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Active Financial Policy

Ensuring viability, enhancing social justice and
boosting economic potential

gute gesellschaft –
soziale demokratie
#2017 plus

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- Democracy and democratic participation;
- New growth and a proactive economic and financial policy;
- Decent work and social progress.

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ACTIVE FINANCIAL POLICY AS AN ENABLING POLICY

A strong state that invests in society's future viability in accordance with social justice pursues an active tax and financial policy, on both the income and the expenditure sides. This is because financial policy has a decisive and very concrete influence on people's everyday lives. In this paper our aim is to show what comprises active financial policy, what its point of departure is and how it can be implemented.

Access to high quality education is a prerequisite of equality of opportunity and justice. Health care provision and security in old age are key to participation and a decent life, high living standards and prosperity that benefits all. Successful integration creates fairness and boosts society's potential. Sound infrastructure guarantees prosperity and future viability. All these key social issues are closely intertwined with financial policy decision-making. Financial policy can promote gender equality, provide for affordable housing in liveable towns and communities and, by means of high quality schools and public transport, for example, influence how people get to work or how children are given early access to decent education. Targeted financial policy promotion of research and development contributes to boosting productivity and growth. Encounters with a citizen-friendly public administration, in turn, are of crucial importance in building people's trust in the state. However, the administration must be able to provide this in terms of personnel, financially and also structurally.

Active financial policy explicitly oriented towards quality of life thus has a direct effect on people's everyday lives and prospects. It has to be measured in terms of a number of challenges. The state must not only ensure that it uses taxation to ensure it has the necessary resources to fund public works and spending, but also do so on the basis of social justice and in a business-friendly way. Strong shoulders can and ought to bear more than weaker ones when it comes to taxation. It is crucial to social stability that the distribution of income and wealth is perceived to be fair. Tax policy can make an important contribution here. Curbing income and wealth inequality is also a boon for economic dynamism, however. But financial policy must always ensure that taxes do not unduly burden the economy and working people. Furthermore, financial policy, on the basis of the extent of

public spending and revenues alone, affects much economic decision-making and thus, like it or not, exerts considerable steering effects. Active financial policy must counteract such effects when they operate in the wrong direction, for example, to the detriment of gender equality or environmental sustainability. Ideally, they direct developments explicitly in the direction of socially desirable processes. With our outline of an active financial policy we would thus like to identify ways in which social justice, growth orientation and financial sustainability can be mutually reconciled in order to open up to everyone the best possible future prospects.

The public debate on financial policy is currently dominated by such terms as "debt brake", "break even" ("schwarze Null") and "tax cuts". As important as it is to maintain fiscally sustainable public finances and not to overburden the populace with taxes, the complex demands of financial policy cannot be reduced to these one-dimensional slogans. In developed economies financial policy is understood as an enabling policy. It provides for sustainable positive development of people's economic and social prospects and, at the same time, maintains natural resources. If framed in the right way it guarantees a high quality of life for all, equal opportunities, social justice and social cohesion. An appropriate framework must be established to ensure that a high-performance and flexible public sector uses tax revenues efficiently, boosts the competitiveness of the German economy and prevents a rising public debt ratio.

In what follows we shall indicate how, in the medium and long term, financial policy should shape its spending and revenues in order to fulfil these demands. We shall present key policy areas in which action is needed particularly urgently at present. We shall outline how the policy areas of education, old age protection, health care, integration, infrastructure and gender equality have to be developed further. Structural reforms are necessary. A strong state is also required to develop and implement solutions. The state needs adequate funding if the public authorities are to be able to perform properly. The focus of the present paper is Section 3, where we formulate the pillars of an active financial policy that must underpin and fund the requisite reforms. We outline how maintenance, but also the further development of

infrastructure can be funded and the performance of the administration enhanced. We show how tax administration could be improved, tax policy given a social orientation and the financial relations between the federal and Land governments established on a new basis. We outline how the social goal of gender equality should be underpinned by the tax and expenditure system.

2

SIX AREAS OF ACTIVITY OF ACTIVE FINANCIAL POLICY

Issues of fairness in relation to distribution and taxation have returned to centre stage in the public debate. Calls for higher taxes on high incomes and great wealth are increasingly finding popular support. At the same time, people are calling for a lowering of the tax burden on low and middle incomes. The meagre development of real incomes in recent decades, which affects many people in Germany, is the main reason for this. However, the effects of tax cuts on low earners are often overestimated. The middle class, too, often gains little or no financial benefit. These groups do gain considerably from improved public services, however. The contrary is the case with regard to high earners, who benefit enormously from tax cuts, while being scarcely (directly) affected by the quality of public services. Thus it is important within the framework of the debate on fair distribution and taxation to note that, for example, free child care within easy reach and open at convenient times would help most people a lot more than modest tax cuts.

ON THE DEVELOPMENT OF INCOME AND WEALTH DISTRIBUTION IN GERMANY

By international comparison among the industrialised countries Germany has a relatively equal distribution of net household incomes (measured in terms of the Gini coefficient) and a high degree of state redistribution. However, the distribution of market incomes is very unequal by international comparison, at the same level as that of the United States. As in most other industrialised countries the inequality of market incomes in Germany has risen substantially over the past few decades. However, inequality does not look much better in the case of net incomes after state redistribution, reflecting the extent to which state redistribution has declined markedly. It is also noteworthy that overall inequality, despite the rapid economic recovery and good employment trends, has not been reduced and affluence or poverty of income, despite

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recent slight falls, persists at a high level (Spannagel 2015). From the standpoint of equal opportunities it is worrying that earnings mobility has fallen substantially in western Germany since the 1980s. Someone who is poor has a high probability of remaining poor and a rich person is also likely to remain so (Spannagel 2015).

Far more unequal even than income distribution is wealth distribution. According to the Household Finance and Consumption Survey (HFCS), a Europe-wide investigation commissioned by the ECB Council (ECB 2013), net household wealth in Germany was strikingly unequally distributed in comparison with the other euro area countries surveyed. Only Austria exhibited a similar concentration of wealth (Fessler/Schürz 2013).

We must thus constantly ask ourselves what public goods and services we need. What level of quality and quantity is necessary and appropriate? Only at a second stage can we seek to clarify how it can be fairly funded through taxation. In particular in the policy areas of education, pensions, health care, integration, infrastructure and gender equality there are acute problems that primarily affect people on low or middle incomes. Here reforms are needed in order to ensure people a high and improving quality of life and equal opportunities. These reforms have to be provided for by means of adequate state funding, married with efficient implementation. In the following six sections our aim is to address the existing problems and identify the requisite reforms.

2.1 EDUCATION ENABLES EQUAL OPPORTUNITIES AND FAIRNESS

Education is decisive for equality of opportunity, integration and social justice. The aim of education policy is thus to ensure access to decent education for all, regardless of social or

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ethnic origin, gender, place of residence or disability. At present the education system meets these challenges with only partial success. Despite every effort, social origin still determines educational success to a considerable extent; the school system is unable to compensate substantially. On top of that, where someone lives is also a key determinant.

The consequences are manifold. Deficient educational opportunities for certain groups mean that their preferred qualifications – and thus occupational goals – cannot be achieved. This state of affairs not only undermines equality of opportunities, however, but also social mobility. This in turn is a factor of influence for rising inequality of incomes and wealth. At the same time, besides its individual harm, inequality of opportunity has adverse economic effects, too.

Increasing diversity, the integration of refugees, digitalisation and many other social developments pose additional challenges to the education system. For this reason education policy must once again be brought centre-stage with regard to policy action. An education policy is needed that brings about improvements for people across the board, from young children to people already in the workforce. Beginning with the youngest, what is required is a comprehensive and high quality, not to mention free day-care system to boost early learning. There must be more investment in »decent schools«, in the sense of all-day schools, a longer period of all-ability learning, well-trained teaching personnel and multi-professional teams, individualised learning and support measures. But there is also need for improvement with regard to occupational training. Instead of measures offered by the transition system young people need dual training resulting in qualifications, complemented by any necessary support (among other things, in the form of assisted training or with the help of young people's occupational assistance agencies). A training guarantee is needed for every young person, with training places at companies and supporting training programmes for regions with tight training markets. Well-equipped vocational schools have a key role to play in this.

Training in institutes of higher education must also be developed further. The 330 occupations requiring training are out of all proportion to the 18,000 or so BA courses currently available in Germany. The number of courses should be cut drastically. Besides the still needed substantial increase in places, secure basic funding is also a must, as well as investment in further education infrastructure. That includes both building projects and teaching and research infrastructure.

In order to prepare people for the new social demands of a digitalised world of work and to prevent people from falling behind over time educationally, lifelong learning must be facilitated. Better further training options are thus needed. Further development of unemployment insurance in the direction of labour insurance would make things easier. Besides unemployment benefit this would also make further training possible and provide security against risky transitions between various forms of work and employment. Labour insurance could amalgamate, complement and fund existing lifelong learning options.

Education is an investment in the future. Accordingly, we have to enable access for all, remove barriers and facilitate transitions. The major education offensive that this requires needs, besides national minimum standards and structural reforms, more state funding.

