Insolvent Local Government: Lessons from Germany

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1 Introduction

The current global crisis, and/or its aftermath, are affecting local governments in most European – and other "Western" – countries with particular impact, not least because the general and "time-honored" tendency of national and regional governance bodies to "hand down" financial obligations to the municipal level. (Schwarting 2008, 268; Faber 2005, 945) That this is a problem is exacerbated by two current phenomena: The increase of the importance of the local life-world for the citizens in a globalized and, where applicable, European world on the one hand (see Stern 1996, esp. 43; also e.g. Isin 2002; Drechsler 1999), which makes more and not less financial resources necessary, and, on the other hand, the late ideological tendency in public administration (PA), associated with the concept of the New Public Management (NPM), to dismantle local autonomy in the name of efficiency and – simply assumed – economies of scale, i.e. a bias in favor of larger and more centralized units and against anything local and municipal. (e.g. Seitz 2008)

Although the latter has been more or less abolished on the academic and scholarly level, at least in Europe, with the rise of the concept of the Neo-Weberian State (NWS) as the post-NPM paradigm (cf. Pollitt et al. 2009), it is still alive and well in policy, and especially on the municipal level. (Reichwein 2007) The NWS is the logical PA paradigm both for getting out of the crisis and for times to come, it is true; also, in its rhetoric and general assumption, NPM is very much "pre-crash" and indeed part of the way of thinking that has led to, or at least significantly helped, the crash to come about as harshly as it did (see Drechsler 2009c); still, one reaction by financially troubled countries has been to force savings, cuts and such NPM measures that "reduce the state" (see Peters et al. 2010) – not without harsh effects for the local level. (see local alliances against over-indebtedness)

All this makes the issue of local governments becoming insolvent a particularly interesting topic. Can this happen at all, should it be allowed to happen, can it be prevented, and if it cannot be, how can it be managed well? It seems that this is an issue not least for Central and Eastern Europe, where Local Self-Government arguably is under particular duress, and thus on the defense, due to the crisis and partially even before that.

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To approach this question, it is especially interesting to look at the Federal Republic of Germany for a variety of reasons. Although several federal investment programs (see Zukunftsinvestitionsgesetz 2009) seem to have a positive effect on many municipalities in the sense that the crisis has not hit as hard as had been feared (OECD Economic Surveys Germany 2010), Germany has been particularly affected by the crisis (BMF 2009), and there certainly are prospects of detrimental effects for the local governments. (Käppner 2009)

Generally, on the one hand, Germany is a country with a classically very strong local sector, and certainly in its self-understanding the cradle of municipal autonomy (and for municipal autonomy the cradle of democracy; see H. Drechsler 2001); its founding father and "patron saint", Karl vom Stein, recently celebrated his 250th birthday (Drechsler 2007; see Duchhardt 2007, esp. 199-203; Ritter 1981, esp. 196-199) and the first establishment act of Municipal Autonomy, the *Preußische Städteordnung*, its bicentennial (Drechsler 2008; Ordnung für sämtliche Städte 1957). This idea also had a significant impact on the restoration of Local Self-Government in Central and Eastern Europe after 1989. (Drechsler 2008, 137)

On the other hand, especially on the local level, NPM – under the name of the "New Steering Model" – has hit especially hard – often even with good intentions, and promoted with verve by the "think-tank" of the municipalities themselves, the Federal Ministry of the Interior, a very powerful foundation (Bertelsmann) and, not least, many academics and civil servants. This created an atmosphere in which to diverge from the assumptions of NPM, even to demand calculations or justifications, was regarded heresy. (Drechsler 2009a: 315-319) Regarding Municipal Autonomy, NPM also united with the "social engineering" approach of the 1970s and its cult of the doable (on the history of the approach, Etzemüller 2009), and Germany had become one of the countries where it was just assumed that larger municipal units would lead to increased efficiency. The otherwise very important "Rastede" decision of the *Bundesverfassungsgericht*, for instance, proclaimed the same view *en passant*,[3] never mind that we have no reason whatsoever to believe that increased municipal unit size automatically increases efficiency, and there is a tendency for it to weaken democracy and citizen identification with the community.

In this context, the current essay sets out to investigate, on an empirical basis, how Germany has so far, i.e. *before* the crash, dealt with the issue of municipal insolvency. It is approaches to resolving the current financial crisis and preventing future financial crises that are at the center of this observation. To look at those pre-crash tools may be of particular interest, because they were formulated and tried without the hastiness and confusion that might have accompanied any crisis-based attempts at solutions; also, there is enough empirical material and analysis for them to render such an investigation possible.

[3] BverfGE 79, 127; "In many respects, however, a centralistically organized administration could work more rationally and cheaply", 153. On the positive aspects of Rastede s. Schmidt-Aßmann 1991.

