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Federalism and the Welfare State: The German Case

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Zusammenfassung

In der vergleichenden Wohlfahrtsstaatsforschung wird der Föderalismus regelmäßig als Faktor identifiziert, der die sozialstaatliche Entwicklung verzögert und dem Wohlfahrtsstaatswachstum Grenzen gesetzt hat. In Deutschland scheint jedoch der Föderalismus vereinbar mit einem der großzügigsten Sozialstaaten der Welt. Der Aufsatz geht der Frage nach, ob die deutsche Ausnahme die besonderen Bedingungen erhellen kann, unter denen der Föderalismus den ihm zugeschriebenen hemmenden Einfluss auf die Sozialstaatsentwicklung besitzt. Zentrale These des Aufsatzes ist, dass in Deutschland die föderalen Staatsstrukturen nicht nur nicht hemmend, sondern sogar ausgabenexpansiv wirkten. Die besondere Spielart des kooperativen Föderalismus begünstigte ‚fiskalische Unverantwortlichkeit' der verschiedenen Staatsebenen und die Beitragsfinanzierung des Bismarckschen Wohlfahrtsstaats ermöglichte es Bund und Ländern, ihre Einigungsprobleme zu Lasten Dritter zu lösen.

Summary

The comparative welfare state research regularly highlights ‚federalism' as a factor that has delayed welfare state development and sets clear ‚limits to welfare state growth'. Yet, apparently German federalism goes together with one of the most generous welfare states of the world. This paper argues that federalism in Germany not only has not hindered strong welfare state expansion, but actually has contributed to it. The special variant of ‚cooperative federalism' has blurred political and fiscal responsibilities, and the contribution financed Bismarckian welfare state has allowed the central government and the states to come to terms at the expense of a third party. A steady process of externalizing costs out of the public budgets and into the parafiscal budgets of the welfare state has been the result.

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1 Introduction[1]

Conventional wisdom strongly suggests that federalism is inimical to high levels of social spending. Two arguments are prominent in this context: a veto-point thesis and a ‘competition of jurisdictions’ thesis. The veto-point thesis is quite straightforward: federal systems have more veto points than unitary systems ceteris paribus (Tsebelis/Money 1997; Tsebelis 1995). This increases the probability that groups opposed to welfare state expansion can exert some influence in the legislative process. Veto points would then give these groups the opportunity to block or substantially water down redistributive legislation (Huber et al. 1993; Skocpol/Amenta 1986; Ross 1997). ‘Competition of jurisdiction’ arguments hold that welfare redistribution is limited in federal systems because those who would pay more than they would gain in a given jurisdiction (high income earners, ‘capital’) can credibly threaten to exit highly redistributive and join less égaliste jurisdictions (Brennan/Buchanan 1988; Weingast 1993; Weingast 1995; Inman/Rubinfeld 1997). At the same time, those who gain more than they would pay (e.g. low income earners) are attracted to regions with higher level of redistribution and these would therefore develop into ‘welfare magnets’ (Peterson/Rom 1990). Thus, a re-distributional policy stance is self-defeating in a federal context.

Indeed, many econometric studies of the determinants of welfare state spending have found that federalism exerts a statistically significant, stable and negative influence on social spending (Wilensky 1975; Crepaz 1992; Huber et al. 1993; Huber/Stephens 2001; Castles 2000; Hicks/Misra 1993; Hicks/Swank 1992; Swank 2001; Swank 2002). Prominent country cases are Switzerland and the United States, both strongly federalist countries and historically, prominent welfare ‘laggards’ (although since 1980 Switzerland has moved rapidly from laggard to leadership status). Other cases providing support for these arguments would be Australia and Canada, again federal countries that, for much of the post-war period, have had well below average levels of social spending. Germany, however, is a federal polity which combines big government with generous social expenditure. This ‘anomaly’ may motivate us to take a closer look at the postulated inverse relationship between federalism and welfare state development. Is Germany only the exception that proves the rule or does the German case provide unsettling counter-evidence to the federalism-thesis? In this chapter, I argue that the German case alerts us to the fact that the dampening impact of federalism on welfare state spending is likely to hold only under special circumstances. Two considerations seem to be of particular relevance in this respect:[2]

[1] I thank Herbert Obinger, Stephan Leibfried, Christine Trampusch, Steffen Ganghof and especially Francis Castles for very helpful > comments, and Annika Schulte for editorial assistance.

[2] A third qualification to the ‘federalism as an impediment to welfare state growth’ thesis may be mentioned here, but is not exemplified by the German case (see Bonoli 2000): federalism only appears to have the postulated blocking effect in times of welfare state expansion (the ‘old politics of the welfare state’), but not in periods of retrenchment (the ‘new politics of the welfare state’).

First, the federalism hypothesis critically depends on *the sort* of federalism that prevails in a given country: is it one that establishes separate jurisdictions between the central and the regional level (interstate federalism; *Trennföderalismus*), or is it one of interlocked or joint jurisdictions (intrastate federalism, *Verbundföderalismus*, *cooperative* rather than *competitive* federalism)? Where federal institutions establish joint jurisdiction over social policy, federalism does not necessarily have a constraining impact on welfare state growth. Race-to-the-bottom dynamics or beggar-thou-neighbour politics, greater political accountability and limited opportunities for blame avoidance – the mechanisms said to constrain welfare state growth in federal polities – all seem to have much less bite in the case of intra-state federalism. Intra-state systems do *not* establish clearly separated spheres of fiscal responsibility, legislative competency and political accountability between different layers of government, but rather mesh them between the regional and national units. In this case, the conventional 'competition of jurisdictions' arguments do not apply (Weingast 1993; Weingast 1995; Brennan/Buchanan 1988). On the contrary: Because legislative and fiscal responsibilities do not fully overlap, but neither are clearly separate, the incongruence between 'having a say' and 'having to pay' provides incentives to shift costs and responsibilities between the different levels of government and between the different budgets of the central state, of the regional states and of the welfare state. This mismatch results in a lack of political transparency. It may, for instance, provide incentives to claim political credit for new spending programmes, while – at the same time – avoiding the blame for corresponding increases in taxation or public debt. This puts a premium on 'fiscal irresponsibility', which may become manifest in the form of *higher* than average expenditure growth dynamics or the 'political overgrazing of the fiscal commons' (Wibbels 2000; Rodden 2002; Rodden/Wibbels 2002). Alternatively, intra-state federalism may make legislating new (joint) taxes extremely difficult, so that a demand for increased state spending is met through the mechanism of para-fiscalism or contribution-based welfare financing – German unification would be a good case in point (see below). In both cases, expenditure *increases* resulting from the common pool resource dilemma inherent in cooperative federalism run directly counter to the veto-point hypothesis.

Second, the veto-point argument crucially depends on the assumption of significant differences in policy preferences between the different veto players/ parties. Yet, this cannot be taken for granted, as again the German case exemplifies. The 'policy distance' between Christian Democracy and Social Democracy has never been very marked on questions of social policy (Budge et al. 2001). This means that Germany's multi-veto-point polity cannot have exerted the hypothesised restrictive influence on government spending during the era of 'the old politics of the welfare state', at least with respect to partisan-political sources of 'gridlock'. It also means that, in the era of the 'new politics' of the welfare state, Christian Democrats and Social Democrats can either diverge *together* from the 'high redistribution' status quo or not at all. Under these circumstances, what hinders reform efforts is not so much the blocking effect of federal structures, but rather the dynamics of inter-party competition (Kitschelt 2001).

In what follows, I will trace the German welfare state's history of institutional development, starting with Bismarckian social legislation (Section 2), continuing with the division of social policy competencies between the central government, the states and the localities in the Weimar Republic (Section 3) and, finally, analyzing the interplay between the federal government, the states and the welfare state in the Federal Republic of Germany (Section 4). On the negative side, my main arguments are that federalism did not function to block welfare expansion, because the policy preferences of the main actors were similar and pro-welfare, and that the dynamics of cooperative federalism served to prevent any kind of interregional 'race to the bottom' in social policy. On the positive side, I argue that cooperative federalism actually encouraged expenditure growth, since unclear demarcation lines between the central government, states and localities invited politicians to adopt credit claiming and blame avoidance strategies with expansionary consequences. In particular I argue that given that the states can veto tax legislation, but cannot prevent increases in social insurance contributions, federal veto structures in the German case translated into welfare state growth. Section 5 summarizes the argument and discusses some implications for a comparative perspective.

2 Bismarckian social legislation as a federalist compromise

Usually the foundation of the German welfare state is understood as having been part of a carrot-and-stick strategy. Repression of the working class through the Anti-Socialist Law (1878) and the imperial edict of 1881, in which the coming social legislation was announced, were indeed closely linked. Less well known is that the foundation of the German welfare state between 1883 and 1889 was also a huge exercise in nation- and state-building. Germany, along with Austria, was at the time a 'constitutional-dualistic monarchy', in which a modernizing state elite could respond to the challenges of industrialization and working class mobilization with the early adoption of social insurance (Flora/Alber 1981).

In *nation-building* terms, the welfare state was designed to provide momentum for the internal foundation of the Reich after the German/French war of 1870/71 had brought external 'territorial consolidation'. The welfare state offered the Social Democratic and the Catholic camps an opportunity for social integration, after both had been stigmatized as enemies of the Reich during the *Kulturkampf*-era and in times of political repression under the Anti-Socialist Law. Bismarckian social legislation was targeted at workers, especially at the better-off strata of the working class. And the party that was second most successful in mobilizing voters and members among the working class besides the Social Democracy party was the Catholic Zentrum or Center Party.