2.2 OLD-AGE PROVISION ENABLES PARTICIPATION AND A DECENT LIFE

Since the reforms of statutory pension insurance, the introduction of the so-called Riester pensions in 2001, all employees »have been faced by altered pension regulations and encouragement to make provision for themselves. At the same time they have been exposed to new regulations and restructuring of their working environments that make it more difficult to meet the new requirements and to build up individual entitlements in relation to the old-age insurance system« (Schulz/Blank 2015: 32). Despite these reforms it is feared that old-age poverty will return as a widespread social problem. This worry is based, on one hand, on the fall in pension benefits, supposedly because that is required to keep contribution levels down in the future. On the other hand, we are increasingly seeing interrupted employment records. Within this framework periods of unemployment, marginal employment and/or precarious (bogus) self-employment result in lower pension insurance entitlements. Besides the danger of poverty, problems of fairness and legitimacy will also arise for the pension system if an increasing number of people, despite paying contributions for decades, will be unable to obtain a decent basic pension.

The idea is that employees should make up for falling pensions by means of private, fully-funded pension provisions. Fifteen years after the Retirement Savings Act (Altersvermögensgesetz) was promulgated, however, it is evident that private provision will not be able to fill the gap, among other things because potential yields from capital gains for ordinary people have been grossly exaggerated. In particular for low earners, but also in the case of those with interrupted employment records, this will in all likelihood result in substantial coverage gaps.

AFFORDABLE HOUSING IS ESSENTIAL FOR A DECENT LIFE

Everyone needs a home, a »roof over their head«. A flat or house, rented or owned outright, is the centre of a person's life. It is not just accommodation, but it protects us, it keeps us warm, it provides us with a safe haven and protects our privacy – thus it is essential to a decent life. Our living space needs to change over the course of life, however. Smaller dwellings are fine for singles and couples, but families with children need more room and older people need accessibility. Anyone who loses their own home slips to the margins of society.

In many towns and cities a large portion of the population are unable to provide themselves with a dwelling in keeping with their living circumstances. On top of that, energy-related renovation often raises rents and previously affordable accommodation is becoming unaffordable for some. The aim must be to enable as many people as possible to remain in or move to the areas where they want to live.

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In order to provide everyone with decent and affordable living space over the long term, a strong housing sector is required, oriented to the common good. For this purpose, besides cooperatives, public housing companies are needed above all. Instead of being sold, the public housing stock must be maintained and expanded. Even companies oriented to the common interest need to expand their housing stock. At the same time, these companies have to be given stronger incentives to build new housing. Key to the building of new affordable housing is an active public land policy, which does not sell plots to the highest bidder, but builds on them itself or permits others to use the land on a tender basis. Utilisation rights should be conferred only on a leasehold basis for an appropriate period of time, with restrictions. That would ensure that the public authorities retain control. An active land policy also requires that the municipalities acquire land on the market and put it to social uses. Here it is important to have a strong public administration that can negotiate on an equal footing with companies and investors. In order to stimulate the building of affordable housing, however, existing development programmes have to be expanded.

However, social considerations must be to the fore with regard to taking care of existing stock, not just in relation to new building. Instead of fearing modernisation people must once again be able to look forward to having their homes renovated. That means that tenants must no longer find themselves forced to move out after renovation because they can no longer afford the rent. Further limits on transferable costs and further development of support programmes would also help here. Even more important with regard to energy optimisation is to turn away from focusing on individual buildings in favour of districts. In this way measures ranging from mobility issues to those pertaining to the building could be coordinated and questions of energy generation, supply and saving could be taken into consideration.

Even though standards with regard to renovation and new building are disparaged as driving up costs, they ensure housing quality. They should be developed, but also understood and applied sensibly. With regard to DIN standards the Federal Supreme Court ruled on 14 June 2007 that they are »not legal standards ... but only private technical rules with an advisory character« (BGH 2007). Besides the further development of all existing norms and standards, the question must be answered of whether the aims of these recommendations can be met more affordably than hitherto by means of innovative construction methods.

Providing people with adequate and affordable housing would be much easier if moving house was easier. Many families with children live in housing that is too small, while older people often have too much living space, which does not meet their needs. This makes sense for older

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people if moving would be expensive and they would have to pay a higher rent. Here cooperatives and public housing companies need to set a good example and actively contact families whose children have moved out to offer them accommodation in the same house or district at the same price. Even financial support for moving is conceivable in order to make the housing market more mobile.

More affordable housing in accordance with current living circumstances is key to a decent life. In order to make this happen structural reforms are required. More and in particular targeted support programmes are needed, but also a strong, properly financed state that can make affordable housing available in all parts of towns and cities.

A pension that enables a decent life can ultimately only be provided by higher insurable earnings and a social pension insurance system. To this end reforms are needed in the labour market and the pension insurance system. They would include, for example, the expansion of pension insurance into an employment insurance, encompassing civil servants and the self-employed. In order to boost workers' incomes the scope of collective agreements must be widened, for example, by means of declarations making them generally binding.

The goal must be to raise or at least stabilise the level of benefits. Social balance must also be strengthened, for example, by pension upgrading for periods of low earnings and joblessness.

In order to ensure a system of old-age provision that enables social participation and a decent life a wide range of reforms are needed, aimed at improving the funding of the system. Where necessary, pension insurance must be more strongly underpinned by state subsidies.

2.3 GOOD HEALTH PROMOTES A HIGH QUALITY OF LIFE AND WELL-BEING

Well-being not only has material, but also social components. Good health enables participation in economic and social life and this contributes decisively to the prosperity of our society. The German health care system is one of the best in the world. It provides good medical care for all, regardless of their income. Health care expenditure has developed in line with GDP in recent years. Thus, despite declarations to the contrary, it is wrong to talk of a cost explosion. Having said that, it is wrong that the cost increases since the introduction of additional contributions have been borne exclusively by employees. How the costs of the health care system develop in the future will depend, among other things, on whether people remain healthy in old age. Prevention and rehabilitation can help to keep people in good health and thus are a key factor in the fundability of our health care system.

Germany's population is ageing rapidly. As life expectancy rises, rising use of medical care and medicines is likely to increase costs. On the other hand, healthy very old people in particular require comparatively less medical care. Demographic ageing thus does not necessarily entail higher health care expenditure. However, this will only be the case if older people remain healthy for longer and are able to take care of themselves for as long as possible in their accustomed environment. If the number of people in need of care rises, as predicted, from its current 2.6 million to 3.4 million by 2030, a lot more will have to be spent on care provision. New medicines and treatments, however, are already giving rise to high cost increases and the future development of such spending cannot be foreseen. Another problem is that good health provision and care require decent work and well trained specialists. But these things are already in short supply. If quality is to be improved, staffing levels will have to be increased and that costs money.

We can find answers to these challenges if we orient our health and care system more closely to patients' needs. Thus we are able to ensure that health care provision is on a solid footing for the future and also based on solidarity. Maintaining and improving quality care, also in innovative ways, must be at the centre of all our efforts, rather than merely the number of doctors or hospital beds. But even stronger cross-sectoral care, in which various care providers (general practitioners, hospital doctors and paramedical staff) and areas of care (outpatient, inpatient, rehabilitation, home care) provide integrated health care helps to improve patient orientation and to mobilise efficiency reserves in the system.

Developments in the health care sector that entail foreseeable cost increases will not necessarily lead to corresponding increases in social insurance contributions or increasing tax funded state subsidies. By optimising the structure of service and care providers efficiency reserves can be utilised without shifting the burden onto the people employed in the health care sector. On top of that, improving quality of life also involves preventing illness as much as possible. Prevention must therefore be boosted and better integrated in people's everyday lives, in other words, at work, at school and in day care centres. Furthermore, medical rehabilitation must be expanded in order, as far as possible, to prevent people from becoming unfit for work or even having to require care. Both also help to curb the costs of provision.

A health and nursing care system based on solidarity must also provide patients, people in need of care and family members with better information concerning therapies, alternatives and follow-up provisions. The health insurance funds, doctors, the federal government, the federal states and the municipalities are responsible in this regard.

However, we will not be able to cope with the challenges of the health care system by means of structural adjustments alone. We must also develop the funding of the health care system so that our society's high quality of life is maintained and can continue to rise in the future. It is important that the state fund prevention, which is a task for society as a whole, rather than putting the burden on health insurance fund contributions. Health and nursing care insurance should also be funded on a parity basis by employees and employers. Another urgently needed measure is the introduction of a parity-finan-

ced citizens' insurance in which employees, the self-employed, professionals and civil servants can be jointly insured. In a society in which more and more people are compelled to fund their lives from work and capital incomes, capital income should also play a part in funding health care.

2.4 INTEGRATION PROMOTES FAIRNESS AND EFFICIENCY

Integration guarantees and consolidates social cohesion. People who are well integrated socially consider themselves to be a valuable part of their lifeworld. This applies to low earners, as well as older people, recent migrants and refugees. Without successful integration there can be no political or social participation. However, in order that people can be involved in all areas of public life on an equal footing, a number of conditions must be met.

Education is of particular importance here, in several respects. For that reason alone access must be open to all. It is also important in this regard that education be more than mere preparation for a successful working life. The various educational institutions through which a person goes in the course of life have to enable inter-cultural learning, giving people the wherewithal to interact appropriately with other cultures. Because around 20 per cent of people living in Germany have a migrant background the acquisition of such intercultural competences is crucial if the demands of our society are to be met.

