Public Investment across Levels of Government: The Case of Brandenburg, Germany

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Key messages

- In an environment of limited autonomy over public investment spending, Brandenburg has maximised the use of its discretionary funds to invest in regional development through bundling sources of financing and establishing cross-sectoral policies.
- Despite few established processes to foster horizontal collaboration across Germany’s Länder, Berlin and Brandenburg have joined forces in key areas of collaboration.
- Brandenburg has encouraged horizontal collaboration across local governments.
- Challenges may arise in the future as EU structural funds and funds from Germany’s Solidarity Pact will significantly decrease.
- Overall, Brandenburg’s existing economic development challenges, marked by the reunification process, must continue to be addressed.
1. Regional overview

1.1. Political context

A former East German Land, Brandenburg became part of the federal republic in 1990. It borders Poland to the east and entirely surrounds Germany’s capital, Berlin. The metropolitan region of Berlin-Brandenburg would consist of 4.8 million inhabitants, but a debate that has been underway since Germany’s unification has prevented a formal merger between the two Länder. Although the Länder Parliaments and the citizens of Berlin were in favour of a merger, the citizens of Brandenburg voted strongly against it (63%). Their concerns include a feared loss of funds from the central government to Berlin, limited decision-making power against a strong core metropolis, and sharing the responsibility for Berlin’s budget issues. Despite the reluctance to merge, the two Länder have developed very close collaboration across different areas. This case study will highlight a number of them.

1.2. Institutional background

Brandenburg is one of 16 German federal states (Länder). It is headed by the Prime Minister, who is appointed by the Land’s Parliament (Landtag). The Land has an indirectly elected executive under the Prime Minister and his Cabinet. The Cabinet participates in federal legislation through the second chamber of the federal legislative assembly, the Council of Constituent States (Bundesrat), which is comprised of the representatives of all German Länder who cast their (weighted) votes conjointly.

The administrative layers of Brandenburg include districts (Landkreise) and municipalities (Gemeinden). There are 14 districts and 4 district-free cities, one of which is the capital, Potsdam, with about 155 000 inhabitants. For regional planning purposes, Brandenburg is split into five sub-regions or regional planning associations of municipalities, which correspond to the OECD TL3 level. Finally, there are a total of 419 municipalities (Kommunen or Gemeinden) in Brandenburg, down from 1 696 in 1995.

Municipalities’ tasks are prescribed by each state’s developed communal code. Local governments in Brandenburg are self-governing entities with a legislative local council and an executive mayor, both directly elected by the citizens. Municipalities in Brandenburg have three types of tasks. The first type includes tasks described in the code. This includes the local registry, the administration of living and social subsidies, construction planning and the administration of municipal elections. The second type of tasks is again obligatory, but the municipalities can decide how to fulfil them. This includes, for example, waste management, spatial planning, provision of day care. Finally, there are tasks for which the Land has a controlling function, including libraries, museums, retirement homes, traffic and others.

The districts are responsible for cross-municipal tasks, i.e. tasks for which collaboration across municipalities is necessary. This includes core tasks, such as transport systems, museums, nature reserves, district roads or waste management. In addition, this could include, among others, hospitals or primary schools. In principle, a district can oblige a municipality to take responsibility for certain tasks that fall under the auspices of the district.

The Joint Tasks (Gemeinschaftsaufgabe) are a key contract marking a long-established collaboration between the Länder and the central government. The broad policy areas covered by this contract are regional economy, extension and construction of higher education facilities, improvement of the agricultural structures and coastal areas, labour market tasks, IT infrastructure and the environment. This could be tasks related to, for example, regional development, R&D or the evaluation of the performance of the education sector. This key instrument for vertical co-ordination will be further addressed in Section 3.

Despite the core federal structure that marks the Länder, they have limited direct authority. Länder have de jure legislative powers, but it is often the central government that passes the laws they have to
As compensation for the increasing power given to the central government, the Länder have gradually received greater powers in the Council of Constituent States (Bundesrat). The tasks assigned to Germany’s Länder include: i) compensation of civil servants (including teachers); ii) regional roads; iii) regional hospitals; iv) regional museums; v) provision of judiciary bodies (administrative, regional and district courts); vi) police; vii) culture, sports, education; viii) spatial planning; and ix) water management.

1.3. Socio-economic background

Low population density and a continuously decreasing population have shaped Brandenburg socioeconomically. With its close to 2.5 million inhabitants, Brandenburg ranks 10th in terms of population, and second to last in terms of density compared to other German Länder. Like its eastern peers, it has suffered a large population decline since unification. This dynamic has been further reinforced since 2000 due to people moving to Berlin. Projections estimate a further 5.8% reduction over the period to 2036 (Bertelsmann, 2011). The Land’s migrant population is relatively smaller than the German average, namely 2.6% with an additional 5% having a migration background (compared to the German average of 19%).

Brandenburg’s economy has been marked by its transition from a closed communist economy to a fully open market economy following German unification. The transition caused a 56% fall in industrial production within one month in December 1989 (OECD, 2012). Around 1 million jobs were lost by 1995. Brandenburg has consequently suffered from a modest capital investment. The transition also led to a reliance on transfers and subsidies from the central government and the European Union.

Brandenburg’s export sector could potentially contribute significantly to the state’s economic development. Brandenburg accounts for 2.2% of Germany’s GDP. Although its export share is 21%, most of it is captured by a few big companies, such as Rolls Royce. Small companies have difficulties in achieving the necessary scale to join the export business. Energy is an important export sector: 50% of its production (from ignite) is exported, whereby 60% of local energy consumption is based on renewable energy (25% solar, 66% wind, the remaining 9% biomass). Chinese competition in renewable energy technology threatens to drive Land producers out of the market.

Challenges in terms of economic development continue to exist. The Land’s unemployment rate, as well as youth and long-term unemployment rates, are around 2% higher than the German average. The low proportion of major companies and the high proportion of small and very small businesses could be a bottleneck to productivity gains in the future.

