PwC Benchmark of Public Budgets in the German States 2013

English Short Version
Executive Summary

In 2012, the German state and municipal budgets continued to recover in comparison with previous years. Taken together, exactly one half of the states and their municipalities posted a positive financing balance in the overall budget. In addition, the improved financing balances concerning the consolidation countries which were reported by the Stability Council indicate that the recovery has been a structural one and is not merely the result of an upturn in economic activity. Consequently the consolidation assistance provided by the Federal Government for the states of Saarland, Schleswig-Holstein, Saxony-Anhalt, Bremen, and Berlin has thus far been effective, and both Schleswig-Holstein and now also Berlin can use these funds for debt reduction. This improvement in the condition of the state budgets is also reflected in the PwC Sustainability Index (cf. Figure 1). The Sustainability Index compares the funds that will be made available to states and their municipalities in the year 2020 with the funds used in the year 2012, relative in each case to the average of West-German states based on a per-resident assessment. In the process, the great majority of the states saw significant improvement mainly as a result of an improved forecast of the financing that will be available in the future. The strongest progress was made by Bremen and Thuringia with a 9.8% and 7.6% increase in their respective rankings. Bremen thus succeeded in moving up one place in the ranking, while Thuringia and Lower Saxony even moved up by three places. Perceptible deterioration was noted only for the states of Baden-Württemberg, Saxony and Hamburg, and was in each case associated with a significant increase in the use of funds from 2011 to 2012. The results for Saxony, however, must be relativized to the extent that a relevant part of the funds was used for the setting up of reserves. In conjunction with the extremely low level of debt in the federal State, this particularly sustainable financial policy will create additional leeway in the future. Nevertheless, the state will have to cope with substantial revenue losses until 2020 due to the phasing out of funding from the Second Solidarity Pact, and the population losses. Hesse, Rhineland-Palatinate and North Rhine-Westphalia continued to make relatively small progress in consolidation, which caused them to fall back in ranking behind the more successful states. Hesse even moved down by four places and now ranks in 14th place.

Figure 1: Comparison of Sustainability Indexes 2013 and 2012
The leeway for future spending increases rose year-on-year for all states except Baden-Württemberg, Hamburg and Saxony. Overall, Bavaria, Baden-Württemberg, Lower Saxony, Hamburg and Schleswig-Holstein are the five federal states that will be able to shoulder the usual public-sector price increases (app. 2.5 % p. a.) without any additional consolidation efforts until 2020, although Hamburg will have to deal with additional cost burdens due to the rising number of residents. The states of Saxony-Anhalt, Bremen and Saarland will actually have to spend less every year. Bremen and Saarland remain extremely challenged and will have to qualify for further government aid to be used for clean-up measures after they have demonstrably exhausted all consolidation options. The spending structure analysis in the individual states is based on figures provided by the Federal Statistical Office which to date have only been published for 2010. The following observations were made concerning the subsidy requirements, i.e. the expenses less the proceeds (e.g. fees, revenues, etc.) generated directly with the respective activity categories: Under the three purely federal functions “Police”, "Legal Protection" and "Colleges of Higher Education“ the category of “Colleges of Higher Education “ has again significantly gained in importance from the financial perspective compared to 2009 with a 5.1% increase in the subsidy requirements and, at 258 euro per resident, is significantly more subsidy-intensive than the categories “Police” at 152 euro per resident and “Legal Protection” at 82 euro per resident. This reflects the efforts undertaken in the context of the Higher Education Pact for creating additional study places for the double intake of “A certificate” school leavers. The highest spending in this context was recorded by the three city states with subsidy requirements between 374 and 397 euro per resident, while the states of Schleswig-Holstein at 172 euro and Brandenburg at 121 euro posted by far the lowest expenditures.

