 1996 the child allowances have been granted in form of a deduction from the income tax duty instead of a transfer payment.

Unitarian states fall into two groups with respect to the intensity of their changes. On one side are those, who obviously have great problems rehabilitating their public sector, on the other side those who run or hold a strict consolidation course, which by the way was supported by an earlier increase of aggregate growth rate than in the countries with staggering reforms. Only the entry into the European Monetary Union which is connected with the so-called Maastricht criteria had the effect that at least certain consolidations were initiated.

To sum up the comparison between countries of administrative federalism and other prosperous industrial states one can at least *prima facie* confirm the problems described above: In Germany and Austria the public expenditure ratio is too high and thus the supply of public goods is obviously too large and too inefficiently provided. Furthermore both countries show an adaptability which is below average, at least as far as consolidating measures are concerned. The fact that some unitarian states evidently have still larger difficulties at mastering their problems can hardly be looked at as comforting. Because the guideline in international competition is never the "lame duck" but c.p. always the flexible location with the best relation between a modern supply of public infrastructure and the "tax price" attached to it.²⁹ In the past both countries of administrative federalism had indeed severe problems with all of the three complexes mentioned above.

29 So the guideline is no way the "anorexia" of the general government sector but the relation between certain performances with regard to quality and the tax burden attached to it. Even in states practising "lean government" at many points the question keeps coming up among critical observers if the state is not doing too little.

6. The contribution to the problems of administrative federalism caused by a misdirected financial constitution

After the unquestioningly very bad empirical conditions once again the question comes up, if it is the concept of administrative federalism that inevitably leads to unsatisfactory public sector outcomes or if certain "faults in the construction" lead right into the problems. It is always and once again the financial constitution, which is extremely important particularly of federative constitutions, in which the rules of the intergovernmental relations in financial matters among the jurisdictions as well as the protection of tax payers in present³⁰ and future³¹ are regulated. As early as 1919 Max Weber stressed the political importance of the financial constitution: "Die Finanzverhältnisse sind in einem Bundesstaat das, was die wirkliche Struktur am entscheidendsten bestimmt."³²

The powers in the financial decision making process also gain from an economic point of view central importance for the order of the public sector as a cross-section competence which builds a more or less "faceless" representative of the respective voters' preferences for the supply of public goods within a jurisdiction. A supply of public goods, which is too large is equally harmful for the competitiveness of a national economy as a supply that is too small. A similarly damaging effect show improperly constructed taxes and altogether excessive charges, for which a majority does not see an adequate equivalent value any longer on the side of existing public goods or expected ones for the future. Considerable losses in welfare can be attributed to all the centrally and uniformly prescribed public performances for which different regional preferences have been existing for some time and which would in the process of decentralization produce no instruments for an unfair competition of locations.

30 See also *Herzog, Roman*: *ibid*, p. 115.

31 The rules concerning the limits to national debts aim at protecting the tax payers in the future from politicians grabbing into their pockets!

32 "The financial relations in a federal state are what determines the real structure most decisively." *Weber, Max*: *Deutschlands künftige Staatsform*, Frankfurt 1919, p. 37.

At least in Germany the fundamental deficits of the German financial constitution³³ are sufficiently known, and they are discussed in politics and science from different points of view. Before the background of the above-mentioned theoretical considerations and with regard to other constructions four points have to be stressed, three of which refer to actual construction defects and one to a putative one:

1. In the course of the distribution of competences between federation and Länder it was forgotten to include rules which allow to transfer responsibilities back to the Länder if justified but also against the will of the Bundestag. This would be the only way the federal legislation monopoly could be broken up and a competition for better public goods provision would be initiated. Minimum requirements would be the right to get a task back also for one individual Land when it is guaranteed in the procedure that the jurisdictions (federation and other Länder) which might suffer damage from the (re-)decentralisation, have a right to object. This would have also to be connected with a discharge of the burden of proof. This means that it is not the Land wanting a different regulation from the uniform federal one, who has to prove that this is sensible for everybody. Instead the federation would then have to examine once again the prerequisites of concurrent legislation and – should the occasion arise – have it voted on again by a qualified majority in Bundesrat and Bundestag.
2. Meanwhile it is also undisputed that the organization of the principle of connexion in the form that the expenditure competence relates to the administrative power has led to an excess of costly legislation of the federation, the execution of which the Länder have to finance from their share of tax revenues. The proportion of public services, which is determined by federal law can – from an economic point of view – be already considered as too large, because the federation does not have to finance all the performances it decides on allegedly in its citizens' best interests from its own tax revenues. A series of federally and uniformly regulated social services – with and without a finance proportion from the federation – has led to the fact that the Länder meanwhile, especially due to their diverging economic problems as well as the unequal distribution of metropolitan areas, have been

33 In the determination of public finance, which means including the distribution of tasks among the federative tiers.

financially charged to an extremely varying extent. Already from this noteworthy differences result in the financial latitudes for the supply of autonomously determined regional and local public goods. This means apart from problems of level the principle of connexion produces by now also problems of regional distribution of public services.