However, Brandenburg has a lot of potential. First, the Land disposes of significant human capital, with only 5.3% low-skilled workers (compared to the national average of 11.1%), and 31% high-skilled workers (compared to 28.1% nationally), despite the transition period, during which many of them left. A number of higher education facilities, coupled with a significant density of scientific institutions, have contributed to this dynamic. Secondly, Brandenburg has very good public infrastructure, particularly benefitting from central government subsidies provided through two “Solidarity Pacts” for large-scale infrastructure projects, including the Berlin-Brandenburg International Airport, an exhaustive road and freight distribution network.

1.4. Main strengths and challenges for Brandenburg

In an environment of limited autonomy over public investment spending, Brandenburg has maximised the use of discretionary funds to invest in regional development through bundling sources of financing and establishing cross-sectoral policies. It combines sources of funding from central level Joint Task transfers, EU structural funds, as well as other regional revenues it has discretion over, and aligns budgetary,
procurement and monitoring processes. In addition to or through this mechanism, it has been able to foster an integrated regional development policy process, thereby maximising the benefits to the region of the available discretionary spending.

Despite few established processes to foster horizontal collaboration across Germany’s Länder, Berlin and Brandenburg have joined forces on key areas of collaboration. The vertical co-ordination mechanisms between the central level and the Länder often impedes the Länder to collaborate on public investment projects because they compete for funding. Despite this, Berlin and Brandenburg have established successful collaboration, contributing to overall regional economic development. These successful collaborations include a joint planning department, a joint innovation strategy, joint R&D projects and collaboration on transport infrastructure projects (such as the integration of the ground transport network or the ongoing construction of a joint airport).

Brandenburg has greatly fostered horizontal collaboration across local governments. Local collaboration has been encouraged through various instruments. Economic development strategies have fostered collaboration (e.g. through establishing preferential dialogues with the regional government or prioritising funding access) across localities in so-called growth centres, of which there are 15 in Brandenburg. Flexible collaboration under working groups has been encouraged in the areas of urban regeneration, tourism and wastewater management. More formal collaboration has been financially encouraged in the transport sector, thereby capturing positive local spillover effects. Finally, collaboration or integration of local municipal administrations has been financially incentivised, whereby the more integrated (from a collaboration on a task up to a complete merger of administrations) the collaboration, the higher the funding is for the collaborating municipalities.

Challenges may arise in the future as Brandenburg’s discretionary budget will significantly decrease, co-funding requirements will increase and the size of the administration will shrink. As the region is catching up in comparison to all other EU regions, EU structural funding, which amounts for around 5.5% of its budget and hence half of its discretionary spending, is expected to decrease significantly in the next funding period from 2014 onwards (by around 50%). In addition, central level transfers, especially through Joint Tasks, will decrease as well. Likely increasing co-funding requirements from the EU could further aggravate the situation. Equally, Brandenburg has benefited from contributions of the second Solidarity Pact of additional transfers through the fiscal equalisation process to the new German Länder. This funding will decrease until it is phased out in 2019. All of these dynamics will require the region to find alternative financing mechanisms, potentially increasing the role of the private sector, and ways to continue fostering regional development through innovation.

Overall, Brandenburg’s existing economic development challenges, marked by the reunification process, must continue to be addressed. The initial economic shocks and significant population decline have challenged economic development. Although the economy has caught up significantly over the past two decades, challenges in terms unemployment and larger business development remain.

2. Public investment in the region

2.1. Background

The German economy was badly hit by the financial and economic crisis in 2008 and 2009. Real GDP growth declined from 3.3% in 2007 to 1.1% in 2008, and turned negative (-5.1%) in 2009. The downturn was chiefly the result of a sharp fall in exports and investment; household consumption was roughly stable, albeit with zero growth in 2009. Government consumption was anti-cyclical, growing at 3.1% and 3.3% in 2008 and 2009 respectively. This helped to prepare the ground for recovery in 2010 and 2011, especially by strengthening household consumption and reviving the fixed capital formation.
In order to cushion the shocks of the crisis, the federal government initiated stimulus programmes. Among other things, it released about EUR 10 billion for local public investment, in addition to EUR 4 billion for investment by the federal government. Moreover, the government acted to accelerate the spending on public investments by deregulating and simplifying procurement procedures. The policy was combined with a number of measures to stimulate private demand, both of households and companies. The support programme for municipal investments was a key element in sustaining local investment budgets.

After the initial stimulus phase, policy shifted towards the consolidation of public finances. The balance of the consolidated general government budget, which had reached −4.3% of GDP in 2010, improved in 2011 to reach a more comfortable level of −1.0%. Moreover, on the recommendation of the Commission on Federalism, and in view of the level of consolidated public debt, a “debt brake” was introduced into the federal Constitution (Grundgesetz) in 2009. Its purpose is to ensure that sub-national public budgets are financed without any structural deficits from 2020 on, with only a small structural deficit allowed for the federal budget. In addition, a new institution, the Stability Council, was established to survey all public budgets on an annual basis using common benchmarks to monitor public borrowing and to co-ordinate medium-term financial planning across levels of government.

2.2. Evolution of the financial capacity of Brandenburg

How has the operating surplus evolved?

Brandenburg’s budget was affected by the crisis. Before the crisis Brandenburg had a balanced budget, i.e. the government was able to finance capital spending from the current surplus and from capital revenue, in particular capital grants. This balance was disturbed when the crisis hit the current balance through falling tax revenues. During the recovery, Brandenburg’s public finances improved, as reflected in the strengthening of the current surplus, but the government also consolidated its capital budget to help redress the total budget deficit. By 2011, Brandenburg had restored its total budget balance, thus avoiding additional borrowing in the capital markets.