However, the amount of expenditures corresponds significantly to the student density. In the “per student” analysis, the states of Lower Saxony, Saxony-Anhalt (which has made a tremendous leap compared to 2009) and Bavaria posted the greatest requirements and Bremen, Rhineland-Palatinate and Brandenburg the lowest requirements. However, the amount of these different subsidy requirements, in turn, depends significantly on the question respecting the scope of offered cost-intensive study programs such as medicine. In the category "Police" the city states also reported the highest subsidies, whereby Berlin at 309 euro per resident again significantly outpaced Hamburg with 261 euro per resident and Bremen with 225 euro per resident. This is a reflection of the fact that police work in city centers and in particular in the capital city are very broad-based. Among the various federal states, the spectrum ranges from 125 euro per resident in Baden-Württemberg to 194 in Mecklenburg-West Pomerania and reflects mainly the different police densities. The increase in spending, measured on a national-average, was relatively moderate at 2.3% compared to the previous year.

At 4.5 %, the increase in the category of “Legal Protection” was stronger despite the partly lower number of proceedings. An important cost driver is the massive increase in the spending for guardianships, nursing care and other care services, which will continue due to the constantly growing number of older people in need of care. While Berlin is also at the top of the list of subsidy requirements in this category at 154 euro per resident, the two other city states are midrange. The second most expensive federal state overall and the most expensive of the large-area states is Mecklenburg-West Pomerania at 116 euro per resident, while the least expensive is Baden-Württemberg at 40 euro per resident due, among other things, to the higher revenues from the partly state-operated notary services. Among the functions which are performed at both state and municipal level, the category of “Schools” is by far the most important with a subsidy requirement of 712 euro per resident, followed by the categories “Pensions and Public Employees Health Benefits” (378 euro per resident), Social (370 euro per resident) and "Governance and Central Administration". In all four categories there were significant increases compared to the previous year which ranged between 4.2 % (Pensions) and 5.4 % (Schools). In the “Social” category this increase was partly compensated for by increased federal funding of social welfare services. In the “Schools” category the spending increase is partly due to the nationwide expansion of full-day schools and investments in school buildings as a result of economic stimulus packages. Another expenditure driver is the strong increase in the share of students attending a “Förderschule” (school for students requiring special attention) in a number of states. On the other hand, the states have also invested in the improvement of teacher-students relations while simultaneously falling number of students have led to a perceptible increase in the use of funds per student. While the states of Hamburg, Bremen and Hesse are at the top of the list with regard to spending per resident, the highest spending per student is recorded for the state of Thuringia at 6,777
euro per student and Saxony-Anhalt at 6,688 euro per student. Low spending per student is recorded for the states of Schleswig-Holstein at 4,418 euro per student and North Rhine-Westphalia at 4,351 euro per student. Contrary to the East German states, however, both states will lose significant numbers of students in coming years. The area of “Pensions” is characterized by continuous significant spending and will significantly curtail the federal states’ financial leeway in the future. The East German states are still benefitting from an extremely low spending level in this segment with subsidy requirements of only 59 euro per resident in Saxony to 81 euro per resident in Saxony-Anhalt in 2010, whereas the most expensive states, specifically Bremen at 682 euro per resident and Hamburg at 647 euro per resident and even the “cheapest” state of Lower Saxony still had to shoulder 388 euro per resident. Different practices with respect to granting the status of permanent civil servant in many states will increase regional disparities. Saxony will particularly benefit from a lower civil servant quota and Berlin will continue to apply its own different approach in comparison to other city states. The differences respecting state aid will develop in parallel. In this context the structure – and generosity - of aid schemes in the individual states is of importance. Bavaria is at the top of the list at 66 euro per resident, while Saxony spends only 9 euro per resident.

