Solidarity Pact I (March 16, 1993)

Abstract

In March of 1993, representatives of the federal government, the parties, and the minister presidents of the *Länder* [federal states] agreed on the so-called Solidarity Pact I, which took effect in 1995 and remained in force until 2004. It replaced the German Unity Fund and made various special federal government funds available to boost the economic development of the new states. The agreement provided for a number of measures, including the introduction of a solidarity surcharge and the revision of the State Fiscal Equalization Scheme. The response from the German press was critical. The Solidarity Pact II, negotiated in 2001, took effect in 2005 and will remain in place until 2019.

Source

The Agreement on the Solidarity Pact

During a closed conference, which brought Chancellor Kohl, the leaders of the parties and parliamentary groups, and the minister presidents of the federal states together at the chancellor's office in Bonn from March 11–13, a basic agreement was reached on the extent and details of the Solidarity Pact as a package of measures to finance the repercussions of German reunification. The parties agreed on the imposition of a solidarity surcharge of 7.5% on the income tax, effective January 1, 1995 (this was to generate additional income of 28 billion Marks for the federal government), an increase in the private wealth tax with a simultaneous raise in the exemption, and the renunciation of the originally planned cuts in statutory social benefits and funds for job creation measures in East Germany. The points were included in the "Federal Consolidation Program" in the form now agreed upon or introduced into the negotiations as the basis for discussion; in March, the federal government passed the program, which envisaged savings of 18 billion Marks. In the current negotiations, the Social Democrats were unable to push through their demand for the introduction of a labor market levy. The Federal Labor Office in Nuremberg will receive an additional two billion Marks to allow it to reverse a freeze on authorizations for job creation measures (JCM) imposed in February; these funds will pay for 225,000 JCM jobs in the new federal states and 20,000 in the old states. The new federal states will be integrated into the federal financial system as equal members beginning in 1995. Representatives from all parties had positive things to say about the compromise that was reached, and the East German minister presidents expressed satisfaction with the revision of the State Fiscal Equalization Scheme, which, they maintained, would make the work of reconstruction easier, while the heads of government of the old [i.e., West German] states were of the view that the arrangement that had been achieved was acceptable, that the financial unity of Germany had been placed on sound footing from 1995 on, and that citizens no longer had to live with uncertainty about additional financial burdens that were coming.

The plan calls for the federal states to receive 44% instead of the previous 37% of sales tax revenue beginning in 1995; in this way they will receive around 55.8 billion Marks a year in fiscal equalization transfers and an additional 2.8 billion Marks in services to retire old debts in the area of East German housing construction, and – from the Credit Institute for Reconstruction – around a billion marks in lower interest rates to boost the program for housing modernization. However, the federal government foregoes a share of the sales tax only on the condition that it succeeds in saving additional expenses to the tune of 4.35 billion Marks, a sum that was previously supposed to come from an across-the-board cut in social services.

The Ten-Point Paper agreed upon in Bonn states: "Financing German unity in difficult overall economic times necessitates a considerable effort by the federal government, the states, and the municipalities to provide the economy with reliable basic data. That requires that Germans endeavor to express solidarity. There is agreement among the parties involved about the long-term financing of German unity beginning in 1995. The basic points of this agreement are:

1. The funding of the new states and their municipalities is guaranteed through a transfer of 55.8 billion Marks in 1995. In addition, the allocation of finances between the federal government and the states will be newly regulated.

2. Additional efforts shall be made to eliminate inherited ecological problems and to secure and renew the industrial cores. With this goal in mind, the credit framework of the *Treuhandanstalt* [*Trusteeship Agency*] will be expanded.

3. With a view toward promoting the sale of products from the new federal states, the suitability of appropriate instruments and the financial means needed in connection with this shall be assessed.

