

**Olga Larina**  
D.Sc. (Law), Professor,  
Head of the Faculty of Theory and History of State and Law,  
Southwest State University, Kursk, Russia  
94, 50 Let Oktyabrya Str., Kursk, 305040, Russia  
lelyc@mail.ru

UDC 342.25  
**Vitaliy Kukanov**  
PhD Student (Law),  
Southwest State University, Kursk, Russia  
94, 50 Let Oktyabrya Str., Kursk, 305040, Russia  
legis-group@mail.ru

## Characteristic features of the federal state economic function content (considering economic function of the Federal Republic of Germany)

**Abstract.** The purpose of the study is to develop theoretical principles concerning the content of the economic function of a modern federal state. The economic policy of the Federal Republic of Germany in terms of state budget stabilization as one of the objectives of sustainable development is considered as the main element of the economic function and the form of the federal states' competence. The main types of the competences (rights and obligations) of the German federated states in financial and budget sphere are studied. On the basis of the conducted study, it can be concluded that the current legislation does not allow the federal states to fully implement their tasks. Introduction of the amendment called «debt brake» at the federated states level is a preventive measure aimed at initiating well-timed corrective actions to balance the budget. However, its implementation effectiveness in terms of solving the problem of budgets consolidation remains low due to the absence of the regulations providing a specific procedure for its implementation in German Federal Laws.

**Keywords:** State Economic Function; Economic Policy; Competence; Financial and Budget Sphere; National Debt; «Debt Break»; Germany; Regional Economics

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**Ларина О. Г.**

доктор юридичних наук, професор, декан факультету теорії та історії держави і права,  
Південно-Західний державний університет, Курськ, Російська Федерація

**Куканов В. В.**

аспірант, Південно-Західний державний університет, Курськ, Російська Федерація

**Особливості змісту економічної функції федеративної держави (на прикладі Федеративної Республіки Німеччина)**

**Анотація.** Ціль дослідження – розробити теоретичні положення щодо елементів економічної функції та компетенцій суб'єктів федерації. В якості прикладу розглядається економічна політика Федеративної Республіки Німеччина у світлі вирішення одного з завдань стійкого розвитку – стабілізації державного бюджету. Досліджуються основні види компетенцій (прав і обов'язків) земель у фінансово-бюджетній сфері. Робиться висновок, що чинне законодавство не дозволяє землям повною мірою реалізовувати свої завдання. Введення принципу «боргового гальма» на рівні земель – вдала профілактична міра, спрямована на коригування в випадку виникнення бюджетних дисбалансів. Однак ефективність його реалізації в аспекті подолання проблеми консолідації бюджетів залишається невисокою через відсутність у федеральному законі норм, що передбачають конкретний порядок упровадження.

**Ключові слова:** економічна функція держави; економічна політика; компетенція; фінансово-бюджетна сфера; державний борг; «боргове гальмо»; Німеччина.

**Ларина О. Г.**

доктор юридических наук, профессор, декан факультета теории и истории государства и права,  
Юго-Западный государственный университет, Курск, Российская Федерация

**Куканов В. В.**

аспирант, Юго-Западный государственный университет, Курск, Российская Федерация

**Особенности содержания экономической функции федеративного государства (на примере Федеративной Республики Германия)**

**Аннотация.** Цель исследования состоит в разработке теоретических положений о содержании экономической функции современного федеративного государства. В качестве основного элемента экономической функции и выражения компетенции субъектов федерации рассматривается экономическая политика Федеративной Республики Германия в свете решения одной из задач устойчивого развития – стабилизации государственного бюджета. Исследуются основные виды компетенций (прав и обязанностей) земель в финансово-бюджетной сфере. Делается вывод, что в настоящее время действующее законодательство не позволяет землям в полной мере реализовывать свои задачи. Введение принципа «долгового тормоза» на уровне земель – профилактическая мера, направленная на инициирование своевременных корректирующих действий в случае возникновения бюджетных дисбалансов. Однако его эффективность в аспекте решения проблемы консолидации бюджетов остается невысокой ввиду отсутствия в федеральном законе норм, предусматривающих конкретный порядок реализации.