In the “Social” category, social welfare expenditures and, in this context, integration assistance for the handicapped are predominant. The most significant spending increases are reported for this category and for the category of basic old age security and work incapacity. Overall, the subsidy requirements spectrum ranges from 726 euro per resident in Bremen to 262 euro per resident in Saxony. Bremen is at the top of the list and way ahead of the two other city states of (586 euro) and Berlin (544 euro). North Rhine-Westphalia is the most expensive large-area state, spending 437 euro per resident. Different social structures are only partly responsible for the significant expenditure differences. In actual fact, the states have some room for manoeuvre regarding the control over these funds which are largely provided on the basis of federal law regulations. In the segment of “Governance and Central Administration” Saarland has by far the highest subsidy requirements at 498 euro per resident, whereby the extremely high increase in municipal subsidy requirements is indicative of classification problems in the course of the introduction of double-entry bookkeeping. High subsidy levels are also recorded for Brandenburg (432 euro) and Hamburg (422 euro). While, at federal level, Saarland pays the highest subsidies at 209 euro per resident, the highest subsidies at municipal level are paid in North Rhine-Westphalia at 312 euro per resident, which reflects the different municipalization level respecting individual states. The lowest subsidy requirements are in Bavaria (246 euro per resident) and Lower Saxony (211 euro per resident). In addition to the category of “Debts” (in particular debt servicing) with subsidies of 283 euro per resident, the states and municipalities expend significant amounts in the categories of “Transport” (250 euro per resident), “Early Childhood Education” (196 euro per resident), “Health, Environment, Sports and Recreation” (152 euro per resident), “Culture” (95 euro per resident) and to a smaller extent for the categories “Housing, Regional Planning and Municipal Community Services” (52 euro per resident) as well as “Nutrition, Agriculture and Forestry” (28 euro per resident). In the category of “Energy and Water, Investment Holdings, Assets” earnings are posted nationwide, on balance. Subsidies totaling 203 euro per resident are allocated to other categories. While the partly federally funded expenditures in the “Transport” category are frequently stagnant (only 0.7% additional subsidies compared to the previous year), which presents a real problem in view of the significant investment backlog in road construction and additional foreseeable costs in the ÖPNV area, the “Early Childhood Education” category saw a particular strong increase in subsidy requirements (11.7%), since the West German states and municipalities, which still had a significant catch-up requirement in the offering for children under the age of three in the year 2010, have significantly expanded child care services. In this respect, great differences in spending are evident in the analysis of subsidies per child, which range from 7,849 euro in Berlin to 2,946 euro in Mecklenburg-West Pomerania.

The category of “Health, Environment, Sports and Recreation”, which posted a significant 6.7% increase includes different federal and municipal activities with different areas of emphasis in the individual states and municipalities. Hospital financing is an expenditure driver in many states, while the expenditures for sports and recreation tend to be retrograde. Great differences in the spending practice of individual states and municipalities are observed in the category of “Culture”, which increased by 4.2% compared to the previous year. The city states and Saxony are the leaders in this category with subsidies of 142 euro per resident.
(Bremen) to 189 euro per resident (Hamburg); Schleswig-Holstein spends the least with only 47 euro per resident. The category of “Housing, Urban Development, Regional Development and Municipal Community Services” is also very heterogeneous. While proceeds and expenditures are frequently balanced in the category of “Housing” and “Urban Development Measures” and are negative only in Berlin with subsidies of 132 euro per resident, the expenditures for regional planning, state planning and zoning services range from subsidy requirements of around 15 euro in Berlin and Bremen to 100 euro in Saxony-Anhalt and Brandenburg. In contrast, the extremely heterogeneous subsidies in the category of “Municipal Community Services” seem to be reflect municipalities’ different accounting practices (double-entry and single-entry bookkeeping), which apparently contributes to the significant 13.8% decrease in subsidy requirements in the overall tasks category. The same also applies for the category of “Energy and Water, Investment Holdings, Assets”. Here, a particularly important factor is to what extent investments are sold or acquired or whether special investment funds assets are set up or released. This category, too, reflects the amounts available to the states from the European Structural fund, which can be used especially by the new German states for regional stimulus packages under their own co-financing. The five-fold increase in revenues compared to 2009 is therefore also significantly characterized by the very poor results of individual regional banks in the previous year. EU funding which is being provided at very different amounts over the seven-year subsidy period and thus significantly limits comparability in any given year, also plays a central role in the category of “Nutrition, Agriculture and Forestry”; in this respect, too, significant differences are observed between the individual (large-area) states and a significant drop in subsidy requirements by 20.9%. In this context, the categories of “Basic Security for Job Seekers” (187 euro per resident), “Youth Welfare” (without early childhood education) (127 euro per resident) and “Public Order, Fire Protection, Disaster Protection” (74 euro per resident) were described as tasks that are almost fully under municipal responsibility. Nearly a third of the subsidy requirements in the category of “Basic Security for Employment” is financed from federal funds. The amount of the subsidies and pertaining financing depend significantly on whether a municipality has taken over full sponsorship, since in that case the federal funds are disbursed completely via the municipal budget. The remaining differences in spending can be explained through the different social structure in the individual states and the different proportion of long-term jobless persons. The list of subsidy requirements is led by Berlin with 442 euro per resident. Bavaria spends only 90 euro per resident.

