Report from Bonn by Rainer Apel

Debt and taxes are killing the cities

German municipalities are raising the alarm over their worsening fiscal crisis.

Infected with the "balanced-budget" virus, the municipality of Wetter, in the western state of North Rhine-Westphalia (NRW), has adopted a radical cure: It sold its 80 public-sector buildings to the VEBA real estate firm, to lease them back for DM 1.7 million ($1.1 million) over the next two years. This, the authorities claim, will save the city about DM 600,000. The trick in this deal, which undoubtedly has the approval of all "streamlining" prophets, is that the city no longer is the master in its own house, that it sold its ownership for a shortsighted "benefit" that will be gone in two years.

A former industrial powerhouse that has been put through radical deindustrialization, NRW has many cities that face grave fiscal problems. No fewer than 62 out of its 274 municipalities "balanced" their budget this fiscal year only by selling real estate and other property. Another 74 barely escaped fiscal emergency rule by decree, by signing a document that solemnly proclaims their will to balance their budgets over five years. Even Düsseldorf, the state's capital, sold its shares in the RWE energy-producing firm, in order to pay at least 25% of its DM 400 million municipal debt in FY 1995.

The situation was so dramatic in 1995, because cities were hit full force by the combined effects of mounting old debt obligations, new debt burdens, and the denial of new loans by creditor banks; by lower tax revenues because of worsening general economic conditions; and by increased social welfare expenditures because of the rising number of welfare recipients (unemployed, refugees from Bosnia, private bankruptcy cases).

The situation is more or less the same on a national scale. Thus, the German Municipal Congress (DST), the political organization of the cities, raised the alarm in a press conference in Bonn on Jan. 22. The combination of increasing debt service, lower tax revenue, expanded social welfare and other social expenditures, and increased pressure to impose deeper fiscal austerity is a recipe for the financial and social collapse of urban communities, DST President Gerhard Seiler warned.

He said that the 15,000 cities in the DST have entered a "valley of tears," with no funds for investment, and no prospect of meeting their obligations. "Some cities are deep into the valley of tears up to their neck, some only to their ankles, so far," Seiler said, reporting a tax revenue shortfall of DM 13.5 billion for FY 95, and an estimated additional DM 12 billion for FY 96.

Seiler took aim at Finance Minister Theo Waigel, a devout monetarist who has most recently blamed the failure of the municipalities to balance their budgets on Germany's being in danger of missing the European Monetary Union's balanced-budget criteria. The DST maintains that many of the cities' problems have been produced by the federal government in Bonn, which, for its own budget-balancing reasons, has burdened the municipal administrations with an additional DM 4 billion in expenses in FY 95 alone for urban day-care centers (which had previously been paid by Bonn), and for several categories of social welfare for citizens who have been unemployed for a long time and therefore no longer receive federal unemployment assistance.

Partly because of the high-interest rate policy which was imposed in late 1979, urban budget obligations have increased by 140% since 1985, while revenues have increased by only 40% over the last 10 years, Seiler charged. The unmanageable fiscal situation has forced the cities to "privatize" municipal real estate and other property, in order to try to balance their budgets. But this is a shortsighted policy, Seiler said, because "everybody knows that one can only do such privatizations once, that there is no second chance to make money from an asset after it is sold."

The budget-balancing of Bonn has made the municipal situation worse; so have the tactics of the state governments for reducing their transfers to the cities. The cities receive subsidies from the states for investments in public infrastructure, for schools and theaters, libraries, and day-care centers.

The eastern municipalities, however, depend on state and federal transfers to a much higher degree than western municipalities: 70-75% of the budget in the east (only 25% is genuine income from taxes, fees, licenses), compared to the reverse ratio in the west.

But the situation is worsening, and western municipal authorities, such as Lord Mayor of Duisburg Josef Krings, have begun to call for state and federal transfers like those which the eastern municipalities receive. The state governments, however, have begun to end these transfers, and have signaled creditor banks that they should be prepared for municipal defaults. If the states stop the transfers, the cities will, indeed, collapse.