**Ключевые слова:** экономическая функция государства; экономическая политика; компетенция; финансово-бюджетная сфера; государственный долг; «долговой тормоз»; Германия.

**1. Introduction.** The economic role which the state must play in a democratic country with market economy is probably the most fundamental issue of economy. In the context of democratic ideas and values, the policy of a state and the measures it implements should reflect public preferences and be based on public choice (Petrunya, 2012). The issues of the state economic role have become particularly important today because of the continuing financial and economic crisis, which has a direct impact on the economy of the EU countries. In this

regard, many studies of the results concerning the policies carried out by different states and the optimization mechanisms of state impact on economic relations emerged (Reinert, 1999; Tanzi, 2009). The time to rethink and specify the existing accepted conceptual approaches to the particular characteristics of the state economic function and the mechanisms of its implementation has come (Samson, 2014; Kuptsova, 2015).

The financial crisis has had a significant impact on the sustainability of national budgets of the EU member states and ne-

cessitated the revaluation of national governments activities. The researchers often do not take into account the fact that in some EU countries (e.g., Austria, Germany, Spain, Switzerland) there are several subordinate levels of governance, which have considerable competence in the field of financial and budget policy, and have a serious impact on the country's financial status.

Since 2002, Germany has been implementing a national strategy of sustainable development. Taking into account the existing financial crisis, it is extremely important to consider the state activities concerning national budget stabilization. Consolidation of the national budgets was and still is the priority of the Federal Government. Amendments to Art. 109 and 115 of the Constitution of the Federal Republic of Germany established a new permissible debt limit for the Federation and the Federated States (Lander) and set up a binding National Budget Stability Pact.

Based on the comparative analysis of the results of the theoretical researches of Russian and foreign scientists, economists and legal experts, we developed theoretical propositions concerning the content of the economic function of a modern federal state. The authors have attempted to analyze and synthesize the competences of German Federated States as the constituents of the Federal Republic of Germany in financial and budget sphere.

**2. Brief literature review.** Since the scope of this study is limited, the essence of the concepts of «economic function of a state» and «economic function of a federal state» defined by foreign and Russian researchers can be summarized as follows:

1. The specific character of certain social relations, which are subjected to the impact of the activities of the state, is considered as the main criterion of distinguishing the functions of a state (Hintze, 1962; Zagajnov, 1966; Petho, 2010).

2. From a viewpoint of a broadside approach, the economic function is construed as one of the national objectives, which shall be implemented by a state (Pashkov, 2012). Economic function, being both an object and an objective, determines the existence of a state as a whole. Process approach to the concept of «economic function of a state» requires it to be personalized: it is necessary to have an executor with certain competencies (rights and obligations). Different levels of a government can act as such executors (Manuel, 2014). The competence of a government in the economic sphere is limited to ensure the effective execution of economic function (Cserne, 2007).

3. Economic policy varies depending on the stage of state development and is defined by the specific character of the state's presence in market economy, maintaining its focus on performing a unified stable economic function (Pierson, 2004; Pashkov, 2012; Alberto et al, 2006).

4. Government economic policy covers the content of economic function and expresses competencies (rights and obligations) of a federation and its constituent federated entities (and local authorities) in terms of achieving the national development goals. A three-level government, i.e. a federation, states / provinces / lands and local authorities, is common to all federal systems. Despite the fact that the place and the role of the federation and its constituent entities vary considerably in different states, the federated states play a significant, and sometimes a primary role in economic policy development and implementation (Milyukov, 2006; Sokolova, 2007).

**3. The Purpose** of this study is to develop theoretical principles concerning the content of the economic function of a modern federal state and to analyze the economic policy of the Federal Republic of Germany as the content of the economic function and the expression of the competencies (rights and obligations) of federated states in terms of state budget stabilization as one of the objectives of sustainable development.