The new social insurance schemes with their proto-democratic structure, provided new avenues for political participation and social integration to workers (Manow 2001, chapter 2). Clearly, the new social rights were meant as partial substitutes for workers' lack of democratic right – general suffrage in the national election was not worth much given the power-

lessness of the Imperial Diet, and state elections were often still based on a plutocratic *system censitaire* (cf. Flora/Alber 1981). But it is also important to highlight that social insurance itself – through the democratic system of workers' self-administration – offered workers important new electoral-participatory rights in areas of direct interest for them. *State building*, on the other hand, meant that social reform offered the central government a new arena of political activity and a genuine legislative responsibility. Social reform established a new administrative domain for the central state, it established the need for a new bureaucratic apparatus, and it promised to open up new sources of revenue for the Reich. All this was an impressive exercise in state building and meant that, from the outset, Bismarck's social legislation had a strong anti-federalist momentum. For instance, an immediate consequence of the central state's assumption of welfare obligations through Bismarckian social legislation in the period 1883 to 1889 was the need to establish a central bureaucracy charged with the oversight of the new welfare system (Kahlenberg/Hoffmann 2001).

Much of the need for social reform and of the central government's more or less undisputed dominance in this new policy domain can be explained by the apparent inadequacy of the old local support systems for the poor and destitute. The regionally scattered system of social assistance had proved inadequate when confronted with steeply increasing worker mobility in the wake of Germany's feverish industrialization in the last quarter of the 19th century. Previously, state aid to the poor and destitute had been provided either according to the principle of origin or according to the principle of current residence. Neither principle proved adequate in coping with the new challenges posed by rapid industrialization. The principle of origin meant that poor rural districts, from which workers had left for the big cities, had to subsidize the new industrial centres of the Reich. Moreover, the principle hindered worker mobility in the first place and aggravated severe labour shortages in the new industrial centres. The residence principle, on the other hand, obliged these new industrial centres to support the poor. Yet, this in turn resulted in fiscal problems as soon as locally concentrated industries faced a business cycle downturn. Thus, the need for a *national* responsibility in social reform and for risk pooling beyond the regional districts was widely accepted by informed opinion in the 1870s and 1880s.

The organisational principles according to which the new social insurance was designed differed from branch to branch, but nowhere did they exactly mirror the federalist structure of the German Reich. True, Bismarck's initial attempt to give the new welfare state a distinct centralist character by establishing a central state agency staffed by civil servants (and financed not by contributions, but out of the central state's budget, see below) failed due to the resistance of the states (Länder) in the Bundesrat, the federal chamber. But nor did the new social insurance follow a purely federalist design (as claimed by Henning 1977:95; Ritter 1983:73). Accident insurance was organized along industrial lines, since firms within the same industry were understood to constitute a distinct risk class. The health insurance funds, on the other hand, either started as regional organisations (with further differentiation for specific occupations), as company funds or as institutions of collective self-help for certain professional groups. Sickness funds quickly grew in number, but soon problems stem-

ming from their small size made themselves painfully felt. A major overhaul of the system in 1911 reduced the number of funds by more than half from more than 20.000 to less than 10.000. In the case of invalidity and old-age insurance, 31 regional insurance agencies ran the system.[3]

Almost nowhere did the administrative units of the welfare state correspond with state boundaries. Moreover, when the white-collar movement succeeded in 1911 in obtaining an exclusive old age insurance branch of their own, this introduced an important element of competition between the 31 *regional* insurance offices and the new single *national* insurance agency for white collar employees. This competition became one of the most important catalysts for a uniform legal and centralist institutional development of old-age insurance. Similarly, sickness funds for white-collar workers were organized as supra-regional, sometimes even nation-wide organisations. Naturally, these funds were of much larger size than the average local or company sickness fund. In 1925, five white-collar funds counted an average membership of 224,500, a number about 100 times as large as the average membership in one of the statutory, local or company funds. Again, this exerted a unifying effect in the health care insurance system, since contributions could be lower in larger funds thanks to administrative economies of scale and the advantages of risk pooling. The unemployment insurance system, which was founded as the last of the classical social insurance schemes in 1927, was organised on strictly centralist lines. A central agency with 13 regional sub-branches took over responsibility from the 22 state and 869 municipal employment offices that, previously, had been in charge of unemployment support and labour market policies (Lewek 1992; Führer 1990).

This process of concentration and centralization continues up to the present day and demonstrates the underlying mechanism that has driven much of the institutional development of the German welfare state towards ever higher degrees of uniformity and centrality: the advantages of larger over smaller risk pools. This combined with the central state's interest in the extension of risk-pools in order to minimize fiscal liability for 'bad risks'. Thus, it is clear that questions of organisational design were simultaneously issues of considerable financial substance.

According to Bismarck's initial plans, the new social insurance schemes were supposed to be, prominently if not entirely, financed by taxes. This would have granted to the new central state a right of taxation that only existed previously in vestigial form. Bismarck planned to use revenue from a newly established state monopoly for tobacco to finance the new social programs. That the Reich possessed only a small revenue raising capacity was a consequence of the fact that the German constitution of 1871 had resulted from a political compromise, which had centralized legislative powers, but had delegated the responsibility for administrative implementation and enforcement to the *Länder* governments. The upshot

[3] 10 additional insurance agencies took care of seamen, railroad workers and miners. See Frerich/Frey 1993:101.

was that policies had to be agreed upon jointly by the central state and the states, effectively granting the states a veto on all political decisions (cf. Lehmbruch 1998, chapter 6). Yet, implementation was the responsibility of the states and this meant that most of the tax revenue remained in state hands, while the Reich possessed no substantial sources of taxation of its own. The Reich could raise revenue from state-owned enterprises (like the post office), and from tariffs and indirect taxes (on sugar, salt, beer, matches, liquor etc.). However, to cover its expenses, the German central state of the late 19th century was also dependent on *Länder*-contributions. Initially, in the 1870s, such contributions amounted to 15 to 20 % of all revenue, although later – especially after the Reich embarked upon protectionism via high tariffs – the central budget became more independent of state subsidies. Yet, Reich tax revenues remained small (Witt 1970:378 f.). In this period, central taxes as a percentage of GDP were around 2%, the smallest figure for countries for which we have comparable data (Flora 1983:268). With respect to the ratio of central to general taxes, only the Swiss central government was weaker than its German counterpart (39.3% of overall taxation in 1886 compared to 49.2 % in 1881; ibid.).[4] In Germany the central state possessed no large administrative apparatus of its own, with the Reich spending most of its revenues on the army and the fleet and, to a small but increasing extent, on the newly established welfare state (Nipperdey 1992; Witt 1970:380). The inadequacy of the Reich's tax base meant that an increasing part of total spending was financed out of a rapidly increasing public debt (Witt 1992).

Bismarck hoped that the central state's new responsibility for the social security of German citizens would legitimise tapping new sources of direct tax revenue for the Reich. Yet, as in the case of the institutional design of the welfare state, its final financial architecture was once again a compromise between the Reich and the *Lände*r. Central tax financing was *not* to play a dominant role in the funding of the German welfare state, but nor did the fiscal structure take on federalist characteristics (which would have introduced the potential for 'competition of jurisdiction' dynamics into the system). Instead, social security contributions became the dominant source of revenue. The welfare state grew rapidly and its increasing fiscal and macro-economic importance is demonstrated by the fact that, already by 1904, overall welfare state revenue amounted to more than two third of the central state's general tax revenue. This has meant that there has always been a temptation to tap the financial resources of the welfare state for particularistic fiscal purpose – as the Reich did for the first time on a massive scale in WW I., when it used the financial assets of the social insurance funds to finance the war. Similarly, the autonomous financial status of the welfare state has also tempted politicians to achieve fiscal relief by shifting costs out of the public

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[4] Interestingly, this picture largely continues to hold true. In the 1980s and 1990 Germany still ranked among the OECD-countries with the highest degree of fiscal decentralization and the lowest degree of fiscal centralization (see, also for definitions, Castles 2000:179ff., Table 8.1), but also as the OECD country in which the share of federal grants and revenue sharing receipts of total provincial revenue was highest (See Rodden/Wibbels 2002:504, Table 1). A third aspect is also important: local plus central revenue make up only about two thirds of total revenue – which hints at the enormous fiscal importance of the welfare state in Germany and of the central role of its para-fiscal mechanisms.

budget onto the special budgets of the welfare state. I will return to the determinants of the long-term erosion of the central state's financial involvement in social spending and its effects in Section 4 below.

The federalist character of the German Reich not only had a profound impact on the institutional architecture and the financial basis of the German welfare state, but also on the *substantive nature* of national and regional social protection. The division of labour between the Reich and the *Länder*, according to which the central state was now responsible for *Arbeiterpolitik* (social insurance for workers), while the Länder and municipalities remained responsible for *Armenpolitik* (traditional social assistance for the non-working poor and destitute), helped to free the new social insurance from Poor Law-traditions. The social protection system could focus exclusively on the social risks and vagaries stemming from industrialization and could be targeted primarily at workers, in fact mostly at the 'labour aristocracy' of trained and politically active workers, leaving local communities to take care for the poor in the traditional way. This dualism, which is most manifest in the largely arbitrary demarcation between social assistance (covered by the municipalities and states) and the lower layers of social insurance, becomes most contested in the case of the long-time unemployed and remains a highly controversial feature of the German welfare system to the present day (Sachße/Tennstedt 1980, 1988, 1992).

In summing up, one can say that central institutional characteristics of the German welfare state were essentially the outcome of a compromise between the Reich and the states. The compromise had three distinguishing features: 1) the centralization/ nationalization of the legislative responsibility for social policy, 2) an independent organisational design of the welfare state which was neither national nor federalist in character (Stolleis 2001:265), and finally 3) the financial autonomy of the new schemes; their para-fiscal status – already relatively high from the schemes' inceptions, but steadily increasing in following decades. These features played a decisive role in the further development of the German welfare state, which involved a steady process of coverage extension plus organisational concentration and centralization.