The category of Youth Welfare also shows great differences with the city states at the top of the list (in particular Bremen with 247 euro per resident) and Thuringia in the bottom range (89 euro per resident). While the subsidies for Basic Social Security for Job Seekers were down (–0.25%), the Youth Welfare category increased partly significantly in the different states (overall by 5.2%). The picture in the category of “Public Order, Fire Protection, Disaster Protection, and Rescue Service” is also heterogeneous. While the subsidy requirements were frequently lower in the sub-category “Public Order” because of higher revenues, the latter categories saw partly significant subsidy increases. The net increase was a moderate 1.7%. Overall, the highest spending here is in Saxony and Hesse (93 euro resp. 87 euro per resident), and the lowest in Saarland and North Rhine-Westphalia (41 euro resp. 34 euro per resident). The state-specific summaries of results are provided in the respective state profiles.
1. Introduction

1.1. Background

Due to the incorporation of the so-called debt brake (German: Schuldenbremse) in Article 109 (3) of the German Constitution, the 16 German states are obliged to achieve a structurally balanced budget until 2020. The challenges the states face due to the new regulation differ from state to state.

The financial equalisation system between the states compensates their different tax income levels. Still, particularly states which accumulated high burdens of debts and pension obligations in the past will face major difficulties in cutting expenditures to an extent necessary to completely reduce their structural deficits. So, states which are now in a very tight budgetary situation receive consolidation aids of 800 million euro annually between 2011 and 2019 if they comply with the agreed consolidation path. Also, the East German states receive supplementary grants until 2020 to catch up on their economic delay compared to Western Germany. Due to a shrinking population which has a significant influence on the amount of revenues the states receive from the financial equalisation system, the East German states will face additional financial pressure.

1.2. Objectives

The objective of this study is to make these different challenges of the states more transparent and to enable the states to derive appropriate consolidation paths. For this purpose, PwC compares the efforts of the states and assesses the progress in an annual report analysing the financial situation of the states.

The annual study pursues two major objectives. First of all, the study outlines the size of the challenges the states face by describing the current financial situation in the states in the actual year and by making a comparative projection of the financial resources of the states to 2020. For this purpose, a calculation model has been used, illustrated by the so-called sustainability index. The calculation not only reflects the budgets of the states but also the municipalities’ budgets as they are legal parts of the states, which in turn are financially liable for their local entities. Also, the European Fiscal Compact demands a balanced national budget including the states’ and the local authorities’ budgets.

As the second major objective, the net expenses of the states and their municipalities in different policy areas (e.g. schools, police and economic development) are illustrated based on a comparative cost analysis of the states’ revenues and expenditures. The comparative analysis shows in which policy areas the individual states are financially better or worse off. This serves as a basis for the identification of efficiency potentials and to learn from the best in class. The financial analysis of the policy areas is complemented by giving an outlook on the financial requirements induced by demographic change.

1.3. Sources

The report is mainly based on special statistics of the Federal Statistical Office. For analysing the overall budgets, the cash statistics available until 2012 were used. Regarding the comparison of policy areas, statistics on the results of the public budgets were used, which were only available until 2010. Besides, the mentioned statistics have been complemented by figures of the stability council, the official tax estimations, the coordinated population projection as well as further specialised statistics.
2. Status and Perspectives of Public Budgets in the German States

2.1. Financial Situation of the States in 2012

The current situation in the states on their path to a balanced budget varies considerably. Due to the financial equalisation system, the different levels of revenue between the states will be nearly compensated; but various exceptions cause significant deviations from homogenous revenues per capita. In particular, city-states and the East German states currently receive higher financial compensations.

