

# German municipalities face breakdown

by Lothar Komp

According to the German municipal finance report for 1995, German cities have to be prepared this year for "their most severe financial test ever." For the third year in a row, tax revenues from local businesses will shrink, despite all the talk about an ongoing "recovery." For the very same reason, social expenditures by municipalities, especially for unemployment compensation, are sharply rising. Deindustrialization and job cuts are taking their toll.

The reaction of German municipalities to their mounting financial problems is twofold. First, they have imposed in recent years more and more fees and charges, both on households and industry. Fees for waste water and waste disposal have seen dramatic increases. Second, despite a large backlog in infrastructure investment, construction outlays by municipalities will be further reduced. In 1993, they spent DM 45 billion (roughly \$25 billion) for construction; in 1994, it was DM 41 billion. This year it will be only DM 38 billion. But still the majority of the bigger German cities, especially in the west, will face huge budget deficits in 1995. The consequences are obvious: decay of transportation and other infrastructure, even higher social expenditures next year, reduction in household's purchasing power, and more debt.

In 1995, German municipalities will spend DM 60 billion for welfare payments. A large part of this will be for people who have run out of federal unemployment benefits. Today, far more than 2 million households are completely dependent on payments from municipal social institutions. Almost 5 million persons are receiving welfare payments, at least temporarily. After an increase this year of 8%, this area of municipal budgets is showing the fastest growth. Personnel costs were reduced by drastic job cuts. Municipal administrations in the eastern states alone have eliminated 112,000 out of 657,000 jobs from mid-1993 to mid-1994. Thousands of nursery schools in the east are being privatized or dissolved due to the expectation that eastern states will see a dramatic decline in the number of children between the ages of three and six—from 600,000 in 1991, to 215,000 in 1999.

In addition to the effects of deindustrialization, the eastern German municipalities are obliged this year to begin payments on "old debts" (Figure 1). These debts had been imposed arbitrarily on eastern municipalities by the former communist regime, and are related to real estate such as nursery and other schools, cultural institutions, and sports

facilities. Right after German unification in 1990, these old municipal debts amounted to DM 5 billion. Today they have risen to DM 7.5 billion.

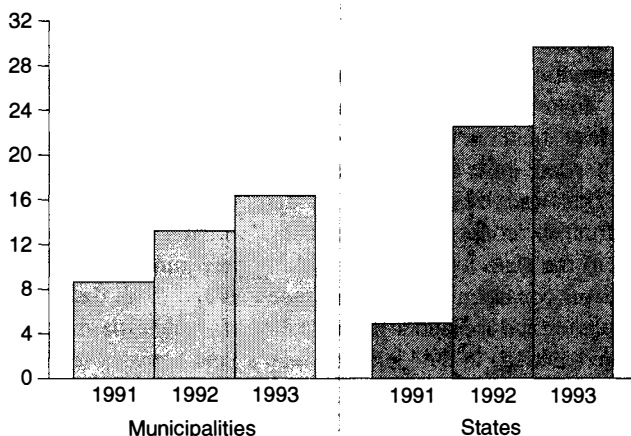
## New investments will be strangled

While eastern municipalities are rejecting their responsibility for these old debts, the German Finance Ministry has now established the "Society for the Old Municipal Debt in Connection with the Currency Conversion" as a debt collection agency. This would have devastating consequences, especially for the former industrial centers in the east. Urgently needed new investments would be strangled. In the eastern German city of Schwedt, for example, the old debt (DM 70 million) amounts to 50% of the municipal yearly budget. Cities such as Rostock (DM 414 million), Leipzig (DM 480 million), and Magdeburg (DM 280 million) are in a similar situation.

Tax revenues from local business are falling in western cities, and are still at an extremely low level in the east. This is no surprise, given the rapid deindustrialization in recent years: Today the share of output of eastern German states is less than 5% for machine building, less than 4% for electrical engineering, and less than 2% for chemicals. In order to make up for these revenue losses, municipalities are increasing fees and charges, this year by another 6%. The main factors here, however, are the exploding costs for waste and waste water disposal, because of the onerous environmental regulations. Since 1985, expenditures of German municipalities for these categories have increased by 152%!

Even more stringent waste water environmental regulations are now in preparation by the German Ministry for the Environment, which, according to the association of German

FIGURE 1  
**Public debt in Germany's new states, 1991-93**  
(without "old debt," billions of deutschemarks)



Sources: German Association of Cities, EIR.

municipalities, cannot be justified on environmental grounds. The regulations will ultimately surpass the financial capabilities of municipalities to meet them, and will lead to dramatic price increases for water usage—an expected several deutschemark increase per cubic meter for both households and industry.