3 Weimar and the conflict over resources and competencies

Social policy moved to centre stage in the Weimar Republic. For the first time, social rights became constitutionally guaranteed (especially Articles 157, 159, 163, and 165 of the Weimar constitution). Their prominent status in the Weimar constitution reflected the fact that the 'coalition of Weimar' – formed by the Social Democratic party, the Catholic Center and the liberal DDP – was crucially based upon the parties' common interest in the domain of social policy. Social policy was a natural point of agreement especially between the two big mass-member parties, the Social Democrats and the Zentrum, since both parties had to please their substantial worker electorate, both possessed tight linkages to the socialist and catholic unions respectively, and both had established extensive networks with either politi-

cally or religiously motivated collective self-help organisations during the time in which they had been excluded from political power. Yet, push factors rapidly began to join these pull factors in the aftermath of the Great War, as Germany found itself coping with a social and economic crisis of massive proportions. The steeply increased number of war invalids, of widows and orphans, of those suffering from malnutrition, of refugees coming from lost territories, of the impoverished elderly and of 6 million soldiers, who returned from the front, added to the serious economic problems stemming from the abrupt transition from a war- to a peace-economy. The number of persons dependent on welfare roughly quadrupled from 1914 to 1924 and per capita welfare expenditure increased nearly eightfold during the same period (Sachße/Tennstedt 1992:81).

The severe social and economic problems of post-war Germany amplified the need for profound reform and substantial reinforcement of the existing social protection system. In face of these problems, the central state's political responsibility for the war combined with the problem overload of state and local authorities to give a strong centralist momentum to Weimar's welfare state development. This trend can be clearly read off from the data. Whereas only 5.3 % of all central government expenditures was devoted to social spending in 1913/14, in 1925/26 the share was already at 35.8 % – only to rise further to almost 50 % at the peak of the economic crisis in 1932/33 (Frerich/Frey 1993:175, table 20; cf. Bürger 1930). Similarly, central government social spending plus social insurance expenditures made up for a steadily increasing part of total social spending – from 53 % in 1913/14 to 69 % in 1932/33 (ibid., own calculations).

The war economy itself had already had a strong centralizing impact, and to some extent the Weimar constitution as well as the important tax reform of 1920 only ratified the new power balance between the Reich and the *Länder*. Centralization of legislative, financial and administrative responsibilities, harmonization of regulation and homogenization of administrative design, increased generosity and extended coverage of social benefits – in all these respects the war had figured as an important "pace setter" of national welfare state development (Preller 1978:85; cf. Titmuss 1976; Skocpol 1992; Kasza 1996). The same held true for federalism. Already in 1914, in the wake of the start of WW I, all legislative responsibilities had been delegated from parliament to the federal chamber, but this led not – as one might have assumed – to a stronger role for the states in policy making, but rather to a hegemony of the central administration due to the dominance of Berlin's central Prussian bureaucracy. Once the war was over, there was no going back to the federalist *status quo ante*.

After the war, the political and financial balance tilted even more clearly towards the Reich. The states' chamber, the Reichsrat, was weakened, since under the Weimar constitution it enjoyed only the right to a so-called 'suspending veto', which could be overridden by the Diet or popular house of parliament and it lost its former exclusive right of legislative initiative. In fact, an effective veto of the Reichsrat remained a rare event, since the political alignment of the central and Länder governments was quite close throughout much of the

1920s. In particular Prussia, by far largest and most important state (2/3 of the territory, 2/3 of the population, and with 26 of 66 votes in the upper house), generally supported or at least tolerated Weimar governments throughout the 1920s (Lehmbruch 1998:70ff.).

Compared to both the pre-World War I Reich and to the post-World War II Federal Republic, the constitutional foundations of federalism were less strongly developed during the interwar years[5]: Under the previous imperial constitution, the federal chamber had possessed an absolute veto on all legislation and an exclusive right to initiate legislation. Today the federal chamber can use its veto to suspend around 45 % of all legislation (*Einspruchsgesetze*) and has an absolute veto on the other circa 55 % of legislation (*Zustimmungsgesetze)* (Schindler 1999:2430, table 3). In the Weimar Republic, the federal house had only the suspending veto – still a powerful instrument given that the override required a 2/3 majority. To this came the loss of fiscal privileges. The tax reform of 1920 for the first time gave the central government access to its own substantial tax-revenue (see Table 2), while the constitution had equipped the Reich not only with the autonomy to legislate in full sovereignty all tax laws it deemed necessary for its own revenue needs (Article 8), but also to regulate the states' taxation. Table 1 identifies and contrasts the essential features and rights of the federal chamber under the Reich, Weimar and in the post-war federal republic of Germany.

5 That parties of the extreme Right and Left used their power position in the regional states, like in Bavaria or Thuringia, to follow secessionist strategies, is another story.

Table 1: The position of the federal chamber in Wilhelmine Germany, the Weimar Republic and the Federal Republic (Sources: Huber 1981:378; Huber 1988:855; Oeter 1998:63; Nipperdey 1992; Schindler 1999:2447; Renzsch 1991)

Imperial Constitution 1871	***Weimar Constitution 1918***	***Basic Law 1949***
Bundesrat has absolute veto (Article 5 of the imperial constitution)	Reichsrat has only suspending veto (Article 74 of the Weimar constitution). To overrule the veto, a two-third majority in parliament is required.	Bundesrat has absolute veto in matters that affect regional administration (≈ 55 % of all laws); in all other matters only a suspending veto (Article 77, 84, 85 and various other articles of the Basic Law). [A suspending veto with a two-third majority in the federal chamber can be overruled with a two-third majority in parliament as a whole; Article 77, paragraph 4.]
25 states (26[a])	18 states	11 states (16[d])
Total of 58 seats/votes (61[a]) ➢ Prussia 17 ➢ Bavaria 6 ➢ Württemberg and Saxony each 4 ➢ Baden and Hesse each 3	Total of 66 seats/votes(68[b]) ➢ Prussia 26 (27[c]) ➢ Bavaria 10 (11[c]) ➢ Saxony 7 ➢ Württemberg 4 ➢ Baden 3	Total of 41 seats/votes (68[d]) ➢ North Rhine-Westphalia, Bavaria, Baden-Württemberg and Lower Saxony each 5 (6[d]) ➢ Hesse, Rhineland-Palatine, Berlin and Saxony each 4[d]
Members are delegates of the regional governments; no free mandate.	Members are delegates of the regional governments; no free mandate.	Members are delegates of the regional governments; there is no free mandate.
States receive all direct taxes, the central state all indirect taxes. Tax laws need the consent of the states.	Taxation is completely a responsibility of the central state. Income- and sales-tax are shared between Reich and states. The central government has *Kompetenzkompetenz*, i.e. it can decide who can levy which taxes. The fiscal equalization scheme is only moderate.	Basically the same as under the Weimar constitution. Extensive fiscal equalization scheme, which guarantees that no state has a per capita tax revenue lower than 95 % of the national average.
The right to legislate lies with the federal chamber.	The right to legislate lies with the Diet or popular house of parliament.	The right to promulgate laws lies with the Bundestag or popular house of parliament, yet laws need the consent of the federal chamber.
The federal chamber has the *exclusive* right to initiate legislation.	The federal chamber has the right to initiate legislation (co-legislation).	The federal chamber has the right to initiate legislation (co-legislation).

* from 1911; ** between 1926 and 1928; [§] since 1926; [$] since 1990.

However, it is also necessary to emphasize that the centralist momentum of the Weimar years was not just an outcome of war and economic crisis, but was also an expression of a more secular trend. In this context, it is important to note that fiscal federalism and strict inter-state federalism have never been distinguishing features of the German polity (Lehmbruch 2002: 80ff.). From the very start, German federalism had a strong bias in favour of national unity and legislative centralization – even if this tendency remained short of administrative centralization. To establish strict interstate federalism was never seriously contemplated outside the southern-Catholic camp with its fear of Prussian-protestant hegemony. Revealingly, in the constitutional debates of the second half of the 19th century, the United States and Switzerland served as negative reference points to exemplify how German federalism should *not* develop (Oeter 1998:32, 34, 40; Lehmbruch 1998:80ff.). But what then explains the German federalist compromise? The federalist structure of the 'belated German nation' simply was an acknowledgment of the fact that the German states already were autonomous, sovereign entities. Therefore, the constitution was clearly meant to be an institutional structure that would *allow and foster* national integration and help *overcome* federalist fragmentation (Hesse 1962). In other words, federalism was not designed as a constitutional safeguard for regional particularism, but rather as the best available instrument for achieving the goal of national unification – given that German unification could realistically only happen through the delegation of power from the already firmly established and sovereign states to the Reich (Oeter 1998). It was in line with this underlying unitary tendency that the states under the Weimar constitution enjoyed only a reduced veto power in the second chamber and lost some of their former fiscal privileges.

The 1920 tax reform finally provided the material basis for the integrative goals that all the major political actors shared. In all matters of taxation, the Reich could now exert influence through its right of concurrent legislation (*konkurrierende Gesetzgebung*), which stated that the states could regulate their tax affairs autonomously only insofar and only as long as the central government abstained from enacting nation-wide standards (Article 8 of the Weimar constitution).[6] Furthermore, the tax reform prohibited the localities from levying additional charges in addition to direct taxation. This not only levelled the enormously varying tax burdens between the different regions, but also had an important welfare side effect: it made local social policy (i.e. social assistance) less dependent on the local tax power, and this, in turn, eased nation-wide regulation of local social policy and standardization of benefits. However, at the same time, the reform intensified the fiscal interdependencies between central state, Länder and localities. It radically changed the relationship between the central state and the Länder: whereas before the Reich had depended on Länder-transfers, now the states became dependent on transfers out of the general budget (Sachße/Tennstedt 1980:176ff.). As Table 2 shows, in the mid-1920s, the central government became, for the first time, the biggest recipient of tax revenues.

[6] Therefore the term ‚concurrent legislation' is misleading. The central government has the *prerogative* of legislation, the German term Vorranggesetzgebung might be more precise.