Figure 1. Development of the budget, current and capital balance of Brandenburg before and after the crisis


On the revenue side, Brandenburg’s finances were severely affected by the financial and economic crisis (see Figure 2). With about 60% of current revenue derived from taxes, the tax-sharing arrangements link Brandenburg’s budget intimately to the business cycle. Tax revenues fell sharply in 2009. Transfers declined somewhat continuously until 2011, reflecting falling transfers from other regions and a decline in
Brandenburg’s population. Capital transfers, by contrast, rose strongly during the crisis, reflecting in particular the central government’s anti-cyclical policy stance.

Figure 2. Development of revenue and its composition of the government of Brandenburg

![Graph showing revenue and composition over time]

*Source: Landeshaushalt Brandenburg, Ministry of Finance.*

Local government budgets were also affected by the crisis. Municipalities’ own resources consist of revenue from a tax on local businesses, a property tax, a share of the personal income tax, and smaller local taxes, user charges and fees. Hence, in contrast to the Land government, whose finances hinge on the national economic climate through VAT sharing, municipal finances depend more on the regional/local economy. The local sector in Brandenburg could almost maintain its level of current revenue bringing the 2011 level back to that of 2008, with some reduction in the interim. Taxes fell by -6.5%, but the increase in other current revenues more or less compensated for this revenue loss. Revenue for capital purposes experienced a significant drop, bringing the budget balance of Brandenburg’s local sector to a small deficit of -0.9% in 2009. The federal programme to combat the recession, which had its main impact in 2009 and 2010, is an important factor for explaining the revenue position of local governments in Brandenburg during the crisis.

What will the future look like?

Brandenburg will have to confront a few key challenges due to significant reductions in future funding. First, EU structural funds to Brandenburg are expected to decrease by up to 50% in the funding period starting in 2014. In addition, federal funding through the Solidarity Pact and specialised funding mechanisms such as the Joint Tasks will decrease as well. These sources of funding make up the lion’s share of Brandenburg’s discretionary spending. In addition, transfers received from the second Solidarity Pact as part of Germany’s reunification process will continue to decrease until they are phased out in 2019. Significant funding gaps could arise, particularly affecting regional development activities. The region will have to find innovative ways to access financing, perhaps tapping into the potential of private sector involvement in financing public investments and services.

Expenditures

Generally speaking, Brandenburg’s main expenditures are on administration and education. The structure of government expenditures by function is based on budget allocations to administrative units (ministries). This only presents an imperfect picture of spending, since ministries often regroup different responsibilities, some of which overlap (e.g. social policy), and there is a large residual comprising not only the general administration, but also the police, courts and finance. Given these caveats, the structure of regional expenditures by sector in 2011 was dominated by general administration (50%), education/youth/sports (14%) and science/research/culture (6%).
Brandenburg’s budgetary autonomy is fairly limited. The majority of total spending is mandated, i.e. it cannot be modified in response to the crisis, as it represents legal or contractual entitlements such as wages and salaries and/or social transfers. The potential for adjustment therefore mainly lies in capital spending (Figure 3). Personnel costs could be reasonably controlled in 2009 due to a wage freeze imposed by regional authorities. However, the wage bill rebounded in the following year. The longer term goal of downsizing the administration did not dominate the policy response in the short run. Debt service declined as a consequence of lower interest rates, as did current transfers to households and companies. Due to the federal anti-cyclical programme capital spending increased during the first phase of the crisis but could not be maintained the two following years. Public fixed capital formation in the region was also sustained through co-funding from the federal government and EU support on the basis of the operational programmes. Although these funds are embedded in longer term perspectives and are reasonably robust to cyclical variations, they are expected to decrease in the future with the phasing out of the Solidarity Pact and a reduction of EU structural funding for Brandenburg.

![Figure 3. Development of expenditures by type](image)

*Source: Landeshaushalt Brandenburg, Ministry of Finance.*

The federal anti-crisis programme pursued long-term structural objectives, which were conveyed through the earmarking of block grants. The federal subsidy was leveraged to EUR 457.1 million due to co-financing requirements for regional and local governments. Secondly, 70% of the financing was mandated for municipal infrastructure development; Brandenburg increased this share to 84%. The law required a minimum of 65% of the support to go to educational infrastructure, the rest to other types of infrastructure. Finally, the *Land* government used the programme to top up the funding for less economically developed areas, demonstrating its desire to address spatial inequalities.

### 2.3. Borrowing capacity

Brandenburg has limited borrowing capacity. Generally, the level of Brandenburg’s public debt (see Figure 4), including that of its municipalities, is at the average national level if measured in per capita terms, and slightly above average as a share of regional GDP. This has not changed during the crisis. Nevertheless, the authorities of Brandenburg consider the borrowing capacity of the region limited and made sensible use of borrowing during the years of the crisis. During 2008-2009 the redemption of debt was higher than new borrowing from capital markets for both the *Land* and local governments in Brandenburg. However, this was offset to some extent by higher cash credits, which rebounded in 2010, especially for local governments. Given a certain inflexibility of current spending and a policy of sustained capital expenditures, borrowing therefore proved to be the main budget stabiliser for regional and local budgets during the crisis – in addition to the transfers received from the EU and the federal government.
Figure 4. Development of public debt in Brandenburg (2007-2010)

EUR millions

Sources: Amt für Statistik Berlin-Brandenburg; Statistisches Bundesamt, Fachserie 14, Reihe 5, 2010, p.82.

Borrowing instruments

Borrowing instruments vary considerably between the Brandenburg government and local regional authorities (see Figures 5 and 6). Whereas the German Länder, including Brandenburg, make frequent use of bond issues, which are highly rated, local governments’ main borrowing instrument is the bank loan, often from local banks of which they are the owners. Similarly, the Land may mobilise resources through its regional investment bank (Investitionsbank des Landes Brandenburg – ILB). There is hence some “connected borrowing” in the German public sector. Brandenburg is no exception. Moreover, local governments may borrow from regional and other local governments. Municipal bonds are not used.