As the purpose of this essay is to familiarize the non-expert on Germany, we have utilized as much as possible the German-language literature (which completely dominates the discourse anyway, of course) to thus also show how and where the issue is discussed nationally. The empirical parts and to a large extent also the argumentation of this essay is based on Duve 2008a, Duve 2008b and Duve 2009b, which also were part of Duve 2009a.

2 An extreme indebtedness as a danger for local autonomy

The debt situation of the municipalities had already deteriorated significantly in the last years, long before the current financial and economic crisis. This development was expressed in the fact that more and more municipalities could not balance their budget (Henneke 2008a, 232). The rapid increase of *Kassenverstärkungskredite* (cash advances) confirm this trend impressively.

The present financial crisis continued to strengthen the deficit budget situation of many municipalities. With the substantial decrease of the trade-tax income – the main source of income of the German municipalities – and the increase of the social costs, the municipalities already had to carry a deficit of 7.1 billion Euro in 2009. (Statistisches Bundesamt 2010) In addition to that, there is a certain number of German municipalities which have to carry risks caused by Cross-Border-Leasing contracts. The financial problems and failures of many American banks and insurances (Shinde 2009, Kirbach 2009) now threaten the involved municipalities. Until today, the feared problems were held off, however, or at least did not emerge.

Generally, the municipal life is suffering from a high indebtedness sustainable if too high a percentage of the revenues is necessary for amortissement and interest payments. The municipalities then often lack money for necessary investments, which consequently has negative effects on the public infrastructure. Also the decline of voluntary tasks, which many municipalities cannot afford any more, harm the social and cultural life within the municipalities (Henneke 2008a: 232; Welt 2010).

The outstanding position of municipalities in the state is evident in a closer examination of their functions and tasks. The municipalities are running approximately 80% of state laws and thus form the basis of the state administration. (Knemeyer 1997, 204) With their investments, e.g. in cultural and social institutions as well as in the municipal infrastructure, they also contribute significantly to the prosperity of the population. (Raske 1971, 172-173) Connected to this is the importance of communities as carriers of the general service for the public (Forsthoff 1958).

In Germany, it is generally the *Länder* (roughly, the states) that deal with the local governments, not the federal level (see chart 1).

Chart 1: Arrangement of the administrative levels in Germany

1st State Level	1 Federation
2nd State Level	16 Länder (of it 3 City states)
1st Local Level	323 Counties and 112 independent Cities
2nd Local Level	12,188 dependent Municipalities (within Counties)

Source: Statistisches Bundesamt, Fachserie 14, Reihe 3.3, 2007; accessed 30 June 2007.

The state-legal allocation of the municipalities to the Länder is connected with a supervision right of the Länder (Wagener and Blümel 1997, 114) A federal supervision over the municipalities does not exist due to this allocation (Gern 2003, 520). This essay therefore deals with the question by which approaches the Länder face up their responsibility for the indebtedness of the municipalities. The focus is in particular on the way the supervising authorities act in handling the local budgetary hardships.

2.1 The range of state interferences

A look at the indebtedness of the German state shows that in relation to the total indebtedness of the State (1.58 trillion Euros in the year 2008), the indebtedness of the municipalities amounts to about 7%. The indebtedness of the Länder amounts to 31.6%, that of the federation to even 61.4%. (Statistisches Bundesamt 2009)

The relatively low level of the indebtedness of the local level is still no reason for carelessness, since it is not distributed equally among all municipalities. A closer look at the local indebtedness shows considerable regional and structural differences (Junkernheinrich and Micosatt 2008, 14). The partly very high indebtedness is challenging to some Länder and especially to their supervisory authorities, which is also reflected in the capacity to intervene. Thus the interventions into the government covered by the supervisory authority varies strongly according to region and financial situation.

The task of the supervisory authority is limited to the monitoring of the legality of the local administrations. (e.g. Art. 49 Abs. 3 Satz 2 constitution of Rhineland-Palatinate) For the enforcement of this mission, there are different measures available.

The repressive measures of the supervisory authority are specified comprehensively in the *Gemeindeordnungen* of the Länder and are used according to the principle of proportionateness. It contains the following actions:

- Instruction right
- Objection right and abolition right (if there are preceding right offences)
- Command right (when omitting legal obligations)

- *Ersatzvornahme* (Accomplishing of an ordered measure by the supervisory authority at the expense and in the name of the municipality)
- Appointing of a commissioner (if the measures mentioned above are insufficient)
- Dissolution of the local council[4] and preterm ending of the mayor's mandate [5] (only possible in some Länder)

The options for interventions of the supervisory authority of the Länder into the local autonomy are thus clearly defined. Beyond these measures, there are no further legal actions.

