Speech of Petra Roth, mayor of Frankfurt and president of the German Association of Cities (Staedtetag), at the occasion of the UCLG world congress in Guangzhou (China)

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Ladies and Gentlemen,

Please allow me to start by giving you a brief outline of the position of local government within the political structure of the Federal Republic of Germany and its position in the financial system. This will give you a better understanding of the effects of the financial crisis. The right of Germany's local authorities to self-government is laid down in the German Constitution. However, this does not mean that local authorities are completely free in their decisions on income and expenses.

On the income side local authorities have their own sources of taxation where they are free to define the rate of taxation, though not the assessment basis. This concerns property tax (or council tax), which is relatively low on an international scale, and trade tax, which is largely dependent on the profits achieved by locally established medium-sized and large companies. This income – which fluctuates year on year – is just under a fifth of the whole income in the budget. In addition, local governments receive a certain share in other taxes, such as income tax, which are beyond their control. More than a third of all local income consists of financial allocations that often depend on the financial situation of the State where a local authority is situated.

On the spending side, local councils are equally restricted, at least with regard to the individual expense types. When it comes to the provision of social benefits, local authorities are in many areas restricted in their options by federal and state laws which specify what kind of services they should provide and to what extent. This includes, for instance, the provision of housing benefits for the long-term unemployed. Social benefits now make up the largest local government expenditure, second only to personnel expenses which effectively do not permit short-term control either. Social benefits are nearly one quarter of all expenses.

The setting of standards by federal and state governments leads to a situation where minimum expenses are externally specified, for instance for fire services. The underlying legislation can only be influenced by local authorities indirectly, both on the expenses side and on the income side. This combination of very little influence on income and merely limited control over expenditure means that local authorities are considerably restricted in their financial autonomy. Even if, in all, funding is reasonably adequate – as it was between 2006 and 2008 – the lack of financial autonomy means that if a local authority is confronted with relatively low income and a high level of committed expenditure, it cannot save itself from this situation in its own strength.

Moreover, there has been a marked increase in discrepancies between the financial positions of different local areas in recent years. The impact of the financial crisis on local authorities has therefore been very noticeable indeed, considering that they lack sufficient funds to counteract those effects.

Local tax revenues will have dropped by an average of 10% this year, and trade tax revenues (mentioned earlier) will have gone down by nearly 20%. Also, this slump differs from one region to another – in Frankfurt for example nearly 40 % – and the allocation of funds to local authorities will also go down by next year at the latest. Local authorities are not in a position to control this development. Instead, their income situation is likely to suffer a further strain from tax cuts which were opposed by local authorities but which they were unable to prevent.

At the same time expenses on social benefits are rising – a development which is virtually inevitable during an economic crisis. In other words: Their income drops, while their expenses rise. This year will not have been the most difficult one for local authorities, even though Germany is expecting a 5% downturn in its gross domestic product.

2010 will be far more difficult: although economic growth is likely to be 1.2%, local authorities are expecting a further reduction in income and a clear increase in expenditure. Expressed in figures, the situation is likely to be as follows: Starting with a positive financial balance of approx. +EUR 7.6 billions in 2008, local authorities are expecting a funding deficit of about EUR 2.9 billions in 2009.

In 2010 this deficit will exceed some EUR 10 billions, thus reaching an all-time low. This does of course pose the question how local authorities are reacting to the present situation. Local authorities themselves are indeed taking a critical look at any of their expenses that are under their own control.

However, as we saw during the very difficult years at the beginning of the millennium, potential savings are not just limited as such, but they have in fact largely been exhausted already. Also, it is important to ensure that local authorities do not endanger economic recovery by being too radical in their expense cuts.

To prevent this from happening, they are being given additional funds of nearly EUR 10 billions so that they can modernise and maintain their infrastructures which are already very good on an international scale. Many local authorities are therefore forced into debt. Forecasts have shown that under the current structure, deficits will not just be a short phase but will turn into long-term structural deficits. Local authorities are therefore demanding a general review of their funding structures.

This would mean increasing trade tax as an original local tax, i.e. by specifying a broader assessment basis and increasing the group of taxable businesses. At the same time, there are demands for a reduction in social benefits. As local self-government is seen very clearly as an essential part of Germany's democratic constitution, we are hopeful that a suitable reform might prevent the current crisis in local government funding from becoming permanent.