**4. Results.** In the Basic Law for the Federal Republic of Germany (Grundgesetz für die Bundesrepublik Deutschland, the Constitution of the Federal Republic of Germany), the sharing of the competencies of the Federation and the federated states is connected with interdependent functions of the Federation. The principle of the federal structure is constitutionally protected: Article 79 (3) of the Basic Law stipulates that «law affecting the division of the Federation into Lander, their participation on principle in the legislative process, or the principles laid down in Articles 1 and 20 shall be inadmissible» (Basic Law

for the Federal Republic of Germany). Therefore, it can be concluded that the state structure (form of government) as well as the principles of the participation of the Federation and its constituent entities in the legislative process cannot be changed.

In comparative perspective, Germany is often regarded as a typical example of «cooperative federalism». However, German legal experts emphasize the vertical dimension of inter-governmental relations (Benz, 2009). Accordingly, a characteristic feature of the forms of the structure of the Federal Republic of Germany is, principally, the interdependent relationship of federal and regional governments (Watts, 2008). In fact, the so-called «Politikverflechtung» (interlocking politics or joint decision-making (Scharpf, 1997)) mainly refers to the federation-federated states (German «Lander») relationship in Germany.

The assessment of the national policy carried out in the sphere under consideration allows applying spatial development theory and identifying high quality economic space (Van-chikova, Chimitdorzhieva Gantamarov, 2012).

The distribution of the competencies and responsibilities between the Federation and the Lander in Germany are set out mainly in the Basic Law. In fact, Germany has three levels of administration: Federation, the Lander and municipalities. However, this structure is not specified clearly in the Basic Law. Thus, for example, the German Constitution stipulates relatively clear provisions that establish the rights and obligations in the area of budget costs and revenues for only two levels of governance, i.e. the Federation and the Lander. At the same time, the Lander plays an important role in lawmaking in the financial and budget sphere. Participation of the Lander in lawmaking and specific decision-making powers in the financial and budget sphere, as well as a certain degree of their financial independence (the latter is established not due to the tax autonomy of the federated states, but due to the possibility of contracting independent loans) is another characteristic feature of German federalism.

The distribution of federal tasks is of purely functional character (Buscher Daniel, 2010). The Basic Law distinguishes between the general and exclusive legislative powers. Most of the legislative powers are centralized, while the federated state governments are generally empowered to implement federal laws. Thus, the German Federal Government require the Lander authorities to be competent in lawmaking, and the federated states governments, which shall have administrative competencies in federal legislation, shall participate in the process of lawmaking (Hildebrandt, 2009). The Lander uses their legislative powers solving any financial problems except the cases, which come under the jurisdiction of the Federation according to the Basic Law.

Section X «Finance» (Art. 104-115) of the Basic Law defines the competencies and responsibilities between the Federation and the Lander. In this regard, it is important to note that, in practice, the Federation has a major part of the legislative powers; the rights to distribute the revenues are divided between the Federation and the Lander, as a rule (Basic Law for the Federal Republic of Germany).

Federal and Lander governments coordinate their financial and budget policies in the Financial Planning Council (Finanzplanungsrat) and the Trade Cycle Council (Konjunkturrat). These bodies were created in the late 1960s in order to coordinate medium-term budget planning and government borrowings at the federal, federated state and municipal levels. Their decisions are not binding, but include guidelines for decision-making (Petrunja, 2012). Currently, the coordination of decision-making is considered as ineffective, but it should be noted that a significant share of tax revenues in Germany is determined by a joint decision-making, i.e., by a federal law requiring the Bundesrat consent. Moreover, to some extent, the Federal Government can influence the amount of the federated states minimum expenditure level through subsidies. There are some «extreme» viewpoints that the federated states are incapable of forming budgetary policies concerning expenditures. However, this is not a case because, for example, the Federation determines only about 11-25% of the federated states expenditures (Seitz, 2008). Even if we accept the independence of the federated states in their budgets management as a given, their autonomy in terms of allocating budget expenditures is limited to a great extent, i.e. de facto, the Lander autonomy is undermined by the legislative powers of the Federation (Buscher & Daniel, 2010).