3 Autonomous acting and national specifications – Which scope do German municipalities have?

By art. 28 exp. 2, the German constitution ensures the municipalities the right to regulate all affairs of the local community within their own responsibility. However, there is a substantial number of national specifications which limits the extent of autonomy and responsibility. Besides the voluntary self-administration tasks, there is also many duties assigned by the Länder. Furthermore the municipal execution of all tasks stands under law proviso, which is used to safeguard the population. (Falk 2006, 117)

Not least because of the duty to execute state tasks, the interconnectedness between the municipal level and the state level with its administrative organizations has increased (Burgi 2006, 88). While voluntary self-administration tasks are the core element of self-government guarantee, in percentage the assigned government tasks prevail. In the majority of municipalities, the voluntary self-administration tasks represent less than 10% of expenditures. (Schwarting 2005, 142)

When transferring state duties to the local level, appropriate funding by the Länder plays a central role. In the past, the Länder did not often pay attention to this matter, and it cannot be denied that this is one of the reasons for the current financial crisis of many municipalities. (Schwarting 2008, 268; Albers 2005, 61; Faber 2005, 945; Frischmuth 2008, 136) This circumstance has changed a bit in the last few years.

On the one hand in 2006, resulting from the federalism reform I[6], the *Bundesdurchgriff* , i.e. the right of the Federal government to directly, rather than via the Länder, impose financial obligations on the municipalities, was abolished among other things. Thus the federal level must not transfer laws directly to the

[4] § 141a GemO Hessen; § 84 Kommunalverfassung Mecklenburg-Vorpommern; § 125 GemO Nordrhein-Westfalen; § 125 GemO Rheinland-Pfalz.; § 122 Abs. 2 GemO Thüringen.
[5] § 118 GemO Sachsen.
[6] With the federalism reform I, the goal was pursued to improve the decision-making process between the federation and the Länder, to reorganize political responsibilities more clearly as well as to increase the appropriateness and efficiency of the task fulfillment. (Parliament printing 16/813 from March 7, 2006).

municipalities. (Article 84 exp. 1 sentence 7 Grundgesetz) On the other hand, the German Länder have implemented a strict Konnexitätsprinzip. (Müller/Meffert 2006, 121) According to this principle ("Who orders has to pay") the resulting costs of a transfer of new tasks from the Länder to the municipalities has to be determined, and an appropriate funding has to be allocated by the Länder. The individual regulations within the constitutions of the Länder are arranged differently in details (Kemmler 2008, 983).

In order for the municipalities to be in a position to carry out their tasks appropriately – not least but also to ensure equal life conditions (See Article 72 exp. 2 Grundgesetz) –, they receive allocations from the Länder within the scope of the municipal revenue-sharing, depending on funding requirements. The former subsidiary character of these allocations has been gone for a long time. In many places, these allocations are now a key source of revenue. In the East German Länder, the share of the allocation of all revenues is around 50% (Lenk and Rudolph 2005, 57), which explains the low revenue power of local municipalities in this region.

The empirical determination of the required financial volume is an unsolved problem. (Junkernheinrich 2007, 173) Another problem arises from the still increasing financial losses of many Länder, which also has an impact on the funding of the municipalities. (Henneke 2008b, 858). Especially in the current crisis that also burdened the budgets of the Länder, cuts in state allocations have catastrophic effects on the budget situation and thus on the local autonomy of the municipalities. (faz.net 2010)

Regarding borrowing, the municipalities are subjected to permit requirements of the Länder. Thus the municipalities have less leeway with this financial instrument (Jochimsen and Konrad 2006, 21).

The legislation for local laws as well as local funding is part of the competence area of the Länder. (Werner-Jensen 2006, 32) The municipalities do not have much influence on that. (Klein 2005, 72) Apart from the funding from the Länder, the municipalities are very much dependent on their own financial resources, whereas the state can establish new taxes for fiscal reconciliation (Zimmermann 2006a, 433).

4 Insolvency proceedings as a sword of Damocles for municipalities?

The current legal situation in Germany does not include municipal bankruptcy. Paragraph 12 Abs. 1 Nr. 2 of the Insolvenzordnung (InsO) declares that bankruptcy proceedings against the assets of legal entities under public law are inadmissible unless the law of the Länder determines this. All German Länder have followed this provision (Faber 2005, 938).

The German municipalities, but also the German state, are considered to be creditworthy without restrictions.[7] Consequently, municipalities receive credits from bank institutes even when they already reached a very high level of indebtedness and are actually already insolvent. Thus, municipalities always stay solvent. For the Länder, this has the consequence that they do not have to stand in for the municipalities' commitments (Engelsing 1999). The other side of the coin is the danger of an indebtedness circle, which will be maintained by credits that are granted and used up again and again. At the same time, it probably cannot be ruled out that the constant credit availability reduces the need for action both on the state level and on the municipal level.