The integration projects of charities, associations and citizens should be supported and promoted. They offer a diverse range of activities and often operate where the state is absent or does not reach particular target groups. Their activities range from child care through youth work to language courses. These projects should not be allowed to fail due to lack of infrastructure or resources. Robust conditions should be created for long-term project work in terms of premises and resources, as well as opportunities to obtain qualifications and the provision of information.

Adequate kindergarten places, further training options and training places are also factors in integration. Another important factor, which is often underestimated, is to try to ensure that public institutions are interculturally accessible, which is not only desirable but necessary. The aim of such opening up is to remove access barriers for people with immigrant backgrounds. Active measures must be taken to ensure that more people with an immigrant background are employed in institutions and participate in policy development in political organisations. The success of our democracy depends on the political involvement of people with immigrant backgrounds. Opening up institutions and organisations interculturally makes it possible to overcome information deficits and remove inhibitions. This can set in train learning processes that react to the cultural diversity of our society.

Housing is also key to integration. A mixed residential area not only reflects our society but contributes to integration. Given the housing shortage new affordable housing must be made available. However, that should not result in certain groups or classes being displaced. A social neighbourhood offers somewhere to live for a range of people and thus contributes to integration.

Access to work is of crucial importance. Qualifications have to be recognised; entry to the labour market should not be obstructed. Better placement of training and workplaces provides for better capacity utilisation in the economy. Further training options lead to better jobs and new opportunities for social mobility. In the case of the integration of refugees the assumption hitherto has been that vocational training lasts around six and a half years because a high level of language competence is needed to obtain qualifications. This process must be further optimised so that people can start their work as quickly as possible. Delays also hinder integration. All these requirements cost money. Measures that successfully promote integration help to avoid future financial burdens on the state and those paying social insurance contributions, however. Successful integration facilitates fairness, efficiency and prosperity for all.

2.5 INFRASTRUCTURE ENABLES PROSPERITY AND FUTURE VIABILITY

Although Germany has relatively good infrastructure by international comparison its quality has deteriorated discernibly in recent years. This judgement is confirmed by the International Monetary Fund (IMF 2014: 79–81), as well as the 2015 expert committee on boosting investment in Germany: both state that considerable investment is required. There are a number of reasons for this state of affairs. Not only has the public investment ratio fallen sharply in recent years, but net overall state investment has frequently been negative in recent decades; municipal net investment has been negative since 2003. The upshot for infrastructure is that urgent, also financial policy solutions are needed. Merely preventing a further deterioration in existing infrastructure would require a prolonged period of investment in the order of tens of billions of euros. If finance policy also pursues an active future-oriented strategy with regard to environmental infrastructure and digitalisation then the need for investment will increase even more.

It is clearly recognised that a well-functioning public infrastructure is a key economic condition for prosperity and employment. Most production processes are dependent on the public infrastructure capital stock. Public investments in this area thus play a direct role in boosting productivity and growth (IMF 2014). That applies in particular to the core areas of transport infrastructure (roads and motorways, railways, ports, airports), communication systems and energy supply. Public infrastructure is an indispensable factor of production. Public investments thus always give rise to private investments and create additional employment. In this context replacement investments can often be as productive as investments in expansion. Empirically, the orders of magnitude of the economic effects of public infrastructure investments are controversial. Current meta-studies indicate, however, very high long-term yields from public investments (IMF 2014: 86; Bom/Ligthart 2014: 907–908). In addition to the long-term positive (supply-side) effects short-term demand-side effects also have to be taken into account. Generally, there has always been a broad consensus that public infrastructure measures represent the fiscal policy instrument with the highest multiplier. This estimation was confirmed by the most

recent multiplier debate (cf. Gechert 2015). In particular against the background of the current crisis in the euro area (monetary policy at the zero-bound interest rate for the foreseeable future) has shown that the fiscal multipliers are high and presumably substantially above 1.

Given all this it is unacceptable that public investment activity has been thrown into reverse in recent decades. Because the positive economic effects of public investments are particularly strong in both the short and the long term, investment activity must be stepped up. Public investments in environmental infrastructure (renewable energy, making buildings more energy-efficient and public transport) and digitalisation are especially important. We understand active financial policy as an enabling policy, which by means of targeted investments increases people's quality of life and also the potential of the economy. Thus besides reforms with regard to the selection and governance of investments above all a solid financial basis is needed, which ensures both maintenance and new development.

2.6 GENDER EQUALITY ENABLES PARTICIPATION AND PROSPERITY

The state has many instruments at its disposal to promote gender equality. They range from regulations and statutory requirements (for example, the law on parental part-time working or non-transferable parental leave months for the second parent) through information (for example, on occupational options) to moral appeals (for example, to companies to create family-friendly conditions) and voluntary corporate commitments (for example, gender quotas in higher management), accompanied by varying degrees of bindingness and efficacy. However, public financial policy also exerts an important influence on equality between men and women.

With levels of public expenditure as a proportion of GDP ranging long-term between 40 and 45 per cent the public sector in Germany gives rise to considerable gender-specific effects, both intended and unintended, by means of its taxation and spending. They concern the deployment of labour (allocative) and the distribution of income (distributive). In this context the state possesses major financial policy potential to promote gender equality. It is of particular importance for a gender-equitable financial policy to correct deficiencies in the economic and social participation of women. It is important to recognise that inequalities with regard to paid employment and labour incomes take a number of different forms. On one hand, they take the form of continuing unequal distribution of the sexes at different hierarchical levels, and on the other they are evident in differences in occupation. This is accompanied by unequal distribution of unpaid household work, disposable income and wealth to the detriment of women.

But there are also gender inequalities that require a redesign of financial policy from a male perspective. For example, the existing distribution of paid and unpaid work – in particular with regard to the reconciliation of work and family life – less and less suits the preferences of men. Furthermore, there are areas of state taxation and spending that take too little account of men's specific needs, such as education and health care.

Financial policy that is properly aware of its active responsibilities and potential must, like all regulations and statutory provisions, consistently facilitate gender equality – in the tax and contribution system and in public functions and expenditure. If an active financial and taxation policy uses its opportunities in this context it can promote both the social participation and the prosperity of both sexes and of society at the same time.

3

CONCRETE RECOMMENDATIONS FOR AN ACTIVE FINANCIAL POLICY

An active financial policy is an enabling policy. It aspires to ensure equal opportunities, social justice and social cohesion by means of targeted investments that improve everyone's quality of life and the potential of the economy. The sustainable development of economic and social prospects must also aspire to conserve the natural bases of life.

We have seen what challenges and shortcomings currently exist in the policy areas of education, pensions, health care, integration, infrastructure and gender equality. At the same time, we have illustrated the need for an active financial policy and the demands to be made on it. In the following sections we shall see what kind of room to manoeuvre financial policy has and how best to use it. We shall present and discuss concrete recommendations for the key areas of active financial policy.

3.1 MAKING ADMINISTRATION MORE EFFICIENT

Financial policy should continuously improve the life situation of as many people as possible. Constant and environmentally sustainable economic growth, a high employment level and decent wages are necessary for this. Constant rises in income for all workers not only benefit individuals, but also boost the tax base, thereby making it possible to finance state provisions. It is up to the state, by means of an appropriate regulatory framework and public infrastructure, to create the basis for growth, employment and decent pay.

Constant Monitoring and Optimisation of How Public Resources Are Used

In the competition for scarce public resources financial policy goals are sometimes misplaced, however. Wrong decisions are constantly being made and sometimes uneconomic practices prevail. There are various institutions tasked with limiting this as far as possible. One might mention parliament, audit offices, the Stability Council and independent advisory boards. Constant monitoring and optimisation of the use of public resources is an indispensable element of active financial poli-

cy. Thus it is important that political decision-makers recognise their responsibility in this respect and undertake this monitoring of resource use by means of internal and external investigations and country and inter-municipal comparisons.

However, it is also important that the state is adequately funded; both as a whole and in its various parts – that is, in all regional authorities. Only in this way can it be ensured that decisions are taken properly and the relevant public tasks are adequately fulfilled. Furthermore, public acceptance suffers if public resources are used inefficiently and not in accordance with the will of the majority. Education, public welfare, public security, cultural participation and other services have to be made available to all in sufficient quality and quantity. To this end inefficiencies and underfunding in the public sector have to be avoided.

THE STATE AS ENGINE OF INNOVATION AND GROWTH

Free markets, smart young inventors and venture capital drive the economy forwards; the state is merely a hindrance in all this and must be relentlessly driven back. This mantra of neoliberalism has been repeated for decades now, but is it true? Economist Mariana Mazzucato, a leading expert on the relationship between innovation and growth, shows that the opposite is the case in her book *The Entrepreneurial State: Debunking Public vs Private Sector Myths*. By debunking these myths she is able to correct the current debate on the future of the economy and the role of the state. Whenever important technological innovations have led to an economic upswing and prosperity an active state has played a decisive role. From electrification to the internet, the engine of development – often up to introduction onto the market – has always been the state.

The US economic model is frequently invoked as more "entrepreneurial" than that of many other parts of the

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world. Providers of venture capital there take on the highly risky funding of ingenious inventors working out of their garages, enabling them to focus on their innovations. The American economic model is more successful as a result, also because the free market has freer rein there.