3. Economists agree insofar that monopolizing the tax legislation power to the federation and the meanwhile complete lack of taxation autonomy in the Länder gradually double the mis-allocation through the faulty design of the principle of connexion. Land parliaments decide on expenditures without considering the resulting burdens on their tax payers. The tax law is by far overloaded with intervention tasks which affect the tax revenues regionally to a varying extent. In many cases it is also extremely difficult to connect the tax revenues caused by the regional real net output to the regionally collected revenues. The tax-expenditure-mechanism, which transfers the preferences of the voters into concrete budget decisions of the parliaments of the respective jurisdictions cannot work in any of the decentralised jurisdictions in Germany.
4. Questionable however is the widely spread statement, that the cause for all the trouble in the German financial constitution is the highly equalizing financial equalization of the Länder which is in many cases even marked as over-levelling.³⁴ There may be no horizontal financial equalization in non-interlinked systems but only vertical grants. In Canada and Australia however, which means in countries with a significantly smaller public sector ratios and a high degree of differences in extent and structure of regional supplies of public goods among the provinces and states the (exclusively vertical) equalisation grants are by far more equalizing than in Germany.³⁵ So far it has also remained unex-

34 Acting for many others see *Huber, Bernd*: Föderaler Wettbewerb: Möglichkeiten und Grenzen; *Büttner, Thies* (ed.): Finanzverfassung und Föderalismus in Deutschland und Europa, Baden-Baden 2000, p. 131. Gegen die unterstellten Anreizwirkungen vgl. u.a. *Schatz, Heribert/ van Ooyen, Robert Chr./Werthes, Sascha*: Wettbewerbsföderalismus, Baden-Baden 2000, p. 46 ff.

35 Canada equalizes up to 100% of the average fiscal capacity of five standard states. The fiscal capacity is calculated in a way as if all provinces for their part raised average tax rates on the complete bundle of regional taxes at a

plained from the theoretical point of view how far the advantages of tax autonomy in member states and municipalities in the Länder with mobile capital and a to a growing extent also mobile work force as well as a growing proportion of intra-industrial trade not only between nations but also between regions can be only realized in favour of an efficient supply of public goods when a highly equalizing financial equalization is carried out on fiscal capacities which is calculated on standardized tax rates. Surely, a high degree of equalization will be the condition for the agreement of the financially weaker Länder to the disentanglement and higher degree of autonomy on the revenue side of the financial constitution.

The summed-up construction defects of the German financial constitution which can partly be also identified in the Austrian version are so weighty that they alone explain a large proportion of the faulty development demonstrated in chapter 4. They keep administrative federalism from realizing its possible inbuilt advantages over non-interlinked federative systems. They should be almost completely responsible for the fact that actors and interest groups of the special policies were able to implement public performances rigidly and lacking in flexibility. Obviously, only political threats such as e.g. the current BSE-scandal spur the Länder into solitary political action and thus at least into a tendency to leave expert political cartels because governments worry about being re-elected.

One can explicitly reject the thesis that the systems of administrative federalism and decentralization of administrative powers to independent lower jurisdictions is already in its concept inferior to federal systems where legislative and administrative competences lie in the same jurisdiction. Both approaches show conceptional strengths and weaknesses. Too much independence between the tiers easily tempts one tier to dominate others especially if it disposes of practically all

time. In Australia the consideration of different regional cost functions can even lead to a change in sequence of the fiscal capacity before and after the financial equalization – similar to the German municipal financial equalization. (see Commonwealth Grants Commission: Report on General Grant Relativities 1999, 3 volumes, Canberra 1999; as well as for Canada Boadway, *Robin W./Hobson, Paul A. R.*: Intergovernmental Fiscal Relations in Canada, Toronto 1993; and *Treff, Karin/ Perry, David B.*: Finances of the Nation: A Review of Expenditures and Revenues of the Federal, Provincial, and Local Governments of Canada 1999, Toronto 1999.

the profitable tax sources³⁶ as in Australia. Too much dependence on the other side causes rigidity, inefficiency and do-gooders at the burden of third parties and altogether a system of "organized irresponsibility".

Holders of political responsibility have to pick up these experiences and integrate them into a comprehensive reform of the financial constitutions in Germany and Austria. Also on the European level a reform of budgetary and financial constitution is high on the list of priorities, even higher than the expansion to the east. Otherwise the irritation of the European voters about the waste of tax means, which can only be denominated as "organized destruction of money" will probably affect the competition for parliamentary seats. Reforms must not be one-sidedly oriented according to recommendations which result from experiences in non-interlinked federative states. Much rather the functioning logic of administrative federalism has to be strengthened and extended which does not lie in an abundance of interlinking but in the emphasis on autonomous administrative powers for the realization of regionally quite different supplies of public goods which are individually quite efficient and according to the respective voters' preferences. A complete disentanglement of the federal financial relations however, "eine radikale Scheidung der beiderseitigen Finanzen"³⁷ remains – like in 1919 – impossible, not only with regard to historical dependences. Thus it is not the Bundesrat that should be abolished, but the pleasure bureaucrats take out of detailed regulation and dishing out benefits at the expense of third parties or as a burden on the future. This means sanctioning "den zuweilen handfesten, den zuweilen auch höchst dezenten institutionalisierten Egoismus"³⁸ by establishing an efficiency and political accountability supporting incentive systems within the financial constitution.

36 See *Walsh, Cliff*: Federal Reform and the Politics of Vertical Fiscal Imbalance; in: *Australian Journal of Political Science* 1992, p. 19 ff.

37 "A radical divorce of the intergovernmental financial relations"; *Weber, Max*: *ibid.*, p. 38.

38 "The sometimes solid, sometimes also very unobtrusively institutionalised egoism"; *Littmann, Konrad*: Über einige Untiefen der Finanzverfassung, in: *Staatswissenschaft und Staatspraxis* 1991, p. 39.