Not only the expenditures of the states vary above all due to the different amounts they have to pay for debts and pensions but also the expenditures in the specific policy areas differ significantly, which can only partially be explained by the different socio-economic structures of the states.

Accordingly, the key financial performance indicators also differ significantly between the German federal states. The main indicator comprises the balance of revenues and expenditures per capita for the years 2010 to 2012 of both the states and their municipalities together as well as separately.

In 2012, the financing balance among the states ranged from a deficit of -1,040 euro per capita in Saarland to a surplus of 402 euro per capita in Saxony. In sum, eight states had a surplus and eight ones had a deficit in 2012. The situation only got worse in Hamburg and to a lesser extent in Saxony. In comparison with 2010, all states could improve their financial situation mainly because the financial crisis had its major effects on public budgets in 2010.

A comparison of the states and its municipalities shows that the good or bad financial situation corresponds between the two levels in most cases. Significant exceptions are North Rhine-Westphalia, where the deficit at
the municipal level is much smaller than at the state level, in Baden-Württemberg, where the municipalities had a major surplus in comparison with the state and in Saxony, where the state had a large surplus in comparison with a slight deficit of the municipalities.

**Debt Level and Interest Spending**

Also of interest for the analysis of the current situation in the states as well as for the projection to 2020 are the debt level per capita and the consequential amount of interest spending. Like in the previous year, Saarland and North Rhine-Westphalia had the highest debts per capita among the German territorial states (German: Flächenländer). In 2012, the debt level per capita of North Rhine-Westphalia even exceeded the one of Hamburg. As regards the municipalities’ debts, Saarland and North Rhine-Westphalia again and also Hesse and Rhineland-Palatinate had the highest debts. But the municipalities’ share in the total debts was relatively low due to the existing legal restrictions for municipalities. Among the territorial states, Saarland, North Rhine-Westphalia, Rhineland-Palatinate, Schleswig Holstein and Saxony-Anhalt have a debt level of more than 10,000 euro per capita. Only Bavaria and Saxony have debts of less than 5,000 euro per capita.

The debt level of the city-states was significantly higher than the average: Hamburg with debts of about 14,699 euro per capita was still behind Saarland and North Rhine-Westphalia, but Berlin already had much more debts of more than 18,000 euro per capita behind Bremen which is unrivalled with debts of more than 30,000 euro per capita.

The interest spending directly results from the different debt levels and shows how tough the future consolidation path will become. The following illustration presents the interest spending resulting from the different debt levels in relation to the tax revenues of the states.

According to the interest-tax ratio, the states and municipalities with higher debts will also face larger challenges. On the one hand, these states will have to spend a major share of their revenues for their interests and on the other hand, they are not able to finance necessary investments by new credits. The figure shows, for example, that Saarland has to spend 18 cents for interests per euro of tax revenues, whereas Bavaria only has to pay 3 cents per euro.

But despite an increase in the debt level in comparison with 2011, in total the interest-tax ratio got better due to increasing tax revenues and lower payments for interests. This is a major reason for the overall good situation of public budgets. Still, if interest rates rise again, public budgets could also come under pressure again.
Perspective for 2020

For a predicting the states’ and municipalities’ financial situation in 2020, a calculation model has been employed. As a starting point for the calculation, the financial resources of the states in the actual year have been set in relation to the financial resources of the West German territorial states. Due to this relative perspective, the results and key messages of the study are still valid if the real developments of economic growth and tax revenues will deviate from the ones assumed in this study.