On closer analysis, however, the opposite becomes evident. New, revolutionary technologies that have driven capitalism in previous decades and centuries derived crucially from state investments. Whether computers, the internet, nanotechnology, biotechnology or green energy, it has often been the state in both the United States and Europe that has been bold enough, in the face of obstacles, to think the impossible, embrace the risk, establish research institutes and networks, and invest massively in the development of new technologies. Private companies and private venture capitalists generally come on the scene only much later in the day, only after the state has funded the riskiest and most capital-intensive parts of the development process, and garnered short- to medium-term profits.

The true history behind the emergence of many path-breaking technologies is thus not a state that stayed out of the economy, but rather an active and visionary state, ready to take risks as both investor and innovator and lay out large sums investing in both basic and applied research. In many cases these state investments have gone as far as backing companies during the start-up and commercialisation phases of new technologies and products.

Innovations and sustainable growth, according to Professor Mazzucato, thus rarely come from private venture capitalists or from the stock exchange, but much more often from a state that uses its capital and drives forward the technologies of the future over the long haul. In contrast to private entrepreneurs the state can assume high risks and provide highly risky, but also long-term and reliable funding. Private financiers and venture capitalists, by contrast, are much more risk averse. They think and act on a much more short-term basis in their investment decision-making.

Problems arise, therefore, not because the state is too big, but because the state does not invest enough and fails to pursue a long-term funding policy. Austerity or even a break-even policy thus achieves nothing. No country that did not invest in key areas, such as education and training, research and development, has ever enjoyed sustainable growth. This is what makes the difference, in tandem with the innovation system, with regard to competitiveness and prosperity growth. An active financial policy must therefore invest in these areas and structures.

These insights have important implications for tax policy. The state should show restraint in granting tax concessions, because tax cuts, whether on capital gains or to reduce research and development costs, are based on the false assumption that the private economy is willing

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and able to invest. Professor Mazzucato shows, however, that that applies only if the state takes the lead in shouldering the risk. A wave of state funding is therefore needed on which venture capital can »surf«. In this situation lower taxes do nothing more than burden the state budget. The state loses the resources it needs to develop, fund and channel visionary ideas, technologies and products.

According to Mazzucato it is crucial to recognise that further economic development depends on an active state often first creating and shaping markets, especially in the areas that require a lot of capital and in which the technology and market opportunities are uncertain. Only if the central role of the state as key risk taker and innovator is recognised and enhanced is there a chance of preventing the risks and costs of tax-funded innovations from being socialised – that is, born by the general public – while the gains and profits are privatised, trousered by the few.

It must therefore be ensured that some of the returns flow back to state coffers or into state "innovation funds", from which the next round of technological progress can be funded. The current tax system, however, pays no regard to such backflows because global multinationals whose products are based directly or indirectly on state-subsidised research exploit legal tax loopholes and pay practically no tax at all. The tax system therefore has to be revised. New ways have to be found to enable the state to invest more heavily in education and training, research and development and, at the same time, to participate more fully in the profits of innovations procured by means of state investments. Only in this way can the state live up to its formative role and meet current and future challenges effectively. Only in this way can intelligent and innovation-oriented, but also inclusive and sustainable growth be achieved.

Making the Administration More Efficient Financially, Structurally and with Regard to Personnel

In order to enable the state to efficiently exercise its governance functions in the social market economy its administration has to be effective. That requires sufficient financial resources, but also structural reforms.

In particular in the course of demographic change public employers are under more competitive pressure than ever from the private sector when it comes to the recruitment of qualified workers. The income gap between comparable occupations in the public and private sectors must thus be prevented from widening even further. On the other hand, the state should critically evaluate public sector law with regard to innovation and efficiency and if need be amend it.

Technological progress provides considerable scope for efficiency gains and savings. That applies in particular to information and communications technologies. Full use has to

be made of them. However, in the course of implementation the right order must be followed: only if productivity gains are achieved can the potential savings be made.

Recommendations for action to boost administrative efficiency

- constantly monitor and optimise the use of public resources;
- evaluate and adapt public sector law with regard to innovation and efficiency gains;
- make use of the efficiency and savings potential of technological progress

3.2 MAKING TAX POLICY SOCIALLY EQUITABLE

A country's economic prosperity and social stability depend on realising and balancing the aim of justice in its various aspects. In accordance with the goal of rewarding people's efforts there have to be sufficient economic incentives within the market economic order for companies, workers and the self-employed. In their absence, growth and employment would be endangered in the long run. However, it is clear that markets alone cannot reward everyone's efforts: market power and informational asymmetry, for example, violate this principle in a variety of ways. This justifies state regulatory intervention. Max Weber already pointed out that (due to market power) workers' freedom of contract does not really exist; pure market processes as portrayed in mainstream economics simply cannot emerge in this context.

But even if it really proved possible to reward effort equitably, distribution of income and wealth based on market mechanisms would still require correction: people who are unable to lead dignified lives because of handicap, sickness, old age or simple bad luck need support. Furthermore, the incomes achievable by individuals in the market are dependent to a considerable degree on extremely unequal starting conditions.

In what follows we thus want to show the available options for handling tax policy on a socially equitable basis. Care must therefore be taken to ensure that the state obtain sufficient resources to finance public tasks and expenditure through the taxation system, in both a socially balanced, but also economy-friendly way. At the same time, tax policy must ensure that income and wealth distribution be perceived as fair, to the greatest possible extent.

FINANCIAL POLICY REDISTRIBUTION SUPPORTS ECONOMIC GROWTH

Until the financial and economic crisis, the goal of bringing about a fair income and wealth distribution by means of strong financial policy redistribution was very much on the back burner. The reasons often included fears of negative incentives or international relocations or profit shifting by companies on the grounds of international tax competition. A strict and irresolvable conflict between efficiency and fair distribution was postulated. In recent years, however, there has been a renaissance of tax justice and redistribution aims.

First, in most developed countries in recent decades there has been a striking rise in income and wealth inequality (OECD), which has raised awareness of the issue.

Second, analyses of the negative social effects of high inequality have come centre stage in the debate. For example, strong inequality can go together with negative social and political externalities, especially if the wealthy are able to leverage their economic power to wield enormous political influence (cf. Bach 2013: 90f). More recent research findings indicate that a multitude of urgent social and individual problems (for example, crime, obesity and mental illness) increase with widening economic inequality (Wilkinson/Pickett 2010).

Third, for a number of years evidence has been increasing that, in contrast to what is often assumed, there is no conflict between fair distribution, on one hand, and growth and employment on the other, but rather that rising inequality is a serious obstacle to growth (IMF 2014; OECD 2015). Empirical research conducted by the IMF and the OECD has shown that higher inequality in the distribution of available income is systematically associated with lower growth rates. The OECD regards above all inequality at the lower end of the income distribution as harmful and points to the resultant lower educational opportunities, too low productivity on the supply side and lower growth. On the demand side, higher inequality can have negative effects by way of various income-specific saving rates: because richer households have higher saving rates than poorer households growing income and wealth differences lead to lower private consumption and thus to weaker aggregate demand. The international increase in income inequality in combination with deregulated financial markets via increasing external economic imbalances has come to be recognised as a key cause or a crucial amplifier of the global financial and economic crisis (Fitoussi/Stiglitz 2009; Kumhof et al. 2012; Rajan 2010; van Treeck 2014). Overall, the distribution-policy goal of taxation has been upgraded by recent analyses and findings. More equitable income is no longer desirable only for reasons of social equity, but also because it underpins economic growth. At the same time, the limits of redistribution policy must be heeded. In particular a redistributive tax and financial policy must not neglect the limits of social accep-

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tance on the grounds of potential negative incentive and location effects. However, even in this perspective the scope for tax-based redistribution has increased in recent years (Bach et al. 2016; Godar/Truger 2016). On one hand, consolidation pressure in many public budgets has led to a reduction of international tax competition. On the other hand, the fight against international tax shifting has been stepped up of late.

Achieving the Goal of Fairness and Distribution Is a Cross-cutting Task

Achieving the goal of fairness and distribution poses major challenges for an active financial policy. In Germany not only is there very high inequality of wealth, but the trend towards inequality in income distribution has increased substantially. What is at issue here is a cross-cutting social and economic task that cannot be dealt with by means of financial policy alone (Atkinson 2016). In particular ensuring people fair rewards for their efforts requires a purposeful competition and labour market policy. Wage policy in turn and, ultimately, its statutory basis play a key role in determining primary distribution and thus reducing the great inequality of market incomes. Implementation of the minimum wage was an important step. That fact that various policy areas have an impact on the goal of fairness must not be permitted to allow individual policy areas to elude responsibility by standing on the sidelines and leaving it to others. Only if all policy areas cooperate decisively will it be possible to ensure fairness and economic and social stability. That also means that public services must be boosted as guarantors of productivity and stability.

Making the Tax System More Consistent with the Principle of Reward for Effort

A very unequal income and wealth distribution contradicts people's conception of social justice. From a tax policy standpoint the principle of rewarding people for their efforts requires progressive taxation. As the saying goes, strong shoulders should be required to bear more than weak ones. If actual income and wealth distribution violate our ideas of fairness in the medium to long term social cohesion is endangered and trust in state action and democracy are eroded. Thus the tax system should once again be called upon to realise the principle of rewarding people for their efforts more consistently and, by means of a wealth-related tax, aim at achieving a fairer distribution of wealth, 80 per cent of which is inherited.

