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REGULATING GOVERNMENT (´S SHARE): THE FIFTY-PERCENT RULE OF THE FEDERAL CONSTITUTIONAL COURT IN GERMANY

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Zusammenfassung/ Abstract

Some numbers in the political sphere seem to be chosen rather arbitrarily. One example might be the rule set out by the Second Senate of the German Federal Constitutional Court in 1995