In order to make an accurate prediction for 2020, the financial resources need to be broken up into its constituent components. Accordingly, the calculation model divides the financial resources into three elements. The first source of revenue is the taxes of the states and municipalities referring to the distribution of taxes after the financial equalisation between the states and including the supplementary federal grants as well as the consolidation aids paid to the states Berlin, Bremen, Saarland, Saxony-Anhalt and Schleswig-Holstein in the framework of the debt brake regulation. The second source of revenue is the disproportionately high grants and benefits paid by the Federal Government and the European Union for the East German states and Berlin. These two sources of revenue constitute the available financial resources of the states in 2012. The third component consists of the states’ deficits and surpluses. Adding this third element to the two sources of revenue results in the financial resources the states actually made use of in 2012.

According to the debt brake regulation and the Fiscal Compact, the deficits of the states and municipalities need to be completely reduced until 2020. For simplification purposes, it has been assumed in the calculation model that the deficits (and surpluses) will be reduced linearly in equal steps from 2011, when the debt brake came into force, to 2020, when the states are obliged to have a structurally balanced budget.

In the target year 2020, the sources of revenue of the states are expected to consist only of their taxes after financial equalisation between the states and limited supplementary federal grants. Accordingly, the financial
equalisation system between the states is expected to continue until 2020 and beyond, whereas the calculation model assumes that the consolidation aids and the disproportionately high grants of the Federal Government and the European Union will expire until 2020. As a result, the East German states and the six states receiving consolidation aids will face a much tighter budgetary situation in 2020. The development of the tax revenues as a remaining source of income is based on the assumptions of the official tax estimation.

Also, the development of the financial resources significantly depends on the expenditures for interests and pensions. Due to their high debt burdens above all, Bremen and Saarland have to spend high sums for interest in 2020. In relation to their available financial resources in 2020, Saarland has to spend about 31.9% and Bremen 29.7% of their financial resources for interest and pensions, whereas Saxony has to spend only 7.1%.

### 2.3. Financial Sustainability of the States

The following figure presents the results of the calculation model. The order of the states in the diagram corresponds to the percentage rate from the best to the least performing state illustrated in the first bar, which presents the sustainability index. The last bar illustrates the starting point, the financial resources the states and municipalities actually used in 2012, including the expenditures for interests and pensions in relation to the average financial resources of the West German territorial states, whereas the bar in the middle shows the available financial resources of the states and municipalities in 2020, including the expenditures on interests and pensions. This is the final result of the calculation model which constitutes the order of the actual financial sustainability of the states and their municipalities.

**Figure 4: Use of financial resources in 2012, available financial resources in 2020 and sustainability index**
This indicator of the actual financial sustainability of the states shows the extent to which the states and their municipalities have to consolidate their budgets. Accordingly, if the state, including its municipalities, has a ratio of 100%, it will achieve the debt brake regulation by having expenditures to an extent corresponding to the average of the western territorial states. If the states manage to have even less expenditures, they are able to reduce their debts and thus create additional financial leeway. In case they have more expenditures and less revenues, they would need to make more debts and consequently will fail to meet the objective of a balanced budget in 2020.

If the ratio is above 100%, the states could have above-average expenditures. Reversely, if the states have a quotient below 100%, their budgets need to develop below the average of the western territorial states. In case the states have a ratio of below 91%, they have to spend even less in 2020 than in 2012 in absolute terms on the basis of the current tax estimations.

Accordingly, Saarland has to solve the most difficult task. It has to reduce its financial resources per capita after payments for interests and pensions from 109.2% of the western territorial states' average in 2012 to 81.0% in 2020. The ratio of 2020 and of the current value in 2012 is 74.2% and so Saarland has to pursue the most ambitious consolidation path. The city-state Bremen, which ranked last in 2011, is not really in a better position. In 2012, it used the most resources amounting to 147.5% of the average of the western states and although in 2020 Bremen is still allowed to use 115.7%, it has a ratio of 78.4% which means that it will also face major challenges to consolidate its budget.

On the other side, the state Bavaria took over the lead in 2012. It used 96.8% of the average financial resources in 2012 and due to its low debts it may have access to financial resources corresponding to 111.4% of the western territorial states' average in 2020 and as a result the state will have the best ratio of 115.1%. Baden-Württemberg slipped from first to second place this year. It used financial resources relatively close to the average of 2012 and will have available financial resources corresponding to 101.7% of the western territorial states' average in 2020 and so reaches a ratio of 105.4%. As a result, the two states are able to pursue a very modest consolidation path with leeway for additional expenditures.