Table 2: Percentage tax revenue shares of national, regional and local government, 1885-1970 (Hidien 1998:338, 460, table 18. See also OECD, Revenue Statistics and Figure 2 below)

Year	***National government***	***States***	***Municipalities***
1885	18	57	25
1913	30	29	41
1925	38	26	36
1936	66	10	24
1950	52	31	17
1970	54	34	11

As in the field of tax law, the central government now, for the first time, also enjoyed the privilege of concurrent legislation in the domain of social assistance. These new powers were soon used to harmonize widely differing standards and levels of local support for the poor and needy. This was not the only proof of the close nexus between tax and social policy. In the case of social assistance, earmarked financial transfers were the government's initial 'foot in the door' in a policy domain in which it had not enjoyed much influence previously. Financial transfers out of the national budget often came with quite precise policy directives. Therefore, it was not accidental that the central state enacted a tax emergency decree at the same time as the important decree on welfare early in 1924 (cf. Stolleis 2001:280). Whereas the tax decree increased the states' share of personal income taxes from 75 % to 90 %, the welfare decree for the first time substituted uniform national legislation for the various state laws that previously had existed in this policy sector. But legal harmonization and central standard setting went hand in hand with administrative reform: Devolution (of central government responsibilities) and centralization (of local responsibilities) conspired in to assign most of the administrative and financial responsibilities attaching to the provision of welfare at the Länder- or regional-level.

The central state's intrusion into the states' own policy territory met with little resistance so long as it relieved local authorities from some of the pressing financial stress resulting from mass poverty and well-nigh permanent economic recession. Prescriptive notions of uniform living conditions and, hence, uniformity of provision also played an extremely important legitimizing role for central policy initiatives in the welfare sector. Different rules and regulations, tariffs and laws had been the prime target of a forceful bourgeois-liberal critique castigating them as indicators of outdated parochialism and as barriers to national market integration which it was the true mission of German national unification to overcome (Lehmbruch 2002:80ff.). An encompassing national system of taxation reinforced centralist tendencies in the development of the German nation state, and also ruled out all 'competition of jurisdictions' dynamics in all tax-financed areas of the welfare state. For instance, tax-financed local social assistance largely followed nation-wide rules and was largely fi-

nanced from the national budget by way of direct earmarked transfers to the states' budgets. In Germany social legislation was *deliberately* used as an instrument of national unification and was explicitly designed to prevent a federalist fragmentation of living conditions.

Nor was this unifying effect of social policy an issue of much political dispute. Conservatives, liberals and Social Democrats alike were in favour of national unification led by a strong central state and leading to 'uniform living conditions'. Social Democracy had been anti-federalist ever since universal and equal (male) suffrage had been granted in 1871 for national-level elections to the imperial Diet, while eligibility to vote in most regional elections before 1918 (especially in Prussia) was on the basis of property qualification. The Catholic Zentrum was not as single minded in its support for central state responsibility. The party represented both federalist and centralist currents, with the faction representing the latter closely linked to the powerful movements of Social Catholicism. In the first decade of the 20th century, Social Catholicism had developed into a powerful *nation-wide* interest group independent from the official church bureaucracy with its still regional structures (Müller 1996). Despite the high degree of party fragmentation in the Weimar Republic, no *major* party voiced decisively regional interests or favoured the organisational devolution of the welfare state.

This preference for a common national response to the 'labour question' resonated well with the ministerial bureaucracy. Both civil servants and German legal thought clearly favoured nation-wide uniform regulation. Social policy was no exception. Contemporary observers characterised the Weimar Labour Ministry as revealing "markedly centralist tendencies"(Preller 1978:290, my translation). This centralism brought the Ministry into conflict with the Länder and local authorities. Yet the substance of their objection did not concern a loss of policy discretion, but rather involved disagreement about the basis for allocating costs between the central government and the states. And the resolution of this conflict by an increasing reliance on contribution financing became something of a natural option within Germany's federal polity. This suggests that the German welfare state's substantial dependence on contribution finance should not solely be interpreted as the institutional embodiment or expression of 'conservatism' (Esping-Andersen 1990). To a very important extent it was the political solution to a conflict between the central government and the states and municipalities over how best to minimize their financial involvement, whilst leaving their rough fiscal balance of power untouched.

The one major social policy innovation in the Weimar Republic was the establishment of unemployment insurance in 1927 (Führer 1990; Lewek 1992). This too was indicative of the centralizing tendencies of the era. Here, the Reich finally established its dominance by integrating existing local and regional labour agencies into a centralist administrative structure with the status of dependent *Reichsunter*- and *Reichsmittelbehörden* (local and intermediate state agencies). This was the endpoint of a long and protracted battle between the central state and the communities over administrative competencies and financial responsibilities. The unemployment insurance scheme of 1927 finally established a hierarchical chain of delegation and largely left states and communities without discretion in a domain

in which they formerly had enjoyed dominant influence. The administrative structure thus became a prominent example of a deliberate break with the old federal compromise by which legislative responsibilities had been centralized and nationalized, while the Länder retained the prerogative for administrative execution and programme implementation. To the present day, the labour office and the tax administration remain the two most important deviations from the established federalist 'division of labor' between centre and regions. In the Federal Republic, a quarter of all labour office employees are civil servants, the unemployment insurance is run by one central agency with regional branches and, in the governing bodies of the labour office, the government represents a third of all delegates, whereas in the sickness-, accident- and pension-insurance schemes, there is equal representation of worker- and employer-delegates. Moreover, the financial nexus between the unemployment insurance scheme and the public budget is quite close, given that the central state is obliged to cover all deficits of the Labour Office (sickness funds are almost completely financially autonomous, while the government covers a fixed share of total pension spending).

Yet, even this strictly hierarchical design of the unemployment insurance scheme could not end conflicts between the centre and the localities in this sector. Since the localities remained responsible for local welfare (social assistance), conflicts between the local authorities and the central government were far from settled with the 1927 enactment of the unemployment insurance law. The central points of conflict were the length of time that the unemployed should receive benefits on an insurance basis and the basis on which the localities could use insurance funds for active labour market policies. Given the legislative and tax-levying powers of the central government, states and municipalities were disadvantaged in the distributive conflict over who should bear the costs of the economic recession that hit Germany extremely hard in 1928 and subsequent years. Both with respect to taxes and the fiscal mix in the welfare sector, the central government used its privileged position to burden the states and localities with welfare tasks without equipping them with the necessary financial means. Compensatory direct financial transfers to the communities out of the public budget remained an insufficient remedy in times of weak economic growth and general fiscal stress. Whereas prior to World War I, the central government lacked the resources to match its increased responsibilities, now states and municipalities were the levels of government with inadequate financial means.

Weimar's politics of welfare were driven by (mainly financial) conflicts between centre and periphery and these conflicts were nurtured by the mismatch between fiscal, legislative, administrative and political responsibilities within the German 'cooperative' federal system. This made the "struggles over resources and competencies between Reich and communities … an essential feature of the social policy dynamics of the Weimar Republic" (Sachße/Tennstedt 1988:89). In this conflict, the states, in turn, were not always acting as the true advocates of the interests of localities and municipalities. These, as the 'protectors of last resort', increasingly were left alone in their struggle against the consequences of the economic crisis, as the phrase 'Kommunalisierung der Armut' [freely translated: devolution of poverty] suggests. Often, central government and states could compromise within Ger-

many's system of cooperative federalism only at the expense of a third party. At times, contributors lost out; at other times, the local authorities. Shifts between state financed unemployment aid and locally financed social assistance indicate the increasingly fierce distributive conflicts between the different layers of the German state (Sachße/Tennstedt 1988).

The struggle between centre and localities over the devolution or centralization of policy responsibilities also had an important partisan-political aspect. The centralization of policy responsibilities was also part of a political attack against Germany's (allegedly red) municipalities. The Catholic Center Zentrum, the bourgeois parties and the bourgeois and religious voluntary welfare associations all tried to instil fears of so-called 'creeping socialism' at the local level (*Munizipialsozialismus*), and corporatist cooperation between the Labor Ministry and welfare peak associations was understood to be an antidote to this allegedly perilous trend (Sachße/Tennstedt 1988). The centralization of social assistance and the integration of voluntary associations as components of the national welfare state were thus also part of an attempt to contain Social Democracy's local influence in the larger cities and industrial centres. Once again, it is apparent that a central distinguishing feature of the German welfare state, the dualism between public *financing* and state *regulation* of the welfare sector and semi-private welfare *provision* by 'third sector' organisations , has been, in large part, an outcome of federalist struggles between Reich and the localities.

Finally, it is worth asking how the German welfare state compared with others of the same era? Comparative data for this early period are fragmentary, but according to the available evidence, theWeimar welfare state was the most developed in Western Europe in respect of both spending and programme coverage (Flora et al. 1983:460f., 365ff.; Alber 1982:152). Obvious reasons include the relative maturity of German insurance programmes initiated in the late 19th Century and the extreme levels of need characterizing interwar Germany.

Summing up, one can say that the dynamics of German social policy in the interwar period essentially reflected the conflicts between the central state and regional and local authorities. Both financial issues and partisan conflict between the different layers of government loomed large in the social policy debates of the time, but the most important conflicts were not between the national government in Berlin and the states, but between central and local governments. A genuine federalist dimension of political conflict was not strongly developed in the interwar years, given that the states were less powerful than they had been before World War I, and given that conflicts were muted by a high degree of partisan-political alignment between central and state governments. Conflicts were also less fierce because the Berlin government and the states often could compromise at the expense of third parties – primarily the insured contributors and the localities. Yet, overall, the Weimar period saw the substantial centralization and nationalization of social policy. Partly, this was due to the extraordinary socio-economic challenges with which the 1st German republic was confronted. Partly, it was due to the overall centralist tendencies of German federalism itself.