4.1 Arguments for local insolvency proceedings

With the introduction of insolvency proceedings for municipalities, the limitation of the local indebtedness is no longer to be achieved only via legal regulations, but also via market mechanisms (incentive effect) as a further measure. (Blankart, Fasten and Klaiber 2006, 571) Furthermore, it is intended to give municipalities in extremely high debt the chance to start over by using an insolvency proceeding (redevelopment effect). (Paulus 2003, 869)

When speaking about municipal insolvency, what is meant are not the classical insolvency proceedings, which results in a complete liquidation of all assets. In fact, supporters of the idea of municipal insolvencies refer to the *Insolvenzplanverfahren*, (a specific mode of orderly debt restructuring) which was implemented in the new bankruptcy law on 1 January 1999. (Frielinghaus 2007; Paulus 2003; Borchert 2004) Thus, what makes this process exceptional is that all participants are to receive a large amount of freedom in conducting the insolvency proceedings in order to negotiate the best solution for them without further obstacles or statutory requirements. (Braun and Frank 2007, 1183).

As a direct consequence of a municipality's insolvency proceeding, the banks would have to take into account the risk of losing a certain amount of the granted credits, which means that the existing zero-risk for credits would have to be put under scrutiny. The potential risk would be determined by the banks on the basis of ratings (interview Bergmann 2008). Accordingly they would have to deposit their own capital funds with the granting of credits. (Pfitzer 2003, 49) Depending on the solvency of the municipality, the credit costs could thus increase and the credit conditions for the municipality could worsen.

According to the calculations of the insolvency supporters, politicians will endeavor in the future to reduce the indebtedness or at least to keep it low in order to avoid high credit costs or even an insolvency proceeding. Thus, cases of insolvency are not to actually occur, but the possibility is to repel and sanction (Meyer 2007).

[7] In accordance with the Solvatibilitätsverordnung, local credits have a risk weighting after the credit risk standard of 0%.

Creditors and debtors would therefore do everything to avert bankruptcy (Blankart 2007).

If a municipality, however, is already trapped in inescapable debt, a modified insolvency procedure is to work as an instrument for reorganization (Paulus 2003, 872) providing the municipality with the possibility for a fresh start. Moreover, with the help of this preocedure, the possibility of reducing the personnel faster is seen as an additional benefit aiding in preventing future burdens (Borchert 2004, 3; Frielinghaus 2008, 997).

4.2 Arguments against local insolvency proceedings

The described expectations certainly seem to be attractive at first sight. At second glance, however, several problems are apparent.

To achieve the decribed incentive effect with the help of variable credit conditions, the Länder would in principle have to rule out rescuing municipalities from financial difficulties (a so-called bailout). Otherwise, the banks would not be able to realistically estimate the credit risks. But how to distinguish between state grants and a bailout? The grants of the Länder to many municipalities are not negligible here. As has already been mentioned, this allocation is an essential part of the revenues. Without this money, a recovery of the budgetary situation would be impossible for many municipalities. It cannot be denied that these allocations already represent a sort of bailout (Schwarting 2005, 145).

Furthermore, to vitalize the incentive, the municipalities need to have enough freedom to act. However, these margins are insuffient due to low revenue autonomy and almost no expenditure autonomy (Interview Dedy 2008). If municipalities are to be sanctioned by the insolvency, they need the ability to influence their financial situation. The municipalities have this kind of freedom only to a very limited extent, since they have been assigned many tasks and are thus tied to legal requirements in a large percentage of their tasks. Unlike private companies, which can, for example, limit their production, order short-time work, reduce personnel quickly or even relocate the headquarters location, municipalities do not have these possibilities at their disposal.

on the revenue side, as well, the range of possible actions is rather limited. In particular, financially weak municipalities are to a very large extent dependent on regular grants by the Länder. Precisely these financially weak municipalities with few options for action are most likely to be affected by insolvency (Interview Wohltmann 2008). Local authorities cannot change this situation much. The municipal legislation and municipal financial resources are part of the Länder's area of competence (Werner-Jensen 2006, 32) and thus escape the immediate control of the municipalities (Klein 2005, 72).

Were an insolvency case to in fact occur, the local assets would necessarily be determined. The Potential for these assets is seen particularly in the voluntary tasks in combination with the relavent infrastructure (Borchert 2004, 2). What is problematic, however, is a clear distinction between voluntary self-government tasks and state-tranferred duties (Albers 2006, 756). Furthermore, if the insolvency proceedings restricted voluntary functions, this would dry out the field of self-responsible performance of the municipalities and thus liquidate local self-government in the affected municipalities. (Faber 2005, 945) The allocation of tasks to the local level leads to assigned municipal assets which cannot be used for the insolvency proceeding.