Given the low level of short-term interest rates, there is a tendency to bridge financial gaps through short-term borrowing (Kassenkredite), particularly in the local sector. This tendency was prevalent even before the crisis and may reveal deeper structural problems of local finances. However, compared to other German municipalities, local governments in Brandenburg are making modest use of this financial instrument.
The maturity of new debt (except cash credits) is rather favourable in Brandenburg. About 97% of municipal borrowing in 2010 had a maturity of over five years. This ratio was 33% for the Land, but it could finance about 59% of its borrowing needs with maturities ranging from one to five years.

Other liabilities include guarantees and local leasing contracts. At the end of 2010, the regional government of Brandenburg had issued 17.6% of its current revenues in guarantees to financial institutions to support private sector activities; the comparable figure for Brandenburg’s municipalities was 7.7%. In addition, districts and municipalities of government in Brandenburg had debt-like commitments from finance-leasing projects and public-private partnerships (PPPs) of a combined total of EUR 123 million. These instruments are therefore of minor importance for public investment policy in Brandenburg, although private companies are in some cases integrated into service delivery as operational agents.

3. Co-ordination for public investment across levels of government

3.1. Vertical co-ordination between the Land and higher levels of government (central and supranational levels)

The central level has a decisive role in determining public investment priorities for the Land. In a number of sectors there are co-ordination mechanisms between the Länder and the centre of government to determine investment priorities through a common platform. This includes, for example, the water and science sectors, but also regional development through the so-called “Joint Task for the Improvement of Regional Economies” (see Box 1). Following the setting of priorities, the central level develops the co-ordination framework, which sets out the requirements attached to central level funds transferred to the Länder for the sector’s public investment. The regional level survey suggests that the role of the centre in defining the co-ordination framework and EU regulations and procedures (on state aid and cohesion policy) is seen as a significant inhibiting factor to the Land’s freedom in implementation.

The central government frequently uses requirements as an instrument to co-ordinate and implement public investment projects at the Land level. The most frequent requirements attached to federal funds include: timeframes (funds are allocated annually over three years and annual funds need to be spent by the end of the year), additionality and matching requirements, ex ante evaluation (cleared/verified by the ILB), thematic priorities, private sector inclusion (infrastructures that are important for businesses are pre-assessed with affected private sector stakeholders). Financial contribution from the private sector is rarely
used as a requirement. The perceived impact of the requirements in making public investment more effective and efficient has been varied. The administration asserts that even though federal requirements are not too demanding and can be realistically fulfilled by the Land, they are not seen as very effective when it comes to improving the quality of the investment outcomes. In addition, they are perceived as increasing administrative burdens, slowing the implementation of public investment projects, and restricting the decision-making and implementation freedom of the Land.

Co-ordination between the centre and the Länder is decisive for the share of investments each Land obtains. For example, for large transport infrastructure projects (such as national highways), the centre consults the Länder, but it is the centre that decides which investments it will finance. The centre procures the project and entrusts the Land with the implementation. In such circumstances, the Länder may strive to maximise their share of investments, and needs’ evaluation such as those based on transport diagnostics play a secondary role. The administration has been confronted with difficulties in obtaining investment in regional priorities such as the expansion of water ways for freight transport, for which central level financing could not be obtained.

Cross-sectoral collaboration varies greatly between the region and the centre. Brandenburg has engaged in an effort to bundle different sources of funding (such as from the Joint Task, EU funds, etc.), which make up the 10% of its budget that it has discretion over, to ensure maximum coherence between different policies. In addition, it has inter-ministerial working groups involving Land ministries. One challenge Brandenburg faces at the moment is the different programming periods between the funding instruments of the Joint Task and the EU. However, it will have to confront a bigger challenge in the future, namely that of significantly reduced funding from both sources. This will require not only finding new financing mechanisms but also new ways in which policy coherence for regional development can be achieved.

At the central level, there seems to be an institutionalised approach to co-ordinating between the centre and the Länder, but it is very sectorally driven with few cross-sectoral co-ordination mechanisms as institutionalised as the vertical ones.

Box 1. Linking governments with regions: Germany’s Joint Task in Brandenburg

Germany’s Joint Tasks are established collaboration mechanisms between the centre and the Länder, through which specific policies are implemented through close vertical co-ordination. Regional development, including the development of businesses and infrastructure, are important elements of the Joint Task. The co-ordinating body for the Joint Task at the central level brings together all the Länder and the central Ministries of Economy and Finance, who together decide on the co-ordination framework.

For Brandenburg, the Joint Task has been an important source of financing for public investments. The Land has received EUR 160 million (out of around EUR 600 million total annually), whereby a co-financing of 50% is required. Together with EU funds, this is the most important funding for regional development in the Land, and contributes as well to the 10% of the Land’s discretionary budget. Unfortunately, there is very little incentive for co-operation across different Länder, which could enhance, for example, the joint business environment development between Brandenburg and Saxony.

3.2. Vertical co-ordination between the Land and lower levels of government

The regional Transport Plan showcases how co-ordination between the sub-national levels can be organised. Brandenburg has established an Integrated Transport Plan, currently covering the period until 2030, which incorporates road, bus, railway, etc. The priorities for Land transport investments are determined in a deliberative process involving the Land, communes and districts, as well as other relevant stakeholders, such as the transport operators and logistics companies. The Land receives earmarked transfers from the centre in the form of a lump sum for transport funding that it disburses to districts. Brandenburg gives districts a fair amount of autonomy by passing on lump sums. The amount of a district’s lump sum is based on performance mechanisms, such as passenger numbers, the connection to other transport networks, the existence of a unified (inter-modal) ticketing system for a region, and collaboration across different districts or communes. The communes also receive funding from the Land for transport infrastructure.