The financial disaster will have catastrophic consequences for municipalities' budgets for construction investments. In total, municipal construction investments will fall by 5.6%. In western Germany, there will be a reduction of 7.1%. According to construction industry association estimates, many western cities plan even greater reductions: Frankfurt, -19.8%; Braunschweig, -17.0%; Cologne, -15.3%; Karlsruhe, -15.3%; Stuttgart, -14.8%; Hanover, -12%.

In February 1995, Friedrich Hassbach, the director of the German construction industry association, warned at a meeting in Bonn that "never before in the history of the Federal Republic has the public financial maneuvering room been so tiny." He noted that since 1992, public infrastructure investments are shrinking; public construction investments, if price inflation is taken into account, have fallen below the level of the mid-1960s; and this will soon lead to shortages in infrastructure equipment.

### Cuts will not improve finances

Apart from construction, many municipalities are planning drastic cuts in services this year. According to a poll by the German municipal association, 56% will reduce outlays for road maintenance, 38% will restrict street lighting, 59% will reduce energy consumption in public buildings, 46% will cut expenditures for school learning aids, 25% will cut school transport, 24% will reduce theater and opera events, 41% will cut expenditures for libraries, 20% will close libraries, and 33% will at least temporarily close public baths. But all that cost-cutting and fee collection will not improve municipal finances. In 1995, most of the big western German cities will still have huge budget deficits, such as Essen (DM 478 million), Düsseldorf (DM 282 million), Bochum (DM 177 million), Mainz (DM 148 million), and Hanover (DM 141 million).

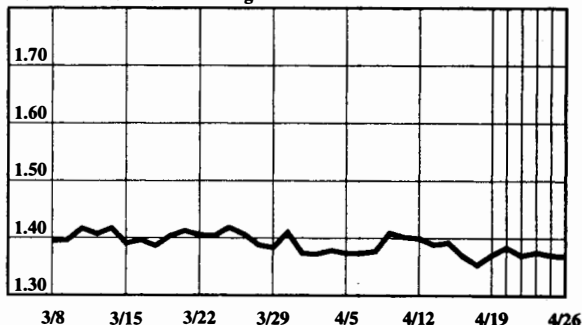
The financial crisis of the Federal Republic, states, and municipalities has reached dangerous dimensions. It is already threatening the German Unity Transport Projects, including investments of DM 230 billion into railways and DM 210 billion into highway modernization. In addition, there is a huge backlog in waste water infrastructure investments—up to DM 300 billion, about 50% of this alone in the east. Another DM 200 billion will be required in the years ahead for waste-processing plants, in order to keep up with new environmental laws.

Unless there is a fundamental break with liberal dogmas of infrastructure financing and "third wave" service sector utopias, formerly rich German municipalities will be turned into wastelands.

## Currency Rates

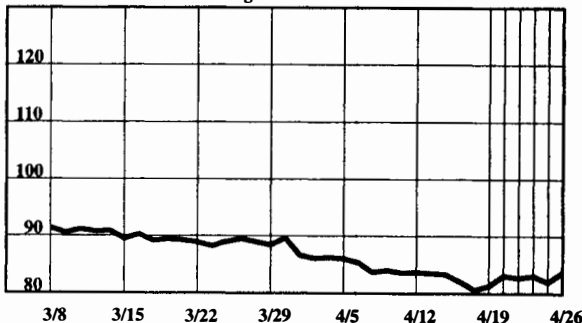
### The dollar in deutschemarks

New York late afternoon fixing



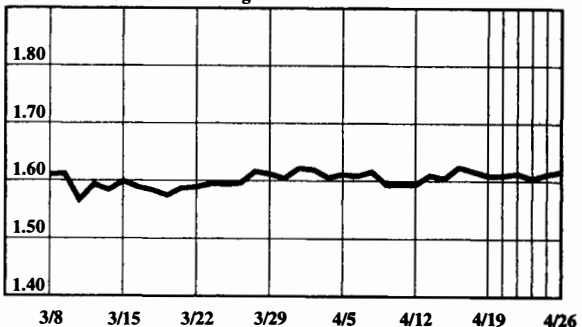
### The dollar in yen

New York late afternoon fixing



### The British pound in dollars

New York late afternoon fixing



### The dollar in Swiss francs

New York late afternoon fixing