Another problem is that undoubtedly in most cases, an intensive budget consolidation process would already have taken place, in the course of which the sale of most of the possible assets would have been taken into consideration. After all, the insolvency would not come at a time of a large variety of possible actions. On the contrary, the debt level would be extremely high and most of the assets would have been absorbed already. There would not be much left for the insolvency proceeding. In addition, in recent years, municipalities have outsourced their assets very much and with that partly also their debts. The proportion of this "outsourced debt" in, e.g., limited-liability companies already amounted to 53.1% at the end of 2007 (Junkernheinrich and Micosatt 2008, 16).

It should not be underestimated that the credit conditions would also change depending on creditworthiness and thus on the financial sitution of the municipalities (interview Bergmann 2008). This would certainly particularly affect financially weak municipalities, which have problems anyway.

All these problems, which cannot be conclusively discussed here, show that the local insolvency will probably not be of much practical relevance. It makes little sense to introduce a mechanism which creates more problems than solutions. The expectations of that procedure can hardly be realized in the existing system. It is not surprising that in the ministries of the interior of the Länder, the introduction of local insolvency proceedings is no topic at present, and the local central associations refuse it as well.[8]

The general need for action remains nevertheless. Thus the question presents itself of how a quasi-insolvent municipality can be reorganized without local insolvency proceedings on the one hand and how the way into the debt trap can generally be avoided on the other hand.

[8] Interviews with Wohltmann; Dedy; Frischmuth; Mnich; Kirchmer; Dornig; Puhr; Stöfen; Penzenstadler-Hennig; Würger, Hoerenz; Wagenführer.

5 The state takes over the local administration - The implementation of a state-appointed commissioner by the example of the city Bad Münster am Stein-Ebernburg

If budgetary deficits cannot be fixed by rather mild actions within the realm of municipal control – or if measures of this sort are not deemed useful –, the respective Land can appoint a commissioner. These appointments are only very rarely implemented; this does not mean, however, that cases of budgetary hardship are as rare. To the contrary! Frequently, however, the budgetary problems are so extensive that the use of state commissioners is prevented either by the Länder – if they do not regard it as an appropriate measure to solve the financial problems of the respective municipalities – or by political obstacles to its applicability.

In an empirical survey of the concrete case of the town Bad Münster am Stein-Ebernburg[9], several problems were identified which can be connected to this instrument in principle and may in the end have an impact on its success. (Duve 2008b)

The main source of Bad Münster am Stein-Ebernburg's deficit was its health spa business which was run by the town itself. This business caused immense losses for a long time, which had to be covered by the town. The situation deteriorated more and more, especially since the late 1980s when the number of patients decreased significantly This trend persisted throughout the 1990s, not least because of an increase in competition of other spa resorts and as a result of federal health-care reforms (Interview Schoon 2007).

Already in the 1980s, the municipal electorate realized that trouble was ahead for BME's financial development. Ever since, the municipal electorate has tried to influence the consolidation process by means of the measures at its disposal (interview Reimann 2008). However, while the municipal electorate demanded in the late 1990s that the spa business be privatized or closed down, the town did not follow suit.

Consequently, the municipal electorate appointed a state commissioner from 17 January 2000 to 31 August 2003 who took over all competences of the municipal council and in addition also some of the mayor's. Thus, the municipality was "administered from outside" for 3.5 years.

Among the state commissioner's tasks was not only closing down the spa business but also the consistent management of the results thereof, the establishment of a stringent policy of savings and an overall improvement of the budgetary situation. (interview Bartos 2007).

[9] The town Bad Münster am Stein-Ebernburg (3,792 inhabitants) is situated to the south-west of Mainz in the administrative district Bad Kreuznach and is one of ten municipalities that make up a larger association of municipalities, also named Bad Münster am Stein-Ebernburg. For more information on the city, see www.vg-bme.de/ (Accessed on 14 March 2010)

The privatization of the spa business, the stringent policy of savings and the realization of revenue potentials, as demanded by the municipal council and implemented by the state commissioner, did not suffice to achieve a sustainable consolidation of the town's budget and to put the town back into a legitimate shape. The town's lack of power to act that had been established by the municipal electorate before the state commissioner was appointed, could not be eliminated by him.

The employment of the state commissioner also uncovered further problems regarding this measure:

Processes of budget consolidations – especially in municipalities that are deep in debt – are usually not short-term issues and far-reaching proposals that take into span several years. As state commissioners can hardly replace municipal bodies for years on end but are better-suited for temporary interventions, they can only have a limited effect on processes of budget consolidations. Their potential lies in the fact that they do not shy away from unpopular measures that local policy-makers did not dare implement.