The establishment of 15 regional core growth areas aimed at increasing the efficiency of co-ordination with the sub-regional levels. The 15 core growth areas, determined by a critical mass of inhabitants and business activity (and hence built around urban areas), are not only aimed at concentrating funding for innovation and other business environment investments, but also to establish a direct and preferential dialogue between the regional government and local partners. A business submitting a funding request to the regional administration or its partner (ILB) will have preferential access to financing if it is associated both with one of the regional core growth areas and one of the 16 identified clusters (described below). The administration believes that the core growth areas have changed the way municipalities have traditionally interpreted their access to finance. Municipalities have come to focus on and highlight arguments for why public investments, such as for an innovative business environment, should be carried out in their localities as opposed to others. The emphasis of the dialogue has therefore shifted the discussion from “entitlements” towards arguments for positive competition, maybe even promoting horizontal collaboration.

3.3. Horizontal co-ordination

Horizontal co-ordination between Brandenburg and other Länder

Horizontal co-ordination between the Länder is often inhibited by central and supra-national funding arrangements. The central allocation of funds for public investments incentivises the Länder to compete rather than collaborate since funding is provided to the Land on specific investment projects regardless of whether they are a cross-state investment. At the EU level, funding is provided to each specific region and may not be shared with other regions. The fact that Brandenburg has been an Objective 1 region and Berlin has not does not facilitate this process.

The policy-making autonomy of the Länder in certain sectors creates further barriers to potential horizontal collaboration. The autonomy of the Länder in certain sectoral areas (such as education, energy and infrastructure) often creates incompatible systems.

Nevertheless, strong co-operation has emerged between Brandenburg and Berlin. There is a particular need for collaboration as the two are geographically intertwined. Despite resistance in Brandenburg to a full merger of the two Länder, strong and effective links have been established in different ways. First, they have founded a joint planning department by a state-level treaty. Joint spatial planning has so far worked well and is important in enabling Brandenburg to control urban sprawl from Berlin. Secondly, some large infrastructure projects have required the full engagement of both Länder, including the new airport (despite the implementation difficulties being encountered) that belongs to Brandenburg, Berlin and the federal government. Joint efforts will be needed to promote the new airport’s position as a hub in Germany, particularly given the strong presence of the nation’s primary airline, Lufthansa, in its traditional
hubs of Munich and Frankfurt. Finally, a fully harmonised transport network has been established between Brandenburg and Berlin, including a unified ticketing policy.

The Innovation Strategy and related activities have intensified collaboration between Brandenburg and Berlin. In an effort to establish critical mass in selected fields of innovation, the two Länder have developed a joint Innovation Strategy. The strategy (adopted in 2011 by the two Ministers of Economy) established five clusters of excellence, or core competencies, based on the economic development strategy. Although the innovation collaboration has had positive outcomes, it still faces some challenges. The joint Innovation Strategy has contributed to greater collaboration among individual organisations across the two Länder. For example, a biotechnology centre, financed by both Länder, was founded to serve as a platform for exchanges between companies and research institutes across Länder. However, the strategy is not backed up by a shared financing. The Länder Parliaments seem to be reluctant to vote in favour of joint budgets for the innovation sector. In addition, an important source of regional innovation funding comes from EU structural funds, which may currently not be shared by the two Länder. The revised draft EU regulations may improve the legal framework for horizontal co-operation between the Länder.

**Horizontal co-ordination across communes**

So-called inter-communal collaboration is common in Germany. Scale effects and efficiency are key drivers for communes to work collaboratively. In addition, the high number of small towns and population dynamics between rural areas and urban centres contribute to the need for municipalities to find more flexible tools to fulfil public service provision obligations effectively (see Box 2 for an example of transport collaboration). Co-operation can be relatively informal, involving ad hoc round tables, working groups, expert roundtables, mayors’ conferences or platforms for sharing experiences. More formal contracts are also used and take various forms. One way to establish collaboration is by way of a public or civil law-based contract that regulates co-ordination between communes. Another way is to create a new legal body (public or private) that pursues the interests of all involved communes in the implementation of the designated task(s). Frequent collaboration under such contracts can be found in tourism, cluster formation and infrastructure investment (schools, leisure amenities, waste management, wastewater treatment and water management). Yet another way of establishing a formal collaboration could be through PPPs.

**Box 2. Co-financing local mass transport**

To provide public transport for around 3.5 million users, the regions of Berlin and Brandenburg have created a joint transport network. In addition to aligning the transport networks between the two regions, the joint network also created a common tariff system. On the one hand, the collaboration for the transport network is based on European as well as national transport legislation. On the other hand, it is regulated by both regions’ transport legislation.

In Brandenburg, the region is responsible for rail transport provision. Districts and district-free cities are responsible for the other transport responsibilities. For district railway investments the Land provides resources to the districts on a competitive basis, monitors the quality and quantity of service provision, and rewards success.

Source: OECD Brandenburg Mission

European regulations ensure that such inter-communal co-ordination can be organised relatively autonomously. There is no need for communes to conduct public tenders or solicit offers from private firms. The idea behind the law is to encourage communes to find innovative ways of providing public services more efficiently and more functionally when the efficient scale of the activity transcends their administrative jurisdictions.
Streamlining local administrations through collaboration has been encouraged in Brandenburg. As noted above, a wave of mergers of municipalities took place after unification. More recently, in 2011, the Ministry of Interior of Brandenburg published a directive on the financial support for voluntary municipal mergers.\(^4\) This was presented, in part, as a response to demographic change in Brandenburg, with smaller and smaller municipalities, facing ever greater difficulties in fulfilling their assigned tasks. By providing financial incentives, the ministry hopes to increase efficiency and quality of service provision. In 2012, EUR 10 million have been allocated to support municipal mergers, EUR 50 000 of which are offered for mergers of municipalities without administrations and up to EUR 500 000 for mergers of municipalities with administrations. Among the first to take up on this initiative were cities and their adjacent municipalities.

**Box 3. Co-operation across Landkreise/districts in Brandenburg**

Co-operation across lower levels of government in Brandenburg is regulated by the Law on Communal Collaboration, which permits communes and districts to collaborate in any of the optional forms to fulfil the tasks they are responsible for. One such example in Brandenburg is the Working Group for Urban Renewal. This working group has existed for over 20 years and has more than 30 members. The cities participating in the working group aim at renewing their historical centres and preventing them from decaying over time. Another example is the Working Group on Water Tourism in the north of Brandenburg. Several districts have been co-ordinating and implementing of a loose network of water sports areas since 2004.

