



## Japan Local Government Centre, London

### **Monthly Report June 2010 (Germany) – Proposal to replace trade tax by Local Finance Reform Commission**

The Local Finance Reform Commission which started work in March 2010 is examining a proposal which was put together by the Free Democratic Party (FDP), the junior partner in the coalition government. This calls for research into replacing the trade tax with a local component on income tax and corporation tax, as well as increasing local government's share in VAT income, which is shared between all levels. However the Association of Municipalities as well as the Association of Cities are both severely critical of this proposal and reject it as unsuitable. Both presidents of the respective associations declare that the main aim of the commission must be to release the burden on local governments and improve their room for action.

The president of the Association of Cities, Frankfurt's Mayor Petra Roth, emphasised: 'The trade tax is much better than its reputation. Examined over a period of time, it shows better dynamic potential than other taxes and as such ensures the provision of vital services for residents and businesses alike. The model proposed by the FDP does not provide an acceptable replacement for the trade tax – and as long as a truly equal alternative cannot be found, the trade tax must not be abolished. As local governments are in the worst financial situation ever experienced in post-war history, experiments with an unsure outcome must be avoided.'

The president of the Association of Municipalities, the mayor of Bautzen, said: "Our financial situation is dramatically bad. We need the trade tax to provide the direct link between businesses and local government. It is local government that provides services locally and is responsible for economic development policy. It is possible to stabilise trade tax by including independent professions and making the tax base broader – while qualified trades such as roofers, builders and bakers already pay trade tax, there is no reason why architects, lawyers and others do not. People newly included could offset trade tax payments with their income tax." He also emphasised that trade tax is not as dependent on the economic climate as is often stated. On the contrary, corporation tax intake fell much more in 2009 – and he also said that about half of the reduction in the municipal tax taking between 2008 and 2010 was due to tax reductions for businesses introduced by federal government.

The other point that was emphasised concerns the burdens placed on local government by legal obligations in social welfare. Expenditure for all the

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different payments that fall under social welfare have risen more than any other part of expenditure – in fact, this expenditure has nearly doubled over the past 20 years. In this area, the local government associations make the following demands:

- Although local government recognises the need for fiscal consolidation, the way in which cuts are introduced stores up problems for local government, which will have to pick up the slack later. This is particularly true for the contribution the federal government makes to pension insurance for those who are receiving welfare benefits. By not contributing to pension insurance, it means that the assistance local government has to pay out to older people as ‘old-age basic benefits’ will increase.
- The federal government has introduced a legal right to child care for under three year olds. However the financial means to provide enough places are not there. It is necessary for federal and *Land* governments to provide an answer as to how this should be financed – municipalities on their own cannot fulfil this task.
- The federal assistance payments contributing to the housing costs of the long-term unemployed cannot be reduced further, as this proportion is continuing to rise.
- The costs for integrating the disabled, for which in large part local government is responsible, are rising continually, and cannot be borne by local government alone.

The current standpoints of federal and local government are very far apart, also demonstrating that the input of local government into the commission is not appropriately reflected, and that in particular the federal level’s influence is much stronger. It remains to be seen what kind of proposals the commission will make when it is due to report in October.

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