With regard to income generation, except in certain cases (for instance, only Lander manage some taxes, e.g., property taxes) the situation is similar. Despite the existence of the veto power, for federated states really autonomous decisions concerning joint taxes are often reduced to income tax and value added tax (VAT), which are only 3-8% of federated state budgets according to various estimates (Deutsche Bank Research, 2011). In general, tax sharing between the different levels of government in Germany has remained relatively constant for the last fourteen years. The Federation and the Lander generate almost equal amounts of tax revenues. However, the share of the Federation is steadily decreasing. Consequently, the fiscal role of the Lander is growing. This process results in making and enacting laws to revise and amend the Basic Law, in particular, to divide tax revenues and to create a financial equalization system.

Intergovernmental relations in Germany as in any federal system developed in parallel with providing federal subsidies to federated states. In 1969, the amendments made to the Basic Law regulated the distribution of subsidies and introduced a constitutional basis for common objectives. Currently, vertical intergovernmental relationships dominate in the German federal system, and horizontal relationships between the federated states are embedded into them. Lander governments coordinate their financial and budget policies through the negotiations with the Federal Government and forming a coalition against the Federal Government. However, the territorial and political fragmentation is «balanced» to some extent by the cooperation of public officials interested in solving specific problems and financing their programs. The strong influence of the integration of political parties and administrative networks explains why Germany is rightly called the country of unitary federalism (Hesse, 1962).

In the case of Germany, horizontal intergovernmental relations should not be underestimated. Firstly, they exist in those areas of governance, in which Lander have exclusive powers, e.g. education and culture. Secondly, the governments of neighbouring Lander cooperate with each other to coordinate their policies, enhancing their cooperation in order to advance their positions within the federal system through joint efforts.

Introduction of the «debt brake» amendment at the Lander level is recognized as the first effective preventive measure aimed at initiating timely corrective actions in case of budget

imbalances. Since the beginning of this year «debt brake» has restricted normal situation and the highest allowable national debt to 0.35% of GDP, and by 2020, any federated state debts will have been forbidden. The provisions of Art. 126 of the Treaty on the Functioning of the European Union [8], which oblige EU Member States to avoid budget deficits, were incorporated in the German Act on the Principles of Federation and Lander Budgetary Law, 1969 (Art. 51) during the second 2009 federal reform (Act on the Principles of Federation and Lander Budgetary Law). Some of the Lander (Berlin, Bremen, Saarland, Saxony-Anhalt, Schleswig-Holstein, etc.) have integrated incrementally relevant provisions into their regulations, and are reducing gradually the structural budget deficit. Regarding other Lander, the discussion on the implementation of «debt brake» is being still continued. In this case, the fact that the Basic Law does not specify exactly how the Lander shall implement «debt brake», how to calculate the cyclical deficit, and others issues are of great importance. In addition, from a legal viewpoint, the principle of «debt brakes», apparently, is not applicable to municipal budgets (Berlit, 2010). Taking into account the debt growth in some municipalities in different Lander, a reasonable question arises: can the financial transfers between the Lander and the municipalities lead to undesirable consequences for the budget consolidation objectives and elimination of budget deficit imbalances?

**5. Conclusion.** Federal political structure has dynamic and functional character. Efforts to reform the Federal Constitution which have been carried out in Germany since 2003 confirm this conclusion. Giving proper respect to German legislators' attempts to decentralize legislative powers, it should be pointed out that they failed to change significantly the institutional framework of cooperative federalism. Besides, the regionalization of the German finance and budgetary policy as part of the development of the horizontal inter-budgetary relations integration destabilizes the integration field of administrative relations and eliminates the efforts in achieving uniformity of German legislation. The effectiveness of the amendments introduced into the Basic Law and Federal laws is largely due to the degree of the federated states readiness to integrate these changes into their laws and to comply with the unity of Lander and municipal approaches to implement these laws.

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