A study by the University of Potsdam investigated the co-operation across Brandenburg’s districts through a questionnaire. Co-operation across districts is especially prominent in fostering the business environment, ambulance services and waste management. The least amount of co-operation has been for executive tasks (Ordnungsaufgaben). The results show that there is a fair amount of willingness to co-operate across districts, but that less than half of the districts had actually evaluated the effectiveness of any potential co-operation. Districts who engaged in co-operation argue that it fulfilled scale expectations, quality of outcomes and flexibility as well as simplified processes. On the downside, the new steering mechanisms were deemed administratively intensive.


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### 4. Selecting and monitoring public investment projects

#### 4.1. Designing and selecting investment projects

Design of regional investment policy. Regional investment priorities of structural funds are defined in Brandenburg’s regional strategy, which was prepared in consultation with all lower levels of government, private actors, NGOs and researchers. Regional investment banks, other financial institutions and citizens are not directly involved in this priority-setting process. The structural fund investments are based on *ex ante* evaluations, both in terms of socio-economic analysis and strategic environmental impact assessments. Under the operational programme established for EU cohesion, spending infrastructure projects need to undergo a sustainability assessment.

*Public procurement*

Public procurement is mainly regulated by the centre. Nevertheless, several changes have been made at the *Land* level to improve public procurement. For example, to make the public procurement process and outcomes accessible to the public, future procurement processes will be handled exclusively online. It is envisaged to make the entire bidding process for a public tendering available online and to make it accessible for actors across the EU. Overall, the questionnaire reveals that procurement regulation is
perceived to be excessively administrative and thus an impediment to reacting effectively during the process. In addition, sub-national capacity for public procurement seems to be an important constraint. Small municipalities have the responsibility to procure certain goods on their own, which often exceeds their existing administrative capacities.

Challenges arise in terms of fostering innovation through procurement. The procurement procedure obliges the state to publish the names of the beneficiaries of innovation resources, which could be at odds with the private recipient’s interests (such as a start-up company). By being made public (including to potential competitors), the company’s idea could lose its value. This is especially challenging if the start-up has not yet obtained patents or other intellectual property protection. Overregulation has also implied that past relationships between the Land and accustomed service providers through tenders had to be stopped and work taken up with new actors, producing significant transaction costs.

Role of the private sector

There is a selective involvement of the private sector in the policy-making process. Private sector agents are involved in some aspects of public investment planning, chiefly where the private sector holds a key stake in the economic development of the region. Examples include investments in the Land’s logistics infrastructure, which is an economically important sector for Brandenburg.

The role of the private sector in investment financing is limited to absent in sectors like transport. One reason for this is a common misapprehension about the potential benefits of PPPs. Despite a Land advisory body on PPPs (situated within the ILB), there are only few examples of the use of PPPs. One of them concerned the reconstruction of the Land’s Ministry of Finance and Parliament. PPPs are generally believed to be uneconomical and an administrative burden for the communes. This is principally because they are chiefly viewed in terms of financing, rather than as mechanisms for improving project conception and execution, and private investors’ cost of capital means that it is usually cheaper to use public funds. In addition, there are fears of follow-up costs. Funding regulations are another impediment to involving the private sector in investment financing. For example, if the private sector is included in public infrastructure financing, the share of public funds received from the central government may decrease to 20%, compared to 80% for regular central level funding.

Future public funding constraints may lead to engaging the private sector more in the financing of public investment. As mentioned earlier, Brandenburg will be facing an important decrease in public funding due to a decrease in central level grants (e.g. through the Solidarity Pact) and an expected substantial decline of EU funds for 2014-2020. These constraints are furthermore coupled with a constitutional limit for new debt incurred by the Länder. In addition, EU funds will require higher co-financing shares from the Land.² This may increase not only the Land’s need for streamlining the investment processes (for example through introducing stricter criteria for obtaining funds, instead of a “first-come-first-serve” basis), but may, at the same time, increase the Land’s demand for funding through public-private co-operation. The success of PPPs will nevertheless depend on the appreciation of their wider benefits, beyond the actual financing.
Box 4. Role of the private sector in innovation and R&D in Brandenburg

A number of policies to involve the private sector in innovation and R&D activities have been implemented in Brandenburg. Several instruments to bridge the gap and improve the exchange between science activities and business development have been introduced, notably to connect the private sector and the Land’s universities. This has been done in at least three different ways.

First, campaigns have been developed to encourage exchange between the private sector and universities to ensure that R&D is conducted in the areas where the private sector needs it.

Secondly, financial instruments were developed to incentivise the exchange between the private sector and university researchers. Through so-called innovation vouchers, initially developed in the Netherlands, firms can obtain seed funding from the Land of EUR 3 000 to engage in a collaborative doctoral research project with a university. Depending on the project’s success and business needs, this can turn into a larger-scale funding of EUR 15 000 for actual product development and production. To facilitate the engagement between the private sector and the relevant university departments and researchers, transfer desks have been established at the universities that co-ordinate and administer the funding application process with the Land’s Ministry of Economy. The programme has proven to respond to an existing demand, as vouchers worth EUR 1 million (maximum funding initially allocated) were disbursed for the “start-up” voucher since their introduction in 2009. A questionnaire among the beneficiaries of the small vouchers revealed that around 10-20% of them will eventually apply for the larger voucher.

Thirdly, the funding window under the Land’s R&D directive will be tailored towards responding to actual business needs. Under this funding window companies were initially able to obtain up to EUR 4 million to finance R&D activities, provided that the company co-finances 50% of the project costs. The issue with this funding was that the research conducted was too basic and thus difficult to apply for actual business development purposes. The future window should be better aligned with “market” demands for research.