Ultimately, however, both the republic and the welfare state broke down when confronted with social, political and economic problems of enormous proportions. Arguably, no wel-

fare state, however designed, would have been able to cope with the economic catastrophe and social dislocations of the late 1920s and the early 1930s. The advent of the National Socialist rule marked the end of federalist state structures and its replacement by a 'dual state' (Fraenkel) constituted of parallel and often redundant central state bureaucratic structures and of their Nazi party organisational counterparts.

4 The Federal Republic´s welfare state and fiscal joint decision traps

We turn now to the development of the German welfare state in the post-1945 era, asking initially how the Nazi interregnum had influenced the structure of the welfare state that post-war Germany inherited. The answer is that the direct impact was surprisingly small and the lasting influences relatively subtle, with the literature substantially agreeing on the lack of success of the radical reform visions of the National Socialists in the social welfare field (Teppe 1977; Sachße/Tennstedt 1992; Scheur 1967). A powerful coalition of forces, comprising the conservative ministerial bureaucrats of the labour ministry, the administrative apparatus of the social insurance branches, business interest groups and competing party and executive factions, struggling for influence within the chaotic regime, effectively delayed the enactment of the grandiose Nazi reform plans until the war began. After 1939, the government shied away from fundamental reforms,because it feared such reforms would endanger social peace and would stand in the way of the smooth working of the war economy by opening a home front. In organisational terms, the 'classical' core of the German welfare state, the social insurance schemes, thus, remained, to a remarkable extent, untouched.

Yet, by abolishing most elements of joint union/ employer administration of the social insurance schemes, especially by destroying the unions, and by integrating the social insurance schemes into the state apparatus, the National Socialists gave an already centralist organisational development a further strong étatist momentum. And with the abolition of the Länder in 1934, German federalism officially ceased to exist. However, since the German welfare state possessed an organisational structure that was largely independent of the structures of German federalism, the end of federalism had no important *direct* impact on the welfare state itself. Yet, the long-term consequences were quite substantial: once the states were re-constituted after WW II, they were confronted with a Bismarckian system that in the meantime had become more centralized and autonomous, more uniform, more encompassing, more bureaucratic and less politicized (Leibfried/Tennstedt 1979).

These tendencies may be best exemplified with respect to the old-age insurance system. Here the fact that the fundamental reform plan of the Nazis (e.g. introduction of a uniform, tax-financed people's insurance that would have fused the white-collar and blue-collar branches) was never enacted should not distract from the fact that subtle, but long lasting, modifications did take place under the Nazi regime. In this respect, we may mention the following five changes: 1) the Nazis started to pay one global (augmented) state subsidy for

the pension insurance scheme instead of the fixed subsidy per individual pension paid previously, 2) they issued a central state guarantee for the pension insurance, thereby taking over fiscal responsibility from the *Länder* and communities which previously had guaranteed pension payments, 3) for the first time, contribution payments were automatically deducted from wages as an exact and *equal* percentage share for both blue collar- and white collar-workers[7] (previously, payments had to be paid in personally at a post office and were differentiated according to different wage groups and with different contribution rates for white- and blue-collar worker), 4) during the Nazi era, social insurance for handicraft workers became obligatory (1938) and 5) pensioners were integrated into the health insurance scheme (1941). Thus, much of what happened in organisational terms during 1933 and 1945 can be summarized as rationalization, membership extension and further centralization, but did not qualify as a radical break with traditional organisational principles. All of these changes survived the Nazi-regime and became part of the re-founded social protection system of the Federal Republic after the war.

When it comes to the post-war period, the most revealing observation about the relation between the federal *Bundesrepublik* and the reconstituted welfare state is one of the 'why the dog did not bark' variety: why did the states not protest against their loss of policy responsibilities in the social policy sector, when the central state reclaimed political responsibility for social policies between 1949 and 1953 after the immediate post-war years had witnessed a significant organisational devolution of the German welfare state? This lack of conflict is, on the one hand, strong evidence for the tacit consensus among the major political camps and between the states and the central government about the *national* role – promoting unity and equality – that the German welfare state is supposed to play. On the other hand it was also the result of necessity. States differed too much with respect to economic starting conditions and were too differently affected by the war (by destruction and the refugee problem) to make welfare state decentralization a feasible option (see on this especially Scharpf 1989).

The process of administrative and territorial consolidation of the states had ended by mid-1947. The first states were constituted as early as September 1945, only half a year after the military surrender (Kilper/Lhotta 1996:83; Boldt 2003). The states were thus at least two years ahead of the Federal Republic, which was re-inaugurated not earlier than late 1949. Once again, as in 1871, the states were already in place before the nation state formed. During this time, the states became responsible for those social protection programmes that had formerly been run at the national level, i.e. especially for the white collar-worker pension and the unemployment insurance schemes (Kahlenberg/Hoffmann 2001). For all other programmes they preserved the right of administrative and legal oversight (but not of legislation) that they had under Weimar. The by and large non-contentious re-delegation of organ-

7 In their effort to create völkische unity (unity of the German people) the Nazis also fought against what they perceived as outdated ständische (status in the sense of social estates) welfare privileges. Their main target was the hitherto privileged status of white collar-workers. See Prinz 1986.

isational responsibilities from the regional level to the national level after 1949 was legitimized by the commonly accepted idea that all Germans should enjoy 'uniform living conditions' (Oeter 1998:532ff.). As was true of the period of initial Bismarckian social legislation, after WW II, nobody forcefully campaigned for an organisational or fiscal devolution of the German welfare state.

When the German parliament, the *Bundestag*, convened for the first time after the first free post-war elections in the three Western military zones in 1949, it had to decide on the future of the German welfare state, while the division of powers between the central state and the *Länder* had already been part of the constitutional compromise that had preceded the elections. The preliminary constitution, the West-German Basic Law, which was supposed to last until the French, British and US-American zones – constituting the Federal Republic – re-united with the Soviet-zone constituting the German Democratic Republic, deliberately refrained from prescribing the institutional details of the future welfare state. Only a vague reference to Germany being a 'democratic and social federal state' (Article 20) could be found in the Basic Law. Yet, with respect to the design of German federalism, the Basic Law was much more concrete. Essentially, the Basic Law prolonged with small but important modifications the Weimar balance of powers. For all legislative initiatives that affected administration at the state level, the second chamber, the Bundesrat, as the representative of the states at the federal level,[8] possessed an absolute veto (see Table 1, above). For all other legislation, the second chamber possessed only a suspending veto. Thus, the states had recouped some political influence lost in the Weimar years. The same picture emerges in the question of taxation.

The Catholic 'South-West' current of German Christian Democracy, which became dominant in the west after Germany was divided into two nations, had always been in favour of federalist devolution – mainly motivated by its opposition to the centralist hegemony of protestant Prussia. These preferences for greater regional autonomy had been reflected in proposals at the constitutional convention to return to the fiscal status quo of Imperial Germany. According to these proposals, the central government would have again become totally dependent on transfers from the states' budgets (cf. Renzsch 1991:55-74). Yet, the German Social Democratic Party – not least because of its expectation of winning the first national election in 1949 – struggled vehemently for a more centralist distribution of revenue – while the pro-federalism stance of the Christian Democratic Party (the CDU) was, in turn, motivated by the very same expectation that the first democratic government of the Federal Republic would be led by Social Democrats. But resistance to a decentralized solution also cut across party-lines. Large differences between city-states like Hamburg or Bremen on the one side and states like Bavaria on the other, different economic starting conditions as well the varying extent to which states were affected by the war (Schleswig-

[8] The German Bundesrat does not follow the Senate-model with elected senators, but is composed of delegates of the state governments, with votes weighted differently according to population size.

Holstein was flooded with refugees from the East, the city states Bremen, Hamburg and Berlin had been heavily destroyed by Allied bombing) rendered strict fiscal devolution almost impossible. Under these circumstances, and given that the states resisted all attempts to rearrange borders and fuse West Germany's 11 states into a few viable entities, federalist principles could only be defended through a regime of centralized but joint taxation. Therefore, the welfare state- and the compromise over federalism can be seen as two sides of the same coin. Given the varying degrees of expenditure need, welfare state devolution was highly problematic. Given the differing revenue potential of the states, fiscal federalism was not a realistic option. This established the paradoxical institutional setup of the Federal Republic: autonomy of the states could only be secured by strengthening their influence on *nationally uniform* legislation and by establishing a complex *national* tax-and-spend arrangement.

When the CDU formed the first German government under Chancellor Konrad Adenauer, the basic compromise between 'centralists' and 'federalists' was already in place. The most important taxes including value added tax (VAT), income tax and corporate income tax were either shared between central state and states (income and corporate tax) or were the exclusive province of the central government (VAT). All in all, a rough and relatively stable 55 per cent (central government) to 45 per cent (states) distribution of total tax revenue was established (Renzsch 1991:13). Today the federal government, the states and local authorities share the personal income tax according to a 42.5/ 42.5/ 15 % formula and the corporate income tax and the VAT are split between central and regional governments according to a 50/ 50 and a 51/ 47 ratio (with local authorities receiving 2 % of the VAT), respectively. Regional differences in tax revenue due to differences in economic development are equalized by a complex system of vertical transfers from the central state to 'needy' states combined with horizontal transfers from rich to poor states (Renzsch 1991; Hidien 1999). These fiscal equalization schemes guarantee that no state has a per-capita tax revenue below 95 % of the national average. With respect to tax-legislation, the Weimar *status quo* remained in place: for taxes comprising 30 % of total revenue, either central government, the states or municipalities can claim exclusive responsibility. For the remaining 70 % of joint taxes, legislation is national, but states have a quite powerful right of co-legislation due to their position in the *Bundesrat*. In fact, since no *major* tax – other than social insurance contributions – falls into the exclusive competence of either the central or regional government(s), the central government's tax policy is dependent on the consent of the states – and in times of 'divided government' also on the consent of the opposition (Ganghof 2004).