Combating Tax Flight at National and International Level

For this purpose, combating tax evasion, avoidance and competition is of particular importance. International tax avoidance strategies and the tax evasion of individuals and companies lead to a hollowing out of the principle of rewarding people

for their efforts and the redistributive intent of the tax system. They also create an unfair competitive advantage for some large international conglomerates. They must therefore be addressed more energetically than has so far been the case. That begins at national level with a significant expansion of tax inspection and investigation, continuing at the international level with corresponding agreements. The agreements reached to date on the exchange of information between financial authorities, as well as agreements on base erosion and profit shifting (BEPS) constitute the first important steps in this direction. Considerable loopholes remain, however. Public registers of the owners, controllers and beneficiaries of firms, foundations and trusts are therefore needed. Business relationships with offshore companies must be made public. Germany and its finance ministry must take the lead in this.

Limiting Unfair Tax Competition with Minimum Tax Rates

The energetic implementation of measures adopted at the G20 level against international tax evasion would in itself do much to put the brakes on tax evasion and avoidance. However, further initiatives on international tax harmonisation are needed. Tax competition was only temporarily restrained by the global economic and financial crisis. Before it, average corporate tax rates were falling regularly across the globe. As a result a considerable portion of tax revenue was under threat because tax privileges were conferred on corporate income and capital gains as against other forms of income within the framework of income tax. In this situation minimum tax rates are required at least in the EU in the medium term. Furthermore, a common consolidated corporate tax base (CCCTB) is urgently needed in the European Union in order to effectively counteract massive corporate tax avoidance.

Abolishing the Withholding Tax

Internationally, income tax is characterised by two tendencies: (I) so-called dualisation, in other words, the privileging of capital gains over labour income and (II) falling higher tax rates (Godar/Truger 2016). However, the sole argument in favour of privileging capital gains – namely the attempt to keep them within the country by applying lower rates so that people are not inclined to circumvent the domestic tax authorities and transfer the gains abroad, where conditions are more favourable – ceases to apply with the exchange of information. To this end the withholding tax introduced in 2008 should be abolished and capital gains should once again be taxed progressively like other forms of income, taking into consideration prior taxation of dividends at company level.

Making the Income Tax Rate More Progressive

With regard to income tax rates there are numerous options for progressive corrections of distribution policy. A so-called "tax on the rich" – a higher top tax rate for those on very high incomes – would make a tangible contribution to improving tax fairness. There is barely any scope for substantial tax relief for those paying low and middle tax rates; it would be fiscally very expensive and benefit those on high incomes.

Leading the Way with a National Financial Transaction Tax

An international financial transaction tax with a broad assessment base and a low rate (between 0.01 and 0.1 per cent) imposed on all financial transactions could have a discernible disincentive effect, in particular on high-frequency trading. This would make a substantial contribution to curbing damaging speculation and stabilising the financial markets. At the same time, Germany would realise considerable income, amounting to tens of billions of euros. The best solution would be to introduce such a tax globally. However, even swift implementation of the model developed in the EU in ten member states would represent major progress. And even if such implementation failed, Germany could introduce a properly designed financial transaction tax on its own. The examples of France and Italy show that such a tax can also be effective in individual countries and can be introduced without discernible negative effects on the financial markets.

Making More Active Use of the Redistributive Options of Asset-related Taxes

From the standpoint of fairness of distribution, in particular a wealth tax properly speaking and inheritance and gift tax are especially important among asset-related taxes. According to recent DIW calculations (Bach et al. 2016) above all a wealth tax would both raise substantial revenues and have considerable redistributive effects. Furthermore, according to a survey conducted by Mau and Hauer (2016) people generally consider a wealth tax to be a particularly appropriate instrument of redistribution. However, this tax is often criticised because of its supposed burden effects on the economy and the relatively high cost of levying it and related assessment. On the other hand, the wealth tax remains an interesting tax and distribution policy option if other redistribution options often considered to be less problematic by wealth tax critics (higher profit tax, inheritance tax) are not used.

Taxing Inherited Business Assets

Inheritance and gift tax is of particular importance; although this does not have much of a profile among the general public, it enjoys a lot of support among experts at the conservative end of the spectrum. It encompasses unproductive asset increases and is thus particularly legitimate in terms of rewarding people for their efforts. In contrast to the reforms implemented recently under pressure from the corporate lobby, systematically stronger taxation of business assets – in line with the recommendations of the Federal Constitutional Court – would yield substantial additional revenues. Although it can make economic sense to favour business assets to ensure the continuing existence of the company and jobs in the event of inheritance, those inheriting a company can bear an appropriate inheritance tax on business assets without major problems, as long as deferment options of around ten to fifteen years at generous interest rates are made available. Even economic liberal and conservative advisory bodies, such as the Council of Economic Experts and the Advisory Council of the German Ministry of Finance have emphasised in their

reform proposals that moderate taxation of business assets to the extent mentioned, as would be the case with a revenue-neutral inheritance tax reform with a flat tax rate on all inheritances and gifts, would not be a problem in terms of the tax burden, as long as it was combined with generous tax deferment options. Inheritance tax on business assets can be paid from current earnings without endangering the continuance of the business and thus jobs. Thus although reductions could be granted for business assets they should not be greater than necessary in order to keep the business viable.

Recommendations for action on the further development of tax policy

- do not pursue implementation of a more equitable income and wealth distribution through tax policy alone;
- fair distribution is a cross-cutting task;
- the tax system should be consistently in line with the principle of rewarding people for their efforts and redistribution;
- tax flight at national and international level should be curbed;
- unfair tax competition should be curbed by means of minimum tax rates;
- the progressive element of income tax rates should be boosted;
- the withholding tax should be abolished;
- Germany should take the lead with a national financial transaction tax;
- adequate minimum taxation of business assets should be ensured in the case of inheritance.

3.3 FINANCING THE MAINTENANCE AND FURTHER DEVELOPMENT OF INFRASTRUCTURE

Over the long term, public tasks should always be financed by means of corresponding tax revenues. But just as every company invests in its own future by means of loans the financing of a country's economic viability by borrowing makes perfect sense. This includes – in particular – investments in public infrastructure, which make it possible to meet social, environmental and economic needs.

Utilising the Scope Offered by the Debt Brake and the Stability and Growth Pact

Despite the debt brake and the restrictions of the European Stability and Growth Pact, which set narrow limits on net borrowing, there is room to manoeuvre that can be used for investments in public infrastructure. For example, within the framework of its »break even« policy the German government has for years not taken advantage of the structural upper borrowing limit of 0.35 per cent of GDP (which currently corresponds to around 10.5 billion euros). Within the framework of the European Stability and Growth Pact, with regard to the economy as a whole there is much more room to manoeuvre because the medium-term structural limit on net borrowing stands at 0.5 per cent of GDP, while the structural fiscal balance was distinctly positive. In this framework higher infrastructural investment could be implemented right away.

Making the Deficit Rules Viable for the Future ...

The previous deficit rule in the Basic Law was fiscally and macroeconomically inefficient, First and foremost, it was prone to manipulation (for example, who says when a "disturbance in macroeconomic equilibrium" has taken place?). Second, it was economically questionable. For example, it relied on the concept of "cameral" [kamerall] investment, which is investment framed on the basis of single-entry book-keeping. This means that budgets have to balance in terms of income and expenditure, but not assets, debts or amortisation. This provides a distorted view of public finances. Declines in value were also neglected within this framework. Thus it was unable to contribute to either a sustainable consolidation or an economically realistic credit financing of investments beneficial to the economy as a whole.

The Basic Law's new debt rule, by contrast, puts the concept of consolidation centre-stage. It permits credit financing of the federal state up to 0.35 per cent of GDP and for the Länder at zero per cent of GDP from 2020; in other words, from 2020 it will no longer be possible for the Länder to engage in additional borrowing. Within restrictive limitations, however, the new debt rule for both the federal and state governments does provide for exceptions to the ban, for example, in the event of recession or a social emergency. The concept of consolidation thus accepts a growing deterioration of infrastructure to the detriment of future generations. The fact that credit-financed investments today could boost the prosperity of future generations is neglected. In particular in times of extremely low interest rates the potential loss of prosperity

due to the prevailing need for public investment is especially grave.

The fact that a deficit rule that is adequate with regard to growth policy but not susceptible to manipulation is demanding from a technical legal standpoint should not be a reason for letting both potential growth and prosperity lie fallow both qualitatively and quantitatively. Even though the German debt rules cannot be regarded as detached from the European Fiscal Pact that is no reason to renounce reform. In particular in the course of the euro crisis it has been shown that a financial policy fixated solely on undifferentiated consolidation and ultimately on supply side policy is macroeconomically inadequate for coping with the crisis effectively.

Thus a reformed debt rule is needed. While of course it has to prioritise robust public finances it must also contain an extended credit financing rule that permits credit financing that is both economically efficient and limited, to the extent that tax financing is not preferable on general economic grounds. That applies to a range of public spending whose credit financing would generate a higher capital stock in the future, such as in the areas of infrastructure, education and research. In this context thought must be given, unlike hitherto, to obligations to avoid a decline in value (periodic maintenance investments), (partial) redemption obligations and better avoidance of social costs (shifting the burden between generations).