The commissioner's job is particularly difficult if at the time of his appointment, the municipal debt already amounted to so high a sum that that even "hard" measures of consolidation could not bring about a sustainable improvement of the financial situation. Certainly even minute improvements are preferable to no improvements at all; still, it is hardly possible to balance the budget by mere means of a commissioner. Many causes of budgetary crises cannot be resolved by the short-term appointment of a commissioner; instead long-term management is necessary in these cases. The state commissioner can stimulate developments in these issues but afterwards, it is up to the municipality to follow through.

It is relevant in this context that financial crises frequently develop in the form of "creeping catastrophes". (cf. Böhret 1993, 35) In some cases, the debt builds up very slowly. The scope of action is reduced only stealthily, which limits the pressure on political actors to act and also makes it hard or even impossible for them to estimate when the financial situation might "capsize".

The empirical survey leads to the following hypothesis: As there are several legal and political obstacles to the appointment of a state commissioner in combination with a number of other measure that precede it and the fact that it is hard to detect the "right" moment for his appointment, state commissioners are usually implemented "too late". Thus, there are certainly limits to a state commissioner's effectiveness. It can be assumed that in future cases, they will continue to play only a limited role in the restoration of a well-ordered budget management (Duve 2008b).

This is accompanied by a dilemma: The chances for success of budget consolidation led by a commissioner diminish significantly, the later it is implemented. An early appointment may be imperative from a financial

perspective; however, this is in conflict with local self-government and is therefore improbable for legal and political reasons. Thus, the state commissioner, commonly seen as “ultima ratio” should not be supposed to be the last solution possible for financial problems. Rather, it is necessary to look for preventive measure that obstruct the way into the dilemma from early on, which in turn indubitably requires a change in political awareness regarding the realization of and responsibility for problems, on the levels of both municipalities and Länder.

6 Preventive approaches to avoid budgetary hardships

The problems that are connected to repressive measures make plain the limited suitability of these instruments to coping with budgetary hardships. To prevent these, measures are necessary that can strengthen the municipalities’ and the Länder’s realization of and responsibility for problems.

6.1 Systematic early diagnosis of municipal budgetary developments

The early diagnosis is to render it possible to recognize symptoms of a looming crisis in time, to interpret them and to react with appropriate measures. (Uhlenbruck 1998, 21) The municipality’s situation becomes problematic especially if the indebtedness has gained so much momentum that it cannot be stopped within the municipality’s realm of power. It is not all too easy for politicians to authoritatively identify that point, particularly as the situation of the economy – and also of the budget – can change very fast; a fact that can be witnessed at the moment.

If budgetary hardships have come up, there is only a very limited range left for supervisory bodies to act. (Fasching 1983, 34) Therefore, it is appropriate to introduce instruments that make it possible for the municipal electorate to proactively prevent the development of budgetary crises. There are only few Länder right now that pursue a systematic prevention based on key figures. Several Länder have established indicator systems for the early diagnosis of budgetary changes leading to first – mostly positive – experiences.

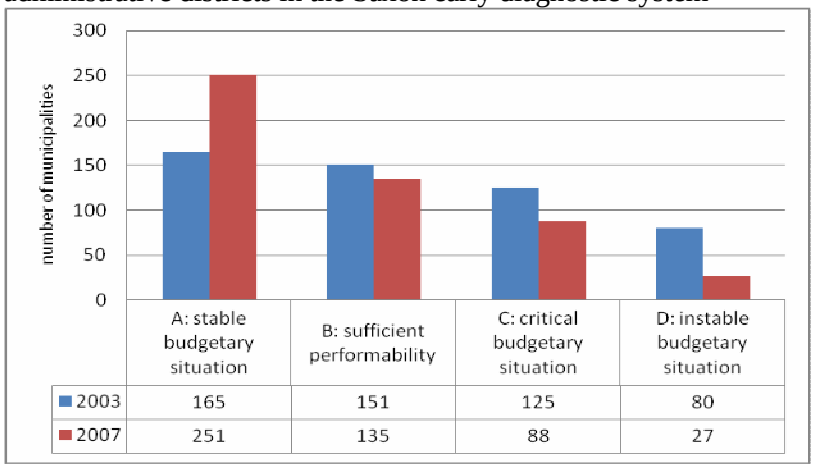
Saxony is a maverick in this as a key-figure-based system was established there as early as 2003 providing the ministry of the interior with information on the state of municipal budgets, including municipal special-purpose associations and housing corporations. (interview Dornig 2008). This practice has been adopted by Mecklenburg-Western Pomerania (Junker 2007, 396); there are also similar systems in Northrhine-Westphalia and Thuringia.