4. There is fundamental agreement about the necessity of reforming the railroad.

5. The following is agreed upon to strengthen housing construction in the new states:

– A solution to the question of inherited debts in housing construction could be reached: a cap of 150 Marks per square meter; the corresponding cap amount of 31 billion Marks will be added to the fund for inherited burdens. Revenue from housing privatization will be used to cover the corresponding burdens in the fund for inherited burdens. The relevant interest rate subsidies amount to 4.7 billion Marks (1994) and 2.35 billion Marks (1995), half of which will be borne by the federal government and half by the new states.

– As long as housing companies cannot yet be entered into the real land registry as owners, transitional guarantees will be granted.

– The Credit Institute for Reconstruction program of the federal government will remain at 30 billion Marks. Ten billion of that will be used to improve prefabricated apartment blocks with an interest rate reduction of three percentage points; for the remaining 20 billion Marks there will be an interest rate reduction of two percentage points.

– The improvement in the environment surrounding the housing will be continued within the framework of the promotion of urban construction in the East.

– The law for the economic promotion zone will be extended for two years for housing construction investments in private assets (50% special deduction in the first five years).

6. To stabilize an active labor market policy over the course of 1993, the federal government will make an additional two billion Marks available.

7. Statutory social services will not be cut. Abuses in the area of social and economic services will be vigorously combated.

8. There is agreement that cuts in spending and the dismantling of tax subsidies must generate savings of nine billion Marks.

9. With regard to the introduction of the solidarity surcharge of 7.5% on January 1, 1995, there is agreement that a social component over and above the exempt amount is envisaged. The private wealth tax will be increased, with an adjustment of the exempt amount from 70,000 to 120,000 Marks. There is agreement that, as a result, the federal government will have an additional 28 billion Marks at its

disposal in 1995.

10. With respect to the financial needs of the new federal states, there is agreement that, for 1993, the federal government and the old states will make their excess revenues from the Interest Income Tax Act (855 million and 1.3 billion Marks, respectively) available [to help] here. An additional 1.55 billion Marks will be made available, namely by the federal government and the old states in equal parts. All in all, an additional 3.7 billion Marks will be made available to the German Unity Fund in this way in 1993. To stabilize the revenue from the German Unity Fund in 1994 as well, the federal government and the old states intend to raise additional funds. This shall be deliberated by the group of finance ministers, with the goal of arriving at a decision by the chancellor and the heads of government of the states. The federal government will contribute an amount of 5.35 billion Marks during these deliberations among the finance ministers. The old states are assessing whether they will provide additional amounts over and above a pledged amount of 3.5 billion Marks.

Critical statements in the media and from politicians referred above all to the additional financial burdens for the federal government, which originally demanded that it receive a higher share of sales tax revenues and must now accept even a reduction from 63 to 56%; by contrast, the old federal states had been spared extensive additional burdens. The "Unity Front of the sixteen old and new states" [*Handelsblatt*] vigorously opposed the federal government and pushed through the majority of its demands. The weekly *Die Zeit* saw a "missed opportunity" and wrote: "The self-praise of those involved sounded boastful – and hollow: the solidarity pact is no proof of political creativity. Still missing is a convincing concept of how the economy in the East can finally be invigorated and the economic downturn in West Germany can be halted. With resolute action, the political leadership could have pulled the ground out from underneath the citizens' moroseness. But the compromise package does not do justice to even the most urgent necessities. Anyone who wants to be content with what has been achieved despite this must put the bar pretty low. In and of itself, clarity about the fact that a solidarity surcharge will first be imposed on January 1, 1995, that is, not during the recession, does not justify a positive verdict on the overall package. […] Just how little creative energy was invested is evident in the fact that, once again, the round of politicians could only come up with one way to finance new and sensible expenditures, like the housing construction program for the new states: debts and more debts. Of all the good intentions – saving and re-allocation – only traces, at best, are visible in the Solidarity Pact."

Source: "Die Vereinbarung über den Solidarpakt", *Archiv der Gegenwart*, March 16, 1993, pp. 48032–36.

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