... Using a Golden Rule for Public Investments

A key element for expanding and stabilising public investments to be striven for in the medium and long terms could be the introduction of a Golden Rule (Truger 2015). This rule, which is widely accepted in the mainstream financial literature, permits the financing of net public investments; in other words, the enlargement of the public capital stock by means of a budget deficit. In order to avoid a conflict between this golden rule for public investments with the goal of stabilising the debt-to-GDP ratio at 60 per cent, an upper limit for allowable net investments in the amount of, for example, 1.0 to 1.5 per cent of GDP has to be established. In this way both intergenerational fairness and economic growth would be served because public investments increase the public capital stock and thus create higher growth to the benefit also of future generations. For this reason it is only consistent to resort to it for financing debt servicing. If in the absence of a golden rule the credit financing option ceases to be available the current generations have to bear the whole burden, which leads to a shortage of public goods – and thus also to lower growth. In particular the drastic investment cuts during the recent euro-area crisis confirm this observation.

Defining All State Spending of High Future Utility as Investment

From an economic standpoint all state spending that generates considerable future utility in the form of higher growth or avoided costs should be defined as investment. For pragmatic reasons initially a technically rapidly implementable definition of net investment within the meaning of the National Accounts minus military spending (as the case may be, plus

investment grants to the private sector) could be used. The net investments defined in this way should then be deducted from the deficit figures of the European Stability and Growth Pact and of the Fiscal Pact, as well as from the national debt brake. Thus public investments would be protected from cuts and investment increases would be facilitated. Over time, the definition of investment can be improved in technical and statistical terms and possibly other public spending, such as in the area of education, can be contained within suitable limits. The political effort would be considerable given the required legal changes, but it would pay off, even if the aim is nothing more than to correct faulty economic design in the existing regulations.

Financing Public Investments through Development Banks

Another option for financing municipal public (and private) investments is the expansion of existing or the construction of new development programmes by means of development banks, such as the Kreditanstalt für Wiederaufbau (KfW), the European Investment Bank and the Landesbanks. Such programmes are in heavy demand and, for example, have proved themselves in tackling the Great Recession within the framework of the economic stimulus packages. Because often merely a slight increase in guaranteed sums is required for this purpose or, as the case may be, debt servicing is to be carried out partly from the state budget, considerable investment resources can be mobilised with relatively little burden on the budget.

Recommendations for action to maintain and expand infrastructure

- make full use of credit limits for investments in infrastructure;
- try to bring about investment-oriented development of the European fiscal rules and the debt brake;
- define all state expenditure with a high future utility as investment;
- finance public investments also by means of development banks;
- avoid public–private partnerships for financing purposes.

Avoid Public–Private Partnerships for Financing

One much-discussed instrument for financing public investments is the so-called public–private partnership (PPP). Private investors pre-finance and carry out a public investment that is subsequently made available to the user public authority for a fee and with the aim of making a profit. In this way the public budget's funding needs fall over the short term. However, experiences with the long-term efficiency of such models are sobering indeed, and these days audit offices tend to complain of the wastefulness of such schemes. Such risks are particularly high when large infrastructure companies are formed at the federal level in the financing of

which private investors are able to participate. With regard to all such forms of PPP projects the question arises of the statistical treatment of the relevant expenditure. If they are put entirely on the books of the state budget, despite the participation of private actors, then no new budgetary scope is opened up.

In fundamental terms, therefore, it must be emphasised that both PPP models and the use of development banks can ultimately represent a circumvention of budget regulations such as the debt brake or the Stability and Growth Pact at the European level. To the extent that the budget rules are too tight from an economic standpoint, however, such – often inefficient – circumvention amounts to an emergency solution. Thus the most rational thing to do would be to revise the European fiscal rules and the German debt brake.

3.4 DEVELOPING FINANCIAL RELATIONSHIPS BETWEEN THE FEDERAL GOVERNMENT AND THE LÄNDER

The federalism laid down in Germany's Basic Law is grounded to a particular degree in democracy theory. After the experiences of the Weimar Era the idea was to complement the horizontal separation of powers with a strong vertical one. A federalism grounded in this way is only accepted by people in the individual regions of the federation, however, if they can expect approximately equal life circumstances. That is in turn conditional on a functioning financial equalisation on the part of the federal government, which guarantees all public authorities financial resources commensurate with their tasks. The compromise reached between the Länder and the federal government on reforming financial equalisation cannot meet these requirements over the long term. The worry is that the agreements reached will, over the long term, rather reinforce the financial, but also economic and social differences between the Länder than reduce them. People's living standards are not converging, but drifting apart, in particular between the different Länder. This development is confirmed by the recent report on disparities (Albrecht et al. 2016). For this reason more far-reaching reforms are required in this connection.

Equal Living Standards Call for Financial Equalisation on a Solidarity Basis

Social cohesion in the Federal Republic of Germany is a precious asset that must not be endangered by the growing gap between the individual Länder. In connection with the debt brake now enshrined in the Basic Law, however, in recent decades the federal government's financial equalisation, far from halting the increasing concentration of economic activities in a small number of growth poles, has even boosted it. As a result of their unequal economic strength and competitiveness, as well as differing demographic development the Länder and municipalities now have very different levels of financial resources at their disposal (Förster 2016) after deducting the main prior encumbrances (interest payments, expenditure on social provisions). Between Bavaria and Lower Saxony, for example, there is a gap of around 500 euros per resident; between Bavaria and Saarland, as well as between

Hamburg and Bremen the gap is as much as 1,000 euros per resident. On top of that burdens differ with regard to social expenditure. They also give rise to increasing disparities between the financial capacities of the Länder and the municipalities.

The current disparities report shows that territorially unequal developments in Germany are becoming reinforced and to some extent even increasing (Albrecht et al. 2016). It is a permanent collective national task, enshrined in the Basic Law, to facilitate equal living standards across the Federal Republic. We must do a lot better in carrying out this task in the future. That means that in the future financially and structurally weak regions must receive financial support within the framework of solidarity-based financial equalisation and a collective national structural policy. The national stability that would result from such an approach would bring welfare gains for all.

With regard to the concrete design of financial relations between the federal government and the Länder two solutions are conceivable (detailed in what follows), taking into account the postulate of equal living standards and the so-called "Parameter law", which among other things regulates the distribution of resources under financial equalisation.

Recalibrate Vertical Revenue Distribution with Regard to Equalisation

The extent to which Länder competence is meaningful with regard to education policy is controversial. More important here, however, is the fact that Länder competence in education policy has more of a political than an economic basis. The historical grounds of German federalism bestow on the Länder a disproportionate predominance over the Bundesrat in the legislative process. This strong position implies that Land governments and their parliaments are supposed to be not only administrative entities along the lines of regional authorities, but rather »proper« legislative bodies. The independence of the Länder with regard to matters of education and culture is an expression of this strength. At the same time, in recent years the expansion and development of education policy has developed into a policy area on which social consensus has been broadening. The upshot of this is constantly increasing financial requirements on the part of the Länder and calls for funding programmes from the federal government. This, in turn, links these demands – consistently – to the demand for substantive participation in decision-making. The closer one cleaves to this mechanism – in other words, ultimately a demand for an end to the current prohibition on cooperation between the federal government and the Länder – the more one undermines the legitimacy of the special situation of the Länder parliaments and their governments under constitutional law.

Conflicts arising from the uncovered financial needs of the Länder need not be so stark if a central provision for regulating financial relations between the federal government and the Länder – namely Art. 106 para 4 sentence 1 of the Basic Law – was also put into practice. According to this provision the shares of the federal government and the Länder in VAT are to be recalibrated if the ratio between the revenues and spending of the federal government and of the Länder gets out of kilter. For years, however, the federal government

and the Länder have not been able to agree how this uncertain legal concept shall be applied in practice.

A well-functioning flexible element with regard to distribution of revenues is essential for a well-functioning federalism with changing social policy priorities. An arbitration procedure can help. It should therefore be examined whether concerted pressure to reach agreement on the federal government and the Länder could be increased by establishing an arbitration procedure that both sides could appeal to if, despite – whether alleged or actual – changed spending obligations no agreement can be reached. Beyond the funding needs of education policy it would be desirable if once again transparency and cohesion could be applied in financial policy practice in this way.

Transferring Länder Debts Entirely to the Federal Government

From 2020 the Basic Law's prohibition on new borrowing for Länder budgets will come into force. By then Länder debts will have grown to around 567 billion euros, according to current estimates. Over the same period the interest payment burden of these budgets (2014: 16.1 billion euros) will fall to around 10 billion euros due to the period of low interest rates. In the event of long-term safeguarding of the current extremely low interest rate and refraining from net new borrowing there will be little risk of interest rate changes for the time being.

As manageable as interest rate payments look for the Länder in the aggregate, for individual Länder they vary by level of debt. Including their municipalities, in 2015 the burdens ranged between 70 euros per inhabitant in Saxony and 907 euros in Bremen, with an increasing tendency. The consequence is a growing and politically unacceptable difference in the viability of Land budgets and thus in the provision of services of general interest for citizens.

The transfer of competences with regard to borrowing to the federal government – from 2020 only the federal government shall be permitted to engage in new borrowing in the amount of 0.35 per cent of GDP – could be the occasion of a complete assumption of existing Länder debts into the federal government debt. The resulting interest burdens can be compensated by the federal government with interest relief with regard to the federal government debt. That might also be possible by means of a partial drawdown on the solidarity tax, which is to be raised for this purpose.