Both in Mecklenburg-Western Pomerania and in Saxony, the highest municipal electorate’s sense of missing certain developments in the budgets of municipalities that belong to administrative districts was not the least important trigger for the establishment of these instruments. The electorates were determined to beat the press to information about the budgetary problems of affected municipalities.

(interview Dornig 2008). This allows the assumption that it was not rare for the communication between different levels of municipal control to be limited resulting in too late detections of budgetary imbalances.

Ever since the early diagnostic system was introduced, the budgetary situation of many municipalities has improved significantly in Saxony (figure 1), reopening their scope of action. The decisive question is which concrete measures led to this for the early diagnostic system as such does not yet change anything about the municipalities' financial situations.

Figure 1: Development of the budgetary situation of municipalities that belong to administrative districts in the Saxon early diagnostic system



Source: Authors' own illustration; numbers provided by the Saxon ministry of the interior

The budgetary improvements were first and foremost reached by means of more intensive communication between the controlling levels. (interview Dornig 2008) As regular budget discussion were implemented, attended by representatives of all levels of legal supervision, problematic cases could not only be identified but also a modus operandi could be determined and concrete tasks could be distributed; thus, a more effective and more sustainable consolidation could be achieved. What apparently had been missing before was the control of lower levels of supervision by the top supervising body.

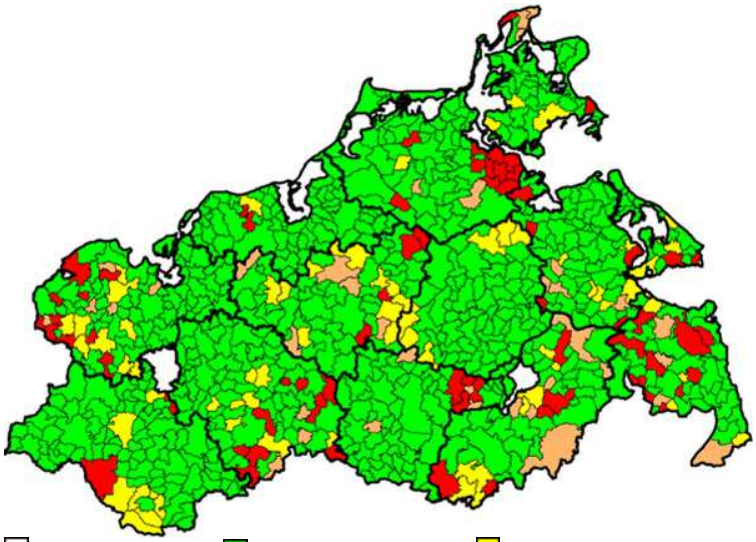
Mecklenburg-Western Pomerania published the results of the key-figure system on the website of the ministry of the interior, a step that significantly increased the system's transparency. Each municipalitiy can follow where it is classified within Rubikon[10] (figure 2); furthermore a number of key figures can be inspected that make up the foundation for the evaluation.

This transparency results in an increasing level of public discussion regarding the financial situation of particular municipalities. This, in turn, also increases the

[10] Rubikon stands for "**R**echner**u**nterstütztes Haushalts**be**wertungs- und **I**nformationssystem der **Ko**mmune**n**" [Computer-supported system of evaluation and notification of municipal budgets]

pressure to act and/or succeed both on municipal and Länder level. According to the ministry of the interior, the reactions have been consistently positive. The key figures have not been doubted in public discussion. (interview Hoerenz 2008)

Figure 2: Classification of municipalities and cities in Rubikon in 2008



Independent cities Secure performability Limited permanent performability Endangered permanent performability Lost permanent performability

Source: http://www.im.mv-regierung.de/rubikon/kreisauswertung/index2007.html (Accessed on 5 March 2010)

Furthermore, the empirical survey also showed that in Germany, these possibilities of action have not been used to their full potential. Most Länder are still only beginning to discover and implement the early diagnostic system (Duve 2009b, 578). The utilization of those early diagnostic systems that have already been established and the experiences connected with that render it possible to identify an initial set of factors of success, without which these systems would only be partially effective: currentness of data, public access to the system, communication between all levels, provision of financial aids, control. (Duve 2009a, 27)

In this context, early diagnostic systems are not only implementable by the municipal electorate but can also be used by the municipalities themselves. The data which are evaluated and made accessible by the early diagnostic system can serve the municipalities to analyze their situation, specifically in the context of other municapilities within their administrative districts or Länder. If there is a whole cluster of red-area municipalities in a district, the respective Land is challenged to find the sources for that situation. It may hint at a general underfunding of municipalities which would have to result in appropriate consequences regarding future financial allocations to and tasks of the municipalities. The party responsible in this issue is the respective Land's legislator.