The fact that the political decisions concerning the fate of the German welfare state came much later than the fiscal compromise between the central government and the states again demonstrates that the states conceived of social policy as not being genuinely part of their own policy domain. In the early 1950s, with a couple of rather unspectacular legislative measures, the Adenauer government reclaimed central authority for the social insurance schemes that before 1945 had been organized at the national level. In 1951, the accident insurance scheme was re-integrated into the administrative domain of the Federal Labour

Ministry, in 1952 a national Labour office was constituted and in 1953 the national white collar worker pension scheme was re-established in Berlin as the successor of the former Imperial Insurance Office for white collar-workers (Kahlenberg/Hoffmann 2001:118f.; Frerich/Frey 1993:43, 84). While there was conflict concerning all three measures – mainly over questions concerning the representation of employers and unions in the administrative bodies of the schemes ('self-administration') – a manifest centre/ periphery conflict dimension was largely absent from the agenda (Hockerts 1980). True, in the case of the accident insurance, the states warned that centralization of responsibilities would lead to a further "puffing up of the federal bureaucracy" (Kahlenberg/Hoffmann 2001:118), and in the case of unemployment insurance system, they favoured a more decentralized solution, in which independent regional labour offices would only be engaged in a loose working cooperation at the national level. However, as soon as the federal state promised to take over the entire administrative staff of the regional labour offices, the resistance to centralist solutions quickly evaporated (Trampusch 2000). Apparently, the Länder were not very principled in their pro-federalism position.

The successful claim of the Adenauer government for supremacy in the field of social policy was not a consequence of a weakened position of the Länder after 1949. Indeed, the opposite was the case. Partly as a consequence of their institutional primogeniture, but also in terms of constitutional authority, the states were in a seemingly powerful position. This was especially due to their right to an absolute veto on all legislation with an impact on Länder-administration or Länder-finance. Initially, the veto was thought to apply to no more than 10 % of all legislation, but today – as a result of extensive legal and political interpretations – about 55 % of all laws are seen as requiring the consent of the second chamber (Schindler 1999:2430f.). In other words: if no compromise can be found between parliament and second chamber, the law cannot be enacted. True, Article 72 of the Basic Law established far reaching legislative competencies for the central government, but these were balanced by no less far reaching rights of co-legislation for the states (Oeter 1998:123f.). Now that hegemonic Prussia had ceased to exist, this right of co-legislation was of much greater potential significance. For the government, it became harder to form majorities in the upper chamber and the possibility of veto in *Bundesrat* became more real.

With respect to social policy, the late 1940s and early 1950s essentially saw the re-foundation of the German welfare state along the traditional Bismarckian principles, with obligatory social insurance, employment-based membership, contribution finance, organisational fragmentation etc. (Hockerts 1980). Many perceived this as a scandalous anachronism. While contemporaneous reforms in Britain and Scandinavia established allegedly 'modern', uniform and universal, central, tax-financed systems of social protection, the defeated and economically weak Germany obviously thought it could afford to stick with the old, expensive, Byzantine system with all its outdated status differentiation and bureaucratic overkill. Especially contentious was the restoration of the 'feudal' differentiation between a blue collar- and a white collar-worker insurance branch (both in the pension and health insurance schemes). From early on, two modifications of the pre-war *status quo*

emerged as a kind of institutional response to this critique: 1) although organisationally separated, entitlements in both schemes became legally 'assimilated',[9] and 2) internal fiscal transfers, as well as transfers *between* the different schemes, were introduced to ensure that equal welfare entitlements would not translate into varying contribution levels between regions or social insurance schemes. Initially these financial transfer schemes were voluntary; later they became obligatory (for an overview see Schmähl 2001; Henke 2001).

The financial transfer schemes proved to be of special importance for the further development of the relationship between German federalism and the Bismarckian welfare state, since uniform entitlements and equal contributions backed by fiscal transfers that levelled regional or economic disparities largely ruled out 'race to the bottom' dynamics in the social policy arena. A nationally uniform contribution rate in the pension insurance made fiscal transfers between pension funds necessary. Finally, in 1969 in the wake of Germany's first post-war recession, the 'good' risk pool of the white collar workers' insurance fund was fully fiscally fused with the comparatively 'bad' blue collar work insurance scheme (Frerich/Frey 1993:52f.). Another motive complemented the 'equal contribution rate' argument. Fiscal pooling was introduced largely to provide financial relief for the central state, because transfers from the relatively well-off white collar-worker pension fund to the deficit-ridden blue collar-worker scheme reduced the need for state subsidies from the general state budget. Similar fiscal interests motivated the integration of the miners' pension schemes (Frerich/Frey 1993:51). Thus, the apparent picture of institutional fragmentation conceals the almost complete pooling of financial resources (VDR 2003). With nationally uniform contribution rates, however, social insurance contributions developed more and more into national quasi-taxes. The high political barriers for tax legislation in Germany can then explain why subsequently much of Germany's fiscal adjustment to a more unfavourable economic environment since the first oil-crisis in 1973 happened through the adjustment of welfare state revenue and spending.

The most striking example of the often problematic interplay between the regulative idea of nationally uniform living conditions, the high degree of financial autonomy of the German welfare state and the particularistic fiscal interests of both central and states governments was provided by German unification in 1990 (Czada 1995). On the one hand German unification exemplified how the German "unitary welfare state easily overcomes federalist dividing lines" (Oeter 1998:534, translation by the author), given the fact that much of the East's rapid catch-up in terms of living conditions and income has to be attributed to the operation of the German welfare state. On the other hand German unification also demonstrated the price that had to be paid for this rapid catch-up; namely, a vast expansion of social spending.

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[9] It is, therefore, wrong to ascribe to the Adenauer pension reform the intention to "restore status differences". See Esping-Andersen 1990:25. In a number of respects, blue collar-workers were for the first time put on an equal footing with white collar-workers. See Prinz 1991.

Massive disparities existed between wages and labour productivity in the area of the 'old' Federal Republic and the five new Eastern *Länder*. However, the electoral appeal of a quick fix of Eastern living standards *without* substantial tax increases or a significant growth in public debt made it more politically attractive to impose 'hidden' tax increases by way of substantial increases in social insurance contributions. But burdening the social insurance funds with the costs of German unification was not only the result of a populist 'read-my-lips' strategy on the part of the Kohl-government motivated by the exceptional density of elections in the decisive year of unification, in 1990 (with a total of 17 national, regional and local elections) (Schwinn 1997; Sturm 1998; Zohlnhöfer 2001). The other side of the story is that in the process of unification the Western *Länder* were quite successful in protecting their fiscal interests (Altemeier 1999). As Table 3 shows, according to conservative estimates roughly a quarter of all financial West-East transfers in the wake of German unification had to be borne by the social insurance schemes, i.e. ultimately by the Western contributors. West/East *welfare* transfers were more than three times higher than transfers out of the Western states' budgets. This is a spectacular instance of the way in which federalist veto structures in taxation and revenue sharing (through the *Finanzausgleich*, the fiscal equalization scheme) translated directly into 'welfare state growth'.

Table 3: West/East Transfers in billion DM, 1991-1999, central and regional governments and social insurance funds[10]

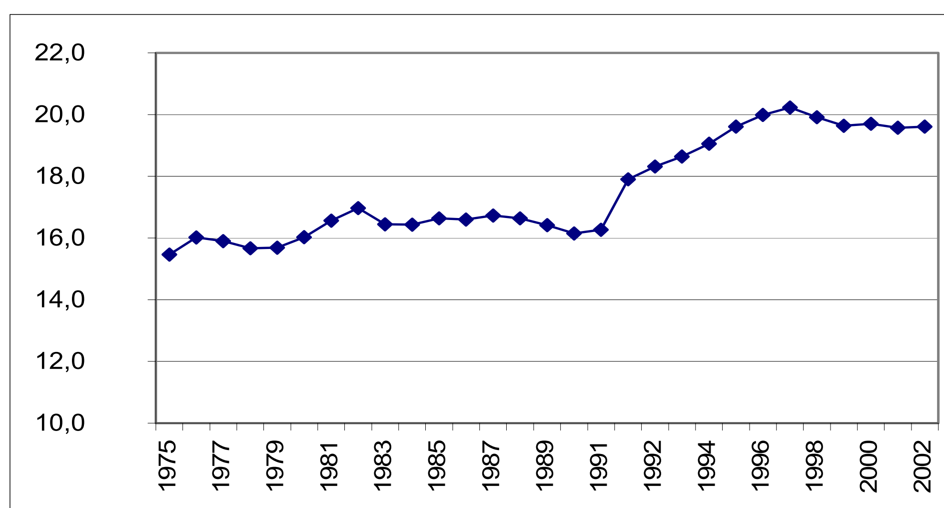
	1991	***1992***	***1993***	***1994***	***1995***	***1996***	***1997***	***1998***	***1999***	***1991-99***
1. Federal Government	75.1	90.0	115.7	115.9	136.7	136.7	129.7	130.8	136.3	1066.9
2. States	5.3	5.7	10.3	13.5	11.2	11.3	11.6	11.5	11.6	92.1
3. Social Insurance	18.7	34.2	23.0	29.8	33.3	30.9	34.7	31.9	36.0	272.2
4. Net Total Transfers	109.9	133.5	150.6	148.8	141.3	137.7	135.1	132.6	140.3	1229.9
5. Social Insurance as Per cent of Net Total Transfers	17.0	25.6	15.3	20.0	23.5	22.5	25.7	24.1	25.7	22.2

As a consequence, contribution rates to social insurance schemes steeply increased and welfare state spending revealed a strong upward trend. Whereas the combined social insurance contribution rates of employers and employees amounted to around 35.6 % of net wages

[10] With respect to transfers to the East data differ. I report here rather conservative estimates, taken from Ragnitz 2003; Bach/Vesper 2002, report slightly higher numbers; again slightly different estimates are provided by the Deutsche Bundesbank 1996