As regards the East German states, only Saxony can look forward to its consolidation efforts without greater concerns; but, also Thuringia moved up three places in comparison with 2011. The two states reached a sustainability index of 96.8% and 91.2% respectively.

But due to a calculation per capita, the states with a declining population have to consolidate to an even greater extent in absolute terms. This is particularly true for the East German states, including Saxony and Thuringia. The further indicators of 90.9% in Brandenburg, 88.4% in Mecklenburg-West Pomerania and 86.3% in Saxony-Anhalt show some improvements in comparison with 2011, but the states still have a long way to go in order to achieve a balanced budget.

3. Comparative Cost Analysis of Major Policy Areas

While the previous analysis displayed the development of the states’ and municipalities’ financial resources in total terms, the following comparative cost analysis presents a comprehensive description of the deployment of the financial resources in the individual policy areas. The strength of the comprehensive analysis is that it prevents from an isolated analysis of each individual task, which tends to claim the highest political priority for itself. Also, the illustration comprising revenues and expenditures, the joint analysis of the state and local level as well as the aggregation of individual tasks to blocks of comparable tasks reduces the possible disturbances in
the comparison of the states’ financial situation. In addition, the comparative cost analysis makes use of an indicator calculated by subtracting the revenues from the expenditures, so these net expenses are just the expenditures which are not covered by direct revenues of the states or municipalities and have to be financed by tax income.

The following table presents the classification of the tasks and the amount of the net expenses in the different policy areas for 2010.

Figure 5: Net expenses of the states and municipalities in major policy areas, in euro per capita, in 2010 and change compared to 2009

### 3.1. Identifying Appropriate Consolidation Measures by Learning from the Best in Class

In the following, the differences in the revenue and expenditure structures of the states and their municipalities will be shown by the exemplary illustration of the two policy fields “Governance and Central Administration” and “Social Assistance”. The comparison of the states in the various policy fields could serve as a valuable basis to improve efficiency and to identify appropriate consolidation measures to meet the objective of the debt brake in 2020.

**Governance and Central Administration**

The field “Governance and Central Administration” comprises the remunerations and reimbursements of costs for the governments (including departments and central administrative units) and members of the parliaments of the states and municipalities.
Figure 6: Net expenses for “Governance and Central Administration”, in euro per capita, in 2010 and 2009

According to the figure, Saarland is leading the list of net expenses on “Governance and Central Administration” which amounts to 498 euro per capita followed by Brandenburg and Hamburg. In contrast, the states Berlin, Bavaria and Lower Saxony have the lowest expenses. The difference between Saarland and Lower Saxony amounts to 287 euro, which shows that Saarland spends more than twice as much as Lower Saxony for its “Governance and Central Administration”. Although both Hamburg and Berlin are city-states and therefore should have quite equal socio-economic structures, their cost structures differ significantly. The distance between Hamburg (422 euro) and Berlin (247 euro) shows Hamburg’s potential to improve the efficiency of its “Governance and Central Administration”. Regarding the municipalities’ costs for “Governance and Central Administration”, North Rhine-Westphalia transferred most of the costs to the local level, which explains the financial difficulties the municipalities have in this state. The difference can partially be explained by a different division of work, but to some extent the difference also stems from economies of scale: North Rhine-Westphalia has 18 million inhabitants, while Saarland has only one million. Since the fixed costs for maintaining a parliament and other central units may not differ largely, the costs per capita certainly do. And finally, these different figures reflect different degrees of efficiency.