4.2. Public investment administrative capacity

The regional administration has faced difficulties in maintaining its administrative capacity, and will continue to face this challenge in the long run. A new national guideline obliges the Land to reduce the size of the public administration from 60 000 to 42 000 (by 2020). Brandenburg currently has 49 000 Land employees. The Land can buffer short-term demands by employing contract workers. Such contracts are limited to two years, thus undermining the attractiveness of public sector employment.

Currently, challenges in administrative capacity exist at the local level, and to some extent at the regional level. At the local level, administrative capacity shortcomings have become apparent in the administration of EU funds, which require management capacity that administrations often do not have (in terms of ex ante evaluations, monitoring, procurement, etc.). They are more accustomed to funding and implementation processes established with the regional and central government, which was demonstrated by the strong take-up of the stimulus funding programmes. At the regional level, as a consequence of the above-mentioned policy, the administration is confronted with two key challenges. First, the average age of its public sector force has increased significantly and the Land has struggled to cover topical issues where new expertise is crucially needed (such as for climate change and sustainable development technologies). Secondly, in the absence of a younger workforce entering the administrations, it has become difficult for the Land to pass on institutional knowledge from senior officials.

Public sector wages could be an increasing challenge in the future. Until 2005, Germany had a unified wage system across its Land administrations. Since then, each individual Land has set its own pay scales; Brandenburg has the lowest pay level in Germany. Wage levels in the Land overall are 20-25% below west German levels, however, so the impact of the change has not been dramatic and public administration wages are still comparably acceptable. This may, however, change in the longer run, if private sector wages increase.
The current trends also affect sub-regional administrations. With fewer administrators and limited new knowledge coming into the administration, districts and municipalities face challenges responding to stimulus programme opportunities and the administrative demands connected with the transfer of EU funds.

The region has several well-established administrative capacity support mechanisms, which could help address future administrative bottlenecks. Brandenburg’s administration benefits from various external capacity support institutions, notably the ILB and a training institute specialised in building and providing accompanying training for sub-Land administrative capacity (see Boxes 5 and 6). The ILB, though also implicated in administering and allocating public funds (for example for businesses), could be an important advisory body for the regional and local administrations, thereby compensating for a potential lack of capabilities, while at the same time increasing efficiency by using resources centrally for several administrations.

**Box 5. External administrative capacity support for local governments:**

The case of Brandenburg’s "Kommunalakademie" (Communal Academy)

Situated in Potsdam, the Communal Academy was created in 2002 as part of the new Law on Communal Collaboration. It resulted from a merger of the Study Institutes (Studieninstitute) for Communal Administration of Brandenburg and Bernau. The objective of the institute was to bundle resources to establish the Land’s own “school” to offer training opportunities for communal administrations. The objective was to provide local administrations with the skills to adapt to the ever-changing environment created by administrative modernisation through high-quality training. Concretely, the Communal Academy has to deliver a number of activities, including: i) training for district and district-free cities’ administrators to enable them to fulfill their given responsibilities; ii) non-technical training for public servants in middle management positions; iii) accompanying training for public servants for administrative professions recognised nationwide; iv) seminars on specific public administration topics. Since the institute’s establishment, it has trained 10,000 local public servants. More than 100 graduates each year pass the exam to become an official public administrator with a focus on communal administration. In addition to its teaching duties, the Communal Academy has supported the Land in organising recruitment processes for various public administration positions.

**Box 6. External administrative capacity support for the Land: The case of its regional investment bank (ILB)**

The German Länder have regional development banks (in Brandenburg it is called the Investitionsbank des Landes Brandenburg – ILB). In the new Länder, they primarily manage government financing programmes, as an agent of the Länder. Decisions concerning the allocation of funds are sometimes made directly by the ILB, such as for SME programmes. Other times, the ILB administers the funding process of an allocation decision made by the Land (such as for the funding of universities or technical institutes). The ILB therefore acts more like a public agent despite being a fully licensed bank.

The ILB is not allowed to compete with private banks or savings banks but can work together with them. For example, the ILB can collaborate with Deutsche Bank to finance a company. It operates in a similar collaborative manner for innovation and R&D investments in Brandenburg. Even though Brandenburg’s innovation agency will decide on the allocation of innovation grants, the ILB manages the application process, especially the financial and technical assessments of the client’s application.

In addition to the capacity support for the Land’s funding programmes, the ILB has provided two kinds of highly specialised consultancy functions for municipalities, which are PPPs and waste/sewage treatment facilities. This role came as a result of the need for a neutral agent to advise municipalities on the design and implementation of PPPs. Given the limited demand (especially for PPPs), the ILB’s activities in this field have been very few. In the waste/sewage treatment sector, the creation of specialised associations of municipalities has, in many cases, resulted in financial problems, arising from poor investment choices. For these cases, the ILB combines consultancy and financial functions in giving grants to help reduce debts.

The ILB’s future role may become more prominent. In the context of significant reductions in (discretionary) funding for regional development activities in the future, it could significantly increase the share of its own funding, in its function as a regional investment bank, through soft loans or specialised equity programmes. It could significantly increase the current 60% share it has on average of ILB funding compared to its overall budget. It may also co-finance the share of the Land in future structural funding.

### 4.3. Monitoring and evaluating public investment projects

Monitoring systems have been established programme-wide in some instances. For example, the introduction of the Emissions Law was accompanied by a set of indicators, such as the number of people affected by certain levels of fine dust or the number of people exposed to significant levels of noise. Every specific project implemented to reduce negative environmental impacts from emissions needs to monitor the indicators whose information is then aggregated to measure the achievement of their target values. The same process is carried out for the Joint Task programme, where an M&E framework has been developed to accompany the achievement of its objectives. One of the indicators in the Joint Task framework is, for example, the creation of jobs of economic development programmes.