The budgetary discharges on the Länder side would be considerable in all Länder, but particularly in the highly and above average indebted ones. The viability of Länder budgets would palpably converge again. A key cause of the ongoing budget emergencies would be permanently eliminated; city states and large cities would obtain robust growth prospects, no Land would have losses to regret and Land budgets would be susceptible to remodelling again. The federal government would in this way comply with its obligation to assume liability with regard to the Länder prohibition on borrowing. The theoretical interest risk would also remain with the fiscal actor with the greatest market importance.

Recommendations for action to improve federal government–Länder financial relations

- recalibrate the shares of the federal government and the Länder in VAT with regard to equalisation;
- establish arbitration procedures for revenue distribution between the federal government and the Länder;
- strengthen transparency and relatedness;
- complete assumption of existing Länder debts by the federal government;
- compensate interest burdens by interest relief with regard to federal government debt and partly a drawdown on the solidarity tax by the federal government.

3.5 STRENGTHENING TAX ADMINISTRATION AND DESIGNING IT MORE EFFICIENTLY

Tax administration is one of the areas of public administration that are of particular importance for an active financial policy. Only an efficient tax administration ensures the state the revenues it needs to perform its manifold tasks. At the same time, the work processes in the financial administration are basically appropriate to create potential efficiencies in the course of automatising. However, the increasing complexity of cases requires adequate staffing.

The tax administration in Germany is in the responsibility of the Länder and their Land finance ministers. Currently, the finance offices raise just under 700 billion euros in tax revenues for the community. The implementation of tax laws must be efficient, equitable and fair. The fact that many spectacular cases of systematic tax avoidance and evasion – all too often with the connivance of banks, financial services and tax consultancy firms – have recently been publicised in the media – Swiss-Leaks, Lux-Leaks, the Panama Papers, Cum-Ex and so on – makes it a matter of political urgency that the quality of implementation be improved.

Providing Tax Administrations with Adequate Staff

As in many other areas of the public sector, in the course of adopting the debt brake there were also substantial staff cuts in the tax administration in recent years. Within only a decade staff were cut from 127,990 in 2004 to 119,315 in 2014. That is equivalent to the entire tax administration of the Land of Hesse. By comparison, the number of tax advisors grew from around 62,000 in 2000 to around 85,000 in 2016. If this continues in a few years' time there will be more tax advisors than tax officials. The tax administration must, like any other part of the administration, do its bit in the consolidation of state finances. However, the particular sensitivity of cuts here should be noted, which go hand in hand with the curtailment of capacities. In particular in the area of tax administration there is the danger that the implementation of staffing cuts will lead to an even greater loss of tax revenues.

In fact, the tax administrations of the Länder need more qualified staff and better career opportunities. The payment structures in the relevant authorities must be adapted to the increasing qualitative and quantitative challenges, also in the interests of a future-oriented recruitment of young talent and staff retention.

Electronic Data Processing Can Support Specialist Processing But Not Substitute for It

Special efforts on the part of the legislator – for example, the Tax Procedures Modernisation Act – are oriented towards the possibilities of a comprehensive deployment of data processing (risk management). That applies in particular to so-called bulk processes. Within this framework taxpayers will be ever more closely involved in the digitalised procedures in terms of “customer self-service” and “customer integration” (ELSTER). The electronic submission of tax declarations that this involves is a key condition for proper and swift handling. However, it should be noted that tax processing is not thereby moving ever further away from the case processing that scrutinises in a responsible manner and the underlying life circumstances. Electronic data processing must support specialist processing but cannot substitute for it. On this basis, among other things, staff planning can be adjusted only after successful introduction of innovative and more efficient procedures.

Implement Standardised Case Processing Nationwide

The expansion of electronic data processing in tax administration requires intensive nationwide cooperation. Its tendency is towards progressive standardisation. The way towards this is, however, difficult and has been pursued since 2007 within the framework of the project Coordinated New Software Development for Tax Administration (Koordinierte neue Software-Entwicklung der Steuerverwaltung – KONSENS). With the Federal Central Tax Office (with around 1,580 employees) the federal government has assumed and is expanding competence with regard to taxation, in particular in relation to especially complex issues with an international element. Further comprehensive involvement on the part of the federal government in the implementation of a nationwide standardised case processing is very important. In the KONSENS project the federal government has to commit itself more both financially and conceptually, beyond what has so far been the case. Organisationally the further development of standardised federal principles on risk-oriented case processing is needed, while at the same time maintaining temporary regional decision-making scope. In this way the Länder retain the possibility of reacting to regional decisions. Time limitations, however, mean that this remains a nationwide coordinated basic conception. Further regional differences are unacceptable in the interest of a nationwide standardised tax implementation.

Strengthening Tax Administrations and Tax Courts Organisationally

A significant improvement in cooperation between the federal government and the Länder in the area of tax implementation is a basic condition of a citizen-friendly and equitable tax im-

plementation. The establishment of common administration units to improve processes, in particular complex investigatory and taxation procedures, should be looked into. If possible, new structures are required here that could replace the previous regional tax offices, which as dual authorities were able to represent the interests of both the Länder and the federal government in tax implementation. Improved international cooperation in all areas of tax implementation and support for the building and maintenance of international relations is also required – including at the working levels of finance administration. Here the federal government has a particular responsibility. Staffing of the tax courts should also be improved. In order to optimise criminal investigations, specialised public prosecution offices are to be established across the country.

Recommendations for action to boost the performance of the tax administration

- ensure tax administrations are provided with adequate staff and organisation;
- improve the quality of tax implementation;
- implement standardised case processing across the country;
- improve cooperation between the federal government and the Länder by means of common administrative entities;
- strengthen tax courts in terms of staff and organisation;
- establish specialised public prosecution offices.

3.6 DESIGNING THE TAX AND SPENDING SYSTEM ON THE BASIS OF GENDER EQUITY

Although men and women in Germany are legally equal, things are otherwise in terms of concrete life circumstances. The distribution of gainful employment, unpaid work, incomes and wealth are very much to women's disadvantage. Negative steering effects arise from financial policy and its taxes and contributions, as well as types and forms of expenditure. Active financial policy thus has the aim not only of being sustainable socially, environmentally and economically, but also of facilitating gender equality.

Reaching Agreement on and Heed Financial Policy Equality Objectives

Gender-equitable financial policy requires politically agreed equality objectives that, in the evaluation of financial policy guidelines are to be taken into account on an equal footing with other key financial policy goals. In the discussion, assessment, detailed design and implementation, as well as evaluation of financial policy guidelines these equality goals must be included alongside the other goals. Prioritisation is up to political decision-makers; however, it must be disclosed and justified.

Given the existing lack of equality between men and women the following equality goals are of particular importance:

- increasing women's employment (with due attention to decent work);
- improving women's income opportunities;
- improving the reconciliation of family life and work for men and women;
- more equitable distribution of paid and unpaid work between men and women;
- alleviation of the unequal primary distribution of incomes and wealth between men and women by means of the tax and transfer system;
- more equal, needs-related access to public services and benefits.

Gender-equitable financial policy must therefore first of all focus on the design of the tax and contribution system.

Paying Due Attention to the Effects of Taxes and Contributions on the Employment of Women

It is important in this context to take notice of the incentive effects of taxes and contributions on women's employment, as well as on the distribution of paid work between men and women. Because taxes on labour income affect women more sharply than men, the hours women can work in the labour market, as well as their decisions about participation are more influenced by marginal tax rates or average tax rates than those of men. The system of household taxation also influences the distribution of paid and unpaid work in the household. For example, econometric studies and model simulations show that so-called marital "tax splitting" in Germany (married couples submit joint income tax returns and their incomes are combined and then split in two) supports a division of employment in which the man is the breadwinner and the woman the supplementary earner, as a result of which she tends to take on the bulk of unpaid work. Only if we include these negative effects on the employment of women in the evaluation of the tax system can they be remedied in the future design of taxes and contributions.

Paying Attention to the Effects of Taxes and Contributions on the Distribution of Unpaid Work

There are also negative effects of taxes and contributions with regard to the distribution of unpaid work in the household. Here the system of household taxation, the treatment of those who perform unpaid work in the social insurance system (for example, contribution-free co-insurance) and the tax treatment of childcare costs are important. Also the level and structure of consumption taxes can play a role if and to the extent that they influence decisions between producing or providing certain goods and services at home through unpaid work and buying those goods and services.

Concerns about the Effects of Taxes and Contributions on Income Distribution

Given the existing unequal distribution of incomes and wealth the various taxes and contributions give rise to gender-specific

effects on personal income distribution. Regressive contributions and taxes, as well as consumption taxes and social insurance contributions impose a heavier burden on low incomes than on high ones. This benefits men because on average they have higher incomes. Progressive taxes, especially wage and income taxes, on the other hand, benefit women more, who are overrepresented in the lower income groups. The same applies with regard to taxes on wealth and capital gains. They, too, benefit women more because on average their wealth and capital gains are lower than those of men. The trend towards the dualisation of income tax systems observed in most industrialised countries in recent decades, which benefits capital gains over labour income is more favourable to men, whose overall incomes on average have a higher share of capital gains.

Cornerstones of a Gender-Equitable Tax and Contribution System

A tax and contribution system designed on a gender-equitable basis, which eliminates obstacles to the equal distribution of paid and unpaid work between men and women and seeks to boost redistributive effects also from a gender perspective would have the following main features:

- replacement of tax splitting by individual taxation, or at least curtailment of the tax relief provided by tax splitting;
- reinforcement of wealth-related taxes;
- review of tax exemptions with degressive effects (for example, tax-free child allowance, tax deduction of childcare costs);
- uniform progressive taxation of different forms of income.