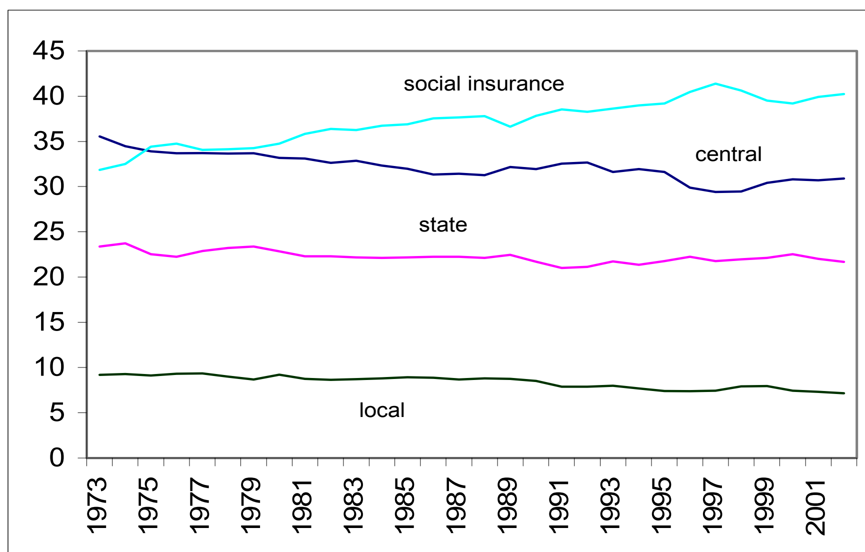
(up to an upper limit) in 1990, today they are at a substantial 42 % (BMG, table 7.7). When it comes to real financial burdens, not nominal rates, Figure 4 shows that the overall financial welfare burden on employers and employees had remained fairly stable over the 1980s with even a small downward trend at the end of the decade, whereas after unification in 1990 employers and employees had to bear steeply increasing costs.

Figure 4: *Absolute volume of contribution payments of employers and employees, as a Percentage of GDP, 1975-2002 (BMG, table 7.6)*



Yet, this is only a particular flagrant example for a much more long-term trend of political cost externalization at the expense of the contribution-financed welfare state – a trend we already had been able to observe for the Weimar period (see above, Section 3). In fact, since the worsening of general economic conditions after the first oil-shock German governments invariably have sought to shift costs onto the contribution financed welfare state rather than taking the electoral unpopular and politically complicated step of raising taxes or of cutting expenditures (Nullmeier 1992; Manow/Seils 2000; Trampusch 2003). From 1965 to 2002 combined revenue from taxes and social insurance contributions has risen from 32.8 % to 38.2 % of GDP, but whereas tax revenue *decreased* from 23 to 20.8 % during this period, revenue from social insurance contributions increased from 9.8 % to 17.4 % or nearly doubled (cf. Manow/Plümper 2003). As Figure 5 reveals, the tax revenue of local and regional governments remained relatively stable over the last 30 years. The major revenue shifts have taken place between the central state and the social insurance funds: "insurance-based programmes … have absorbed a steadily growing share of social expenditures since 1970 … entirely tax-funded programmes … lost a lot of ground" (Leibfried/Obinger 2003). German unification accelerated, but did not initiate this process.

Figure 5: Total Tax Revenue, relative Shares of Central, State, Local Government and Social Security Funds, Germany 1973-2002 (Source: OECD, Revenue Statistics)



As figure 5 makes clear, there is indeed ample evidence of *expansionary* expenditure tendencies in German-style 'cooperative' federalism. These findings with respect to welfare state finance mirror the more general point that federalism can "exacerbate collective action problem" and "might undermine fiscal discipline" if the fiscal and political responsibilities of the different layers are not clearly separated from each other (Rodden/Wibbels 2002:495f.). It is, therefore, hardly a surprise that the veto-point hypothesis so strongly emphasised in the literature on the political consequences of federalism does not seem to fit the German case very well. And this is so despite the fact that Germany can be considered a 'critical case' for the veto point thesis with a strong second chamber and the frequent occurrence of countervailing majorities (Lijphart 1984; Money/Tsebelis 2003).[11]

Yet, from 1972 and 1994, only 34 laws has been successfully blocked by the federal chamber, either because the majority in the Bundesrat exercised an absolute veto (N=29) or because the parliament abstained from overruling the federal chamber's suspending veto (N=5). Only 10 of these 34 laws had anything to do with social policy, and none of them represented a major reform act (Schindler 1999:2434ff.). This is not a particularly impres-

[11] In Germany the central government has enjoyed a political majority in the federal chamber for only 9 of the 31 years since the end of the "golden age" of the welfare state, from 1972 to the present. These 'happy years' of political alignment of the first and second chamber fell basically into the first two (and a half) terms of the Christian Democratic government under Chancellor Kohl, from 1982 to 1991.

sive demonstration of federalism's veto power. Of course, looking at outright legislative failure gives us only a small part of the picture. Since the impact of federal veto structures presumably lies in that they have the capacity to 'water down' substantive reforms and force the government to agree on lowest common denominator policies, it is clearly not enough to focus exclusively on failed legislative initiatives. Even with only little strategic capacity, a government can anticipate resistance in the second chamber and will draft legislation accordingly, in order to avoid complete political stalemate. Therefore any 'evidence' for the veto-point thesis must be based on hard-to-prove and hard-to-falsify counterfactual reasoning of the kind: 'would government x have proposed a bill substantially different from the bill it introduced had it acted in a unicameral rather than a bicameral system?'

Stalemate politics can be motivated either by calculations of partisan advantage or by states' special interests. If we take into account that the two mass-member parties, the German Social Democratic Party and the Christian Democratic Party (SPD and CDU), are programmatically quite close to each other in questions of social policy (see for instance Budge et al. 2001:235), the rarity of partisan-motivated policy blockade is not that surprising. In fact, almost all major social policy reform acts since 1949 have been enacted with the support of the major opposition party, no matter whether this was the SPD or the CDU. This might be not seen as particularly surprising in the case of the generous expansion laws of the 1950s and 1960s. However, there was also a broad consensus between SPD and CDU in respect of many of the major retrenchment laws in the decades after 1980, including the health reform of 1988, the pension reform of 1990, and the present health reform of the second Schröder government. Moreover – contrary to the 'new politics of the welfare state' thesis – the introduction of a completely new social insurance branch, the long-term care insurance (LTCI) in 1994, two decades after the 'golden age' of welfare state expansion was over, also relied on consensus between Christian and Social Democrats. Indeed, in the case of long-term care, the conservatives were the initiators of expansionary reform. [12]

True, as Jens Alber has shown, broad political consensus is less likely if welfare cuts are on the agenda than if the legislation is expansionary (1989:262, table 43), a finding that appears trivial only as long as one does not fully recognize how much this tells us about the non-trivial fact that Social Democrats and Christian Democrats largely share a general pro-welfare state attitude. However, it is also the case that major legislative cost containment efforts have frequently been enacted by super-majorities. In international comparison Germany is a country in which welfare retrenchment started early – already under Social Democratic chancellor Schmidt in the second half of the 1970s – and where retrenchment "actually was quite substantial" (Leibfried/Obinger 2003: 214; see for further evidence among

[12] The introduction of the LTCI is another example for cost-externalizing social policy at the expense of the welfare state. Financed in the traditional Bismarckian fashion through contributions paid by employers and employees, the LTCI brought substantial financial relief for the budgets of the municipalities and states, since support for the handicapped, frail or elderly that previously had been financed by tax-financed social assistance was now to be covered by the new, 'fifth' social insurance branch; see Götting et al. 1994.

many Siegel 2002, chapter 9; Alber 1998; Alber 2001). Both the health sector and the pension insurance were subjected to continuous cost containment measures (see also Jochem 2001). As a welfare state spender Germany had receded from a leading position to the middle-field by the late 1980s. German unification then once again supplied a strong expansionary momentum. But both before and after 1990, successful cost containment was thwarted by two other countervailing trends. First, high and persistent mass-unemployment, costly medical progress and – lately – also the first impact of rapid population ageing have operated together to significantly increase the demand for social spending. Hence, successful cost-containment was successful only in reducing the growth rate of expenditure. Second, and more important in the context of this analysis, cost-cutting had its main effects on the tax-financed state share of total social spending, but had a much lesser impact on contribution-financed share. In fact, the importance of contributory finance increased, since the central government sought to ease its own fiscal stress by shifting social spending obligations out of the public budget and into the special budgets of the social insurance funds, and by accepting (automatic) contribution hikes as substitutes for legislating unpopular and politically blocked tax hikes.

This last point is of especial importance since it highlights the important nexus between taxation and welfare state finance. This linkage helps explain the otherwise puzzling combination of relatively successful cost-containment before 1990 and significant cost increases thereafter. In principle, in response to fiscal stress, the German government either could increase debt, cut costs or increase revenue. The strong Bundesbank and, since 1992, the Maastricht criteria have set quite clear limits to the debt option (see for the general argument Manow/Plümper 2003). On the other hand, legislating taxes hikes in order to raise revenue is not only notoriously unattractive in electoral terms, but, in the context of the German federalist system of joint taxation, strong bicameralism and frequent divided government,[13] also extremely complicated in partisan political terms. Welfare retrenchment did occur to some degree, but was never sufficient to close the ever widening revenue / expenditure gap. The welfare state provided a fiscal pressure-valve in two respects. First, public budget cuts plus task-delegation at the expense of the social insurance funds reduced the fiscal involvement of the central state. Second, semi-automatic increases in social insurance contributions substituted for legislated tax hikes. This further diminished the importance of tax-financed social spending with strongly regressive consequences. Social contributions are already levied from low incomes and given that welfare transfers are either not taxed at all or only at a very low level, income taxation does not correct for the regressive effects of the Bismarckian system. In terms of *net* social spending Germany – on a par with Sweden – is still the world's most 'generous' welfare states and is, yet at the same time one of the world's least redistributive social policy systems (Adema 1999; Ganghof 2004).