The monitoring conducted by the ILB focuses on the eligibility of the use of its funds, but also has outcome-oriented features. For example, during the five-year period after which a company has received funding from the ILB, the beneficiary must provide certain information, such as employment levels or equipment financed. However, the monitoring is confined to the actual use of the grants, rather than the economic success of the company. Soft loan funding is more demanding in that economic performance is taken into account. The more risky the investment for the ILB, the more “rigorous” the monitoring seems to be.

The Land shows a clear commitment to evaluation. In the innovation sector, for example, a recent and ongoing evaluation was carried out of the innovation vouchers programme. Direct beneficiaries were asked what was the impact of the innovation vouchers on their businesses through a structured questionnaire. Once the programme is finished, a more rigorous ex post evaluation will be carried out. Ex post evaluations have also been conducted rigorously for business support programmes. A matching study was developed,
whereby each company that received funding in the region was matched up with a company with similar characteristics (company size, number of employees, sector, etc.) through a stratified random sampling approach. The evaluation found that companies that received funding did perform better than those that did not.

Nonetheless, evaluations may not be carried out systematically enough. For example, for infrastructure funding, rigorous evaluations are generally not carried out for all infrastructure investments, partly due to the often challenging time horizons of the investment (such as e.g. 15 years). For the tourism sector, evaluation is viewed as being difficult, and the region points out that the ILB only controls how the money is spent on particular projects, rather than evaluating its impacts. There is, however, a clear interest on the part of the Land to conduct evaluations, even if it is the central level that carries them out. In fact, the region has several evaluation questions in mind that it seeks to investigate, such as the effect of the number of contracted or leased staff on a company’s performance, but the funding for conducting such studies remains limited.

5. Lessons learnt and good practices

Overall Brandenburg has shown remarkable dynamism since reunification. After a difficult economic transition, it has continued to build up a sizeable human capital base and has shown a strong commitment to strengthening its economic structure in the future, through well-developed innovation strategies and projects. Its core growth centres and cluster development have been paving the way to streamlining and focusing on its core competencies, thereby incentivising local and regional partners to work towards a common agenda.

Its administrative capacity has evolved over time, contributing to these positive dynamics. Brandenburg streamlined its local administrations, significantly downsizing their number and encouraging mergers and “softer” ways of collaborating, with the aim of achieving administrative efficiency and capturing positive spillovers. In addition, there have been number of regional external capacity support facilities emerging, including the ILB and the Communal Academy providing expert input on specialised tasks (such as PPPs) and training administrative staff.

Well-established horizontal co-ordination within Brandenburg and vertical co-ordination between Brandenburg and higher levels of governments is aimed at maximising the resources available to foster regional development. Horizontally, Brandenburg has encouraged a collaborative approach to engaging in investments for regional development through merging or collaborating administrations, creating the core growth centres and clusters to focus resources on selected areas and avoid fragmentation. Vertically, Brandenburg has also engaged in harmonising and focusing different sources of funding. For example, the policy objectives implemented through EU structural funds have been aligned with central level transfers from Joint Task funding. This maximises not only the leverage of the two funding sources but the influence of the Land administration on its discretionary budget as well, to which the two sources of funding contribute largely.

Despite the fact that horizontal collaboration across German Länder has not been actively encouraged by higher levels of government, Brandenburg has established successful and intensive collaboration with Berlin. At the central level, funding mechanisms for public investment encourage a more competitive rather than collaborative approach between the Länder. In addition, EU funding arrangements are set up in a way that they inhibit joint projects with Berlin. Against these odds, Brandenburg has successfully established collaboration with Berlin, notably on spatial planning, innovation and transport programmes, to leverage the entire region’s economic potential. This collaboration could pave the way to further integration of the two Länders’ policies in other sectors where differences currently pose barriers to free mobility between the two (such as in secondary education).
Future major funding reductions will require Brandenburg to find innovative ways to foster public investment in the region. As highlighted in this report, the region will face significant reductions in EU structural funding, central government funding (through co-funding of Joint Task activities), and reduced and eventually phased out Solidarity Pact funding. This will significantly reduce its discretionary spending that it currently engages for its core regional development activities. The region will have to face the challenge of finding innovative ways to finance regional development and public investment. The ILB could be not only a core provider of finances, extending its current soft loan or specialised equity programmes, but also a key advisory body to further increase the efficiency and efficacy of public investment.

The currently untapped private sector potential could help bridge the rising funding gaps in the future. There is also a larger role for the private sector to contribute to regional investments that has so far been unused. There are common misapprehensions, partly stemming from past experiences, about the benefits of involving the private sector in financing and managing public investment projects in the region. Among them one can find difficulties in financial planning security.

Even though monitoring and evaluation systems have been well established, evaluations could be carried out more systematically. Brandenburg shows a key commitment to monitoring and evaluating its public investments. The counter-factual evaluation of one of its enterprise investment programmes is just one example of this. However, there is the potential to carry out rigorous evaluations and to streamline monitoring systems more systematically for future public investments.

Higher levels of government need to set policies to incentivise horizontal collaboration between the Länder. The impediments of horizontal collaboration lie in the funding mechanisms provided by the central and European government levels. The central government (and the supra-national institutions such as the EU) should orientate public investments more functionally, encouraging collaboration, especially between bordering states. Funding mechanisms need to be adapted to accommodate this in the future.

NOTES

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1. The first Solidarpakt (1994-2004), inter alia, increased the Lands’ share of VAT from 37% to 44%, included the Eastern German Lands in the horizontal equalisation scheme and introduced special federal support grants to the “new” Länder. The second Solidarpakt (2005-2019) continues the federal support, but with allocations declining yearly.

2. It was implemented through the Law on Investments into the Future (Gesetz zur Umsetzung von Zukunftsinvestitionen der Kommunen und Länder [Zukunftsinvestitionsgesetz]) of 2 March 2009.

3. The difference between the current budget balance and the operating balance is net financial income (interest received minus interest paid), which is of minor importance in this context.


5. These major changes in the EU funding framework are due to a change (of Brandenburg regions) in EU regional policy categories, with an impact on the level of funding and on the minimum level of regional budget co-financing.