6.2 Advisers and mentors as substitutes for commissioners

As has been shown, the appointment of state commissioners for the restoration of well-ordered budget management brings with it a set of possible problems; for this reason, the municipal electorate in Northrhine-Westphalia opted in some cases to introduce measures that interfere less with self-government, namely external advisers, a position that so far has been tried in Waltrop (2006-2008), Marl (2007-2008) and Hagen (2008-2009).[11] These external advisers, also referred to as mentors or advising savings commissioners by the press, are granted a comprehensive right of notification. They do not, however, have the power to direct; their task is to advise the municipalities regarding their budget consolidation providing warnings and recommendations.[12] The intention on the part of the municipal electorate is to give the municipalities the chance "to solve the budgetary problems to a substantial part by their own power."[13] The municipalities' readiness to cooperate is regarded here as a necessary condition for the appointment of such an adviser. If they are not willing to do so, the municipal electorate may consider appointing a state commissioner[14] to implement the measures that are required from the Land's perspective.

The municipality still has the possibility to mainly shape the consolidation process according to its preferences. The external advisers' success is dependent on whether their warnings and recommendations are heeded and implemented. If the municipality fails to implement the measures in the end, this might lead to a further delay of the whole process resulting in an ever graver crisis. As the readiness to cooperate is more or less forced upon the municipalities, this measure remains a balancing act between patronization and self-government.

Much depends on local conditions, the concrete sources of the debts, the size of the municipalities but also the time when the adviser is appointed. If he finds that all possible measures for budget consolidation have been exhausted without sustainable improvements, a state commissioner will not be able to ameliorate the financial situation either. In these caes, the adviser is not a stage before the state commissioner but the final stage. The situation is different if there are still exhaustable measures that are not implemented because the municipality does not properly follow the adviser's recommendations. As external advisers do not have the power to direct, these cases call for the appointment of a state commissioner to implement the necessary measures.

In all three cities, the advisers' terms have been concluded. In Marl and Waltrop, approvable concepts for budget stability could be drawn up, which had been

[11] Regarding the specific cases: www.sparkommissar-waltrop.de (Accessed on 5 March 2010); more city information under: www.marl.de; www.hagen.de; www.waltrop.de (Accessed on 14 March 2010)
[12] Justification of Münster's district government regarding the appointment of an external adviser in the city of Waltrop according to § 124 GO NRW analog, from 11 January 2006, 10.
[13] Ibid.
[14] Reply by the ministry of the interior from 23 January 2007 to inquiry 1266 from 20 December 2006, Landtag NRW, Drucksache 14/3617.

deemed unthinkable by the municipal electorate before the appointment of the advisers. Time will tell if their appointment actually brings about the desired success in the end; this also depends on whether the cities remain consistent in pursuing a sustainable consolidation strategy. In February 2009, a commission was created in Hagen, consisting of the city's political leadership and the municipal electorate to work out a concept for a balanced budget. The former external commissioner's recommendations served as a basis for this. (Jakobs 2009, 3)

Still, the "adviser approach" can only be regarded as preventive measure to a limited degree. His appointment is intended to avoid the involvement of a state commissioner, it is true. However, when an adviser is used in a commissioner's stead, the crisis must have reached an advanced stage. Thus, advisers are appointed in order to rid the municipalities of crises that exist already; because of the advanced debt dynamic, this can lead to problems similar to those connected to commissioners.

7 Conclusion

From a CEE – and generally an international – perspective, lessons that can be drawn from Germany for insolvent municipalities can be summed up as follows, always for the German context:

1. While preventing municipal insolvency is important, it may not serve as an excuse to abrogate local independence, and care must be taken to steer a middle course.

2. This is especially the issue with state-appointed commissioners: If they are sent too early in the process, they violate local independence; if too late, they cannot be effective anymore.

3. Thus, it is more sensible to focus on prevention, which is best done by the development of (mandatory) indicators that reflect imminent problems of the municipal budget. In cases where the reason for a coming insolvency is less ill will than lack of knowledge, this is indeed the most promising approach.

Of course, the complexities of a possible transfer are as immense as is the general issue of policy learning and the issue of best practices. (Randma-Liiv 2007) In addition, radical discontinuities of the nature of the current crisis (though it was by no means impossible to foresee, including effects on the public sector; see Drechsler 2009b) make extrapolations of previous experiences difficult. Nonetheless, within the discussion of how to best prevent local insolvency, it should be interesting to note, especially during times of crisis, that the German experience shows that cooperation between the local level and the coordinating and supervising one "above" is much more promising and effective than any hard-handed intervention from "above" which may also easily lead to the diminishing of

municipal autonomy, which in the end would be detrimental to the interests of the level "above" and to all citizens.

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