[13] In this context it seems worth mentioning that only shortly after unification in October 1990 the Kohl-government lost its majority in the upper house because of the Hessen-elections in April 1991.

Inter-party consensus with respect to steady incremental retrenchment has not prevented fierce clashes between government and opposition on issues with a high electoral salience. The massive campaign of the Christian Democratic opposition against pension cuts in 1976 is one example as is also the campaign of the SPD against the retrenchment proposals of the Kohl government in 1996 (reduction of sick pay, a lowering of employment protection for small firms, pension cuts by introduction of a 'demographic formula', an increase in retirement age, etc.). In 1976, as in 1996, electoral motives were clearly dominant. In 1998 the Social Democrats benefited from the fact that finally the Christian Democratic– liberal coalition had begun to engage in more than incremental tinkering with welfare state costs. For the first time, the Social Democrats' continuous lament that the Kohl-government followed a neo-liberal course of deregulation could point to, at least, some evidence. Achieving office with the promise to modernize *Modell Deutschland* without neoliberal neglect of equality and social security, the Schröder-government quickly delivered the promised 'counter-reform', i.e. it undid the few retrenchment measures of the last Christian Democratic/Liberal administration.[14] It soon became clear, however, that this was not enough. Space prohibits a thorough description of all reform measures, but I think it is fair to say that taken together the tax, pension, health and labor market reforms of the first and second Schröder government cut much deeper into the existing structures of the German welfare state and political economy than all the reforms enacted during the 16 years of CDU/FDP rule.

If at all, only a modified version of the veto-point theory is compatible with this finding, given that the red-green coalition only enjoyed a very short period of 6 months majority status in the Bundesrat compared to the 9 years of concurrent majorities in both houses during the Kohl chancellorship from 1982 to 1991. Since April 1999, the Schröder government has been confronted with a hostile upper house, as had been the Kohl government from 1991 to 1998. How, then, can one explain their different reform records? Intense political competition between two mass membership parties, both of which attempted to woo the pro-welfare median voter would lead one to expect at best incremental changes, more often, perhaps simply political stalemate. Furthermore, we would expect governments to shy away from harmful measures or to take action only where the opposition could be brought on board, given that the many state elections (16), spread over the parliamentary term, provide strong political disincentives to any programme of painful reforms. Governments try to avoid unpopular cutbacks since they fear electoral punishment, which might result in the loss of power at the state level and, as a consequence, in an oppositional majority in the upper house (Lehmbruch 1998; Burkhart 2003; Dinkel 1977). Differences in reform intensities therefore have to be mainly attributed to the changed party constellation: the Christian

[14] For a (highly critical) overview over the welfare reforms of the first Schröder government see Schmidt 2003. See also the contributions by *Rose* (labour law), *Heinelt* (labour market), *Buhr* (social assistance), *Nullmeier* (pensions), *Bleses* (family), *Brandhorst* (health), *West* (education), *Leitner* (gender) and *Vogel/ Wüst* (immigration in Antonia Guhr/ Martin Seeleib-Kaiser (eds.), 2003).

Democrats in government were electorally more vulnerable to the charge of being the 'gravedigger' of the welfare state. Now, in turn, the SPD is forced to be an initiator of reform, while the bourgeois parties find it difficult to 'leapfrog' the left by protecting the *status quo* (Kitschelt 2001). What before 1998 was a situation of mutual stalemate has turned into an overbidding game in which the CDU attempts to top the reforms of the red-green coalition with even more radical proposals.

Compared to antagonistic party competition, political gridlock in the federal chamber as a result of special Länder-interests seems to occur more often. Case studies often stress that the veto power of the regional governments in the upper house has regularly prevented more far-reaching reform measures from being enacted. The health care sector in particular has regularly been mentioned as exemplifying this tendency (Webber 1988; Webber 1989; Rosewitz/Webber 1990). However, even here, the empirical evidence is not particularly strong. Neither is it true that health sectors in which the states have direct interests (hospital sector, pharmaceutical industry), seen fewer cutbacks than other sectors such as physicians' reimbursement, where the states' interests are weaker (cf. Döhler/Manow 1997). Nor is there much of a difference between social insurance branches in which the states have a veto position and those where they have none. With respect to the first point we can observe that in the hospital sector, sickness funds spent 29.4 % of their total outlays on hospitals in 1974, at the onset of the 'period of permanent austerity'. In 2000 they spend only slightly more, 32.2 %. Change in the pharmaceuticals sector is even less evident, with the share of total expenses remaining more or less stable with 23.2 % in 1974 and 24.7 % in the year 2000 (Statistical Yearbook, various years). As to social insurance branches, much the same picture emerges. In respect of most laws in the health care sector, the states have an absolute veto, since here legal measures usually affect regional administrative responsibilities in one way or another. This is typically not the case in the pension insurance scheme. Yet, if we compare the spending dynamics of these two sectors (both similarly affected by demographics), we cannot see much of a difference. The ratio of pension to health care expenditures in 1974 was 1.8, in the year 2000 it was at 1.73 (Statistical Yearbook, various years). Thus, health care costs grew relative to pension costs, but not strongly enough to justify a convincing argument about the influence of federal veto points.

In more general terms, the federalism as a veto-point thesis has substantial problems in accounting for Germany's post-war welfare state development, given the fact that federal state structures seem to *not* have hindered Germany from becoming the most generous welfare state of Western Europe in the 1950s and 1960s (Alber 1982, see Table 4) and did not stand in the way of quite substantial retrenchment relative to other OECD nations in the period 1970 and 1990.

Table 4: Total Social Expenditures as a percentage of GDP, 1950-1970, 11 countries (Source: ILO, Costs of Social Security)

	Austria	*Denmark*	*Finland*	*France*	*Germany (W)*	*UK*	*Italy*	*Netherlands*	*Norway*	*Sweden*	*Ireland*
1950	12,57	7,84	6,64		15,34	10,93	8,73	8,65	5,70	8,72	7,32
1955	15,76	9,40	6,77		14,81	11,23	n.d.	9,55	7,44	9,89	n.d.
1960	15,74	11,09	8,55		n.d.	12,53	12,22	11,93	9,35	10,94	9,00
1965	18,35	11,20	10,33	16,56	17,93	13,87	17,99	16,00	10,95	13,67	10,10
1970	17,86	15,69	12,48		18,35	15,80	17,69	20,89	15,46	18,63	14,32

The overall German spending trajectory – first fast growth and very high spending levels, then moderate growth at medium spending levels, finally again strong expansion in the wake of German unification – is not well accounted for by the veto-point thesis which would predict below average growth in the golden times of welfare state expansion up to the mid-1970s, but, from that time onwards, above average growth rates due to the political difficulty of effecting substantial welfare retrenchment in federalist polities.

5 Conclusion

"Decentralized redistribution is self-defeating" (Prud´ homme 1995:202). In this sense, it is true that federalism and welfare states represent potentially antagonistic institutional settings. Federalism can be a powerful institutional impediment to substantial redistribution. And this is exactly how federalism seems to have impacted on welfare state development in the English-speaking liberal nations with systems of interstate federalism. Yet, as the German case made clear, as soon as political actors pursue extensive redistributive aims by superimposing *nationwide* tax and transfer systems on still federally fragmented political accountability structures, the strategic logic of the interplay between federalism and welfare state may change profoundly. Here, the diffusion of responsibilities and the incentives for shifting costs between central government, states and the welfare state instead are conducive to an 'overgrazing of the fiscal commons' especially if the welfare state is – as is the case in Germany – largely financed by contributions. Instead of the restrictive influence predicted by the standard versions of veto-player theory, federalism here leads to expansionary spending dynamics and a low degree of fiscal discipline. I have argued that federalist veto structures has played a role in Germany's welfare state development in the period of retrenchment, but in a way not foreseen in the literature. Given that the German states have

a powerful veto position when it comes to legislation on joint taxes, which account for 70 % of total tax revenue, but have no say in matters of social insurance contributions, increasing welfare state revenue offered relief in a situation of severe fiscal stress – particularly, but not exclusively in the wake of German unification.

Founded with the aim of furthering national unification, the German welfare state indeed has become *the* great national unifying institution. The feedback effects of the welfare state on both living conditions in Germany and on the functioning of German federalism itself are enormous. The welfare state together with the national tax system has effectively prevented inter-regional economic competition. These national achievements have been so successful that proposals to reverse the trend and to introduce what has been called federalist competition not only in education and taxation, but also in the welfare state arena, have become ever more articulate (cf. Münch 1998; Pitschas 1994; Papier 1995). Competition would also – so it is hoped – re-introduce experimentation and learning into German federalism, now largely absent because of nationwide regulation and encompassing fiscal balancing schemes.[15] However, political support for these calls for welfare state devolution is weak and will remain so in the future, given that the relevant actors are fully aware of the distributional consequences. The new Eastern states as well as the less affluent Northern states can only lose from political and fiscal devolution. Thus, even if, in Germany, federalism does not hinder welfare retrenchment, it still makes it difficult to effect major structural reforms. In Germany's "grand coalition state" (Schmidt 2002), there is still no alternative to 'negotiated' change.

If we refer back to the two 'points of qualification' noted in the introduction, the preceding paragraphs have shown that neither the implicit 'interstate-competition'-assumption nor the implicit 'incongruence of political preferences'– assumption of most contributions to the subject have had much bite in the German case. It is, therefore, hardly surprising that German federalism has not prevented the Bismarckian welfare state from becoming one of the world's most expensive, generous, and encompassing systems of social provision. Correspondingly, and contrary to the received wisdom of the federalism thesis, federalism has also not prevented substantial retrenchment in the era of the 'new politics of the welfare state'.

[15] Hence it is not surprising that the only instances of policy experimentation and mutual learning are to be found *outside* the traditional social insurance framework, especially in local care for the elderly and local social assistance; see Schmid 1990; Alber/Schölkopf 1999.

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