An important factor which should be considered for future consolidation measures in the field “Governance and Central Administration” is the demographic change. States with a decreasing population, like the East German states and Saarland, also have to adjust their “Governance and Central Administration” according to the demographic change if they want to avoid additional expenditures per capita. As the majority of public servants in the West German states are aged 50-60, these states have the chance to use this coming wave of retirements to adjust their central administrations until 2020. In contrast, the East German states have less freedom to use this opportunity until 2020 as the bulk of their public servants are just between 45 and 55.
Social Assistance

A further example for showing the different cost structures of the states and municipalities is the field of “Social Assistance”. For getting an accurate and detailed picture of the states’ and municipalities’ costs for social affairs, the social assistance statistics of the Federal Statistical Office have been used. Accordingly, city states spend the most for social security, whereas the East German states have the lowest costs, partly because the people in the former German Democratic Republic received pension entitlements on a large scale, which they were entitled to receive before obtaining social assistance. These differences in the structures of costs on the one hand reflect the dissimilar socio-economic structures of the states, but on the other hand they also make the potentials for efficiency improvements transparent, especially with respect to the individual expenditure items.

Figure 7: Net expenses for “Social Assistance”, in euro per capita, in 2010

The highest expenditures in the field of “Social Assistance” are spent for “Integration Assistance for People with Disabilities”, which on average account for 50% of total expenditures. The regional disparities can be mainly explained by different standards the states provide for people with disabilities (since disability quotas are largely the same all over Germany). This is a surprising result as this task is based on federal law and the rights of the disabled people should be the same all over Germany. But the remaining leeway in the management of this task is large enough to account for large differences.

Significant regional differences are present in case of “Assistance in Old Age and for People with Reduced Earning Capacity” as well as in case of “Help for Care”. Both types of assistance heavily depend on the social structure of the states and to what extent entitlements for pensions and nursing care insurance were built up in the past.

In future, the expenditures on “Social Assistance” are expected to rise due to demographic change which results in a higher and higher share of elderly and dependent persons. This development becomes even more severe for people with gaps in their working life. As a result, the trend of increasing expenditures during the last years is...
expected to continue. Between 2005 and 2010, the expenditures grew by four billion euro, which corresponds to an annual increase of 3.7%.

4. States’ Profiles

In addition to the analysis of the single policy areas, the study also provides a cost analysis from the perspective of the states. This perspective provides the opportunity for each state to identify its strengths and weaknesses. The states’ profiles illustrate how many euros per capita each state spends more or less in comparison with the average of the states in the several policy fields. So if the bar has a negative value, the state spends less and, if the bar has a positive value, the state spends more than the average of the states used for the comparison. In addition to a comparison with the average of all states, each state has been compared to the equivalent group, i.e. to the West or East German states or to the city-states.

The following example of Bavaria and Hesse shows very well how different the spending patterns between two states can be.

![Figure 8: Net expenses of Bavaria and Hesse in comparison with the average of the western territorial states, in euro per capita, in 2010](image)

According to the example, Hesse spends about 57 euro per capita above the average of West German territorial states for “Governance and Central Administration”, whereas Bavaria pays 46 euro less. It is obvious from this example that Hesse may learn a lot from Bavaria in terms of administrative efficiency. So this analysis provides a good starting point for a more detailed analysis of the causes of these differences.
5. Concluding Remarks

Incorporating the debt brake in the German Constitution in 2009 as well as the European Fiscal Compact requires the 16 German states and its municipalities to reduce their deficits to achieve a balanced budget in 2020.

The study highlights the challenges the states have to face to achieve the target of the debt brake. This is done by describing the current financial situation in the actual year and by projecting the states’ available financial resources to 2020. On the basis of the sustainability index, the states are able to identify appropriate consolidation paths. Due to an analysis in relative terms, key messages are still valid in case of a deviating development of tax revenues or interest spending.

Also, a comparative cost analysis indicates concrete potentials for consolidation in the different policy areas. In this regard, the different socio-economic structures of the states need to be reflected, but the aim of the states should be to learn from the best in class and proactively use the opportunities induced by the demographic change.

To sum up, the study is an important contribution to achieve sound and sustainable public budgets in the 16 German states. The authors of the study already successfully employed such benchmarks to support different German states in their consolidation efforts and it is our aim to further assist the German states and municipalities to comply with the debt brake until 2020 on the basis of a regular analysis and publication of the states’ financial situation.