Making Public Spending Gender-Equitable

Gender equality, however, requires not just a corresponding tax and contribution system, but also a gender-equitable approach to public spending. To that end the equality of men and women with regard to economic and social participation should be reinforced. Secondly, gender inequalities that adversely affect men should be removed. And thirdly gender-differentiated incentives and (distributive) effects should be taken into account. Heeding these maxims in the design of transfer systems (family benefits, pension system, unemployment insurance), education care and health care, as well as public infrastructure is key to boosting gender equality. This is required not just at the federal level, but also at the Land and municipal levels.

Institutionalising Gender Equality Policy in Financial Policy

In order to embed gender equality policy in financial policy it must be institutionalised. This can take the form of an obligation stipulating that draft laws and larger projects have to undergo an impact analysis at an early stage and after implementation. Gender equality goals should be transposed into outcome-oriented budgetary management (for example,

in the form of performance budgeting) and medium-term financial planning. Furthermore, the equality of men and women should be formalised as an award criterion in public procurement.

Recommendations for action to ensure gender equity

- agree on and heed financial policy gender goals;
- replace tax splitting with individual taxation;
- limit tax exemptions with degressive effects;
- progressively tax all forms of income on an equal basis;
- take a gender-equitable approach to public spending;
- undertake impact analyses of draft laws, larger project planning and the evaluation of implementation;
- integrate gender equality goals in outcome-oriented budgetary management and medium-term financial planning;
- embed the equality of men and women as award criterion in public procurement.

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SUMMARY

The effects of financial policy are felt in people's everyday lives – in the family, at work and in their free time. Active financial policy supports people in manifold ways and enables them to participate in economic and social life. It also contributes to social justice and boosts economic potential. The high and increasing wealth inequality and the inequality of income distribution in Germany are leading not only to social, but also economic upheavals, as recent investigations show (cf. Fichtner et al. 2016). Active financial policy alone is not enough to tackle these undesirable developments. Only if all policy areas cooperate purposefully will it be possible to ensure fairness and economic and social stability. But financial policy is crucial. On one hand, active financial policy has room to manoeuvre that it must exploit. On the other hand, reforms are necessary. We have identified six key recommendations for action that we shall summarise here once more.

ACTIVE FINANCIAL POLICY

The distribution policy debate has recently been enriched by a seminal contribution. In *Inequality: What can we do about it?* leading British economist (the late) Sir Anthony B. Atkinson presents a comprehensive and creative catalogue of policy measures for reducing inequality.

In three sections he presents a diagnosis, elaborates fifteen concrete reform proposals and shows that his recommendations are affordable and would result in a massive reduction in income inequality. As Atkinson shows in the first part, it is totally inadequate to try to tackle inequality by enhancing equality of opportunity. What is needed instead is a comprehensive approach to redistribution of income at numerous levels. It begins at the level of gross income determined by the market. In the third part of his book Atkinson shows that the necessary reforms would harm neither growth nor employment. He presents numerous historical, theoretical and empirical arguments to show that a redistributive welfare state can boost the

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efficiency of the national economy. Atkinson shows that as soon as all too facile basic models or one-sided normative attitudes are overcome even the models of the neoclassical mainstream could achieve very positive results. Influential opponents of redistribution policy, such as Germany's Council of Economic Experts, are revealed as normatively and theoretically biased in an explanatory note.

The core of the book comprises "proposals for action" with which a marked reduction in inequalities can be achieved. In contrast to what one often encounters in the policy debate, for Atkinson it is not merely a matter of a couple of redistributive tax policy elements, but a comprehensive concept tackling gross incomes determined by the market – primary distribution – including some comparatively radical ideas. In five chapters he lays out fifteen measures; another five ideas are considered worth pursuing.

For more "technical progress" Atkinson calls on the state to be more innovative in boosting employability and in social services. The public authorities have directives and development programmes that can be used for this purpose. The social consequences of new technologies have to be given closer attention and answers found to meet the challenges. For example, from a social standpoint it makes sense to invest in human capacities rather than in fully automatic machinery. For the purpose of decent "employment and wages in the future" Atkinson calls for functional income distribution – the distribution of national income to the factors of production labour and capital – by way of an appropriate competition policy, the strengthening of trade unions, the fixing of minimum wages, but also guidelines that exert more influence than hitherto on remuneration at the top end of the scale. Full employment should also be restored as an explicit goal, including an employment guarantee for the unemployed in the public sector on minimum wages.

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Under the heading »shared capital« Atkinson calls for measures to enable a more equitable distribution of capital incomes. Specifically, he proposes that small investors be guaranteed a positive real interest rate by means of national savings bonds. Furthermore, all adults on reaching their majority should be given a capital endowment – a form of minimum inheritance for all – while the state through a public investment authority should operate a sovereign wealth fund to share in the productive wealth of the national economy, expanding it to allow the community to participate in the capital gains.

Under tax progression there are a number of recommendations on tax policy. What is needed is an income tax that is markedly progressive, on top of which – as was previously usually the case – labour income should be favoured, not capital gains. However, inheritance and gift tax must be developed in such a way that they are progressive and paid on all gifted or inherited money and assets. Moreover, a property tax should be levied that is as progressive as possible, based on realistic real estate values. In the proposals that Atkinson calls "ideas to pursue", he proposes in this connection the introduction of a general wealth tax, as well as minimum corporate taxation.

To ensure »social security for all« Atkinson proposes a substantial child benefit to be paid for all children, although subject to income tax. A social basic income, based on social participation, should be paid or alternatively existing social transfers should be raised substantially. Finally, with regard to global inequalities, development aid should be significantly increased.

(1) Improve the performance of the administration

Public resources should be used to continuously improve the living circumstances of as many people as possible. This requires a public administration that is fit for purpose. Public resources should be deployed as efficiently as possible. In order to ensure that public services law maximises efficiency and facilitates innovations it must be continuously scrutinised and adapted. At the same time, the quality of tax enforcement should be improved. For that purpose tax administrations and the financial courts must be provided with adequate personnel and organisational resources.

(2) Take social considerations into account in tax policy

Striking a balance in pursuit of the aim of justice is key to economic prosperity and social stability. In accordance with the goal of equitability, economic incentives must be provided for companies, employees and the self-employed. However, markets alone are incapable of generating equitability. The manifold violations of the principle of equitability require state regulatory intervention. Only with the creation of equal opportunities is equitability feasible. For this reason the tax system must be consistently oriented towards the principle of equi-

tability and redistribution. Tax evasion and avoidance should be combated at national and international level; progressive income tax rates must be reinforced; and the withholding tax must be abolished. Also required are a – if need be national – financial transaction tax and appropriate taxation of business assets in terms of inheritance tax.

(3) Finance the maintenance of infrastructure and further development

A key principle of robust public finances is that public spending be financed from tax revenues. Just as companies fund investments in the future from loans, credit financing of public investments can make sense if it boosts a country's capacities. Active tax policy should raise public investments and make full use of the available funding options. Instead of attempting to circumvent the, from an economic standpoint, too narrow rules of the German debt brake and the European Fiscal Pact by more or less creative alternative strategies, such as development banks and public-private partnerships, in the medium term the aim should be to revise the regulations in order to enable credit financing of net public investments (Golden Rule).

(4) Further develop financial relations between the federal government and the Länder

Federalism is one of the anchors of German democracy. However, it will only be accepted by people in the regions if they are able to expect convergence of living standards. This means that the regions must have sufficient capacities. In order to ensure this the equalisation system must be re-established to ensure the right balance is struck. To this end an arbitration procedure for the distribution of revenues between the federal government and the Länder should be established. It should also be considered whether the federal government should assume the existing Land debts and apply the solidarity tax for that purpose. A major cause of ongoing budgetary emergencies would thus be permanently eliminated. At the same time, the debt rule should be made fit for purpose.

(5) Strengthen tax administration and make it more efficient

An efficient tax administration ensures the state the revenues it needs in order to be able to perform its manifold tasks. An adequate number of well trained and educated employees, efficient administrative structures and up-to-date IT provision are required for this. The tax administration of the Länder, however, requires not only more qualified personnel, but also better career opportunities and remuneration structures. In order to ensure uniform case processing across the country the central handling of particularly complex cases with an international dimension has to be expanded by the Federal Central Tax Office. With regard to tax enforcement the establishment of common administrative units for complex investigation and taxation procedures should be examined. But the financial courts also need to be better resourced. The nationwide establishment of specialised public prosecution offices would help to improve and speed up criminal investigation procedures.

(6) Shape tax and spending systems in a gender-equitable way

Women and men are on an equal legal footing in Germany. Their specific living situations, however – that is, the distribution of paid employment, unpaid work, incomes and wealth – are another matter. Finance policy with its taxes and contributions, as well as spending can exert strong steering effects that at present are only reinforcing the status quo. An active tax policy should aim not only to be socially, environmentally and economically sustainable, but also to facilitate gender equality. To this end it must agree on and take into account financial policy equality goals, replacing marital tax splitting with individual taxation and boosting wealth taxes. Furthermore, it should be ensured that public resources are deployed in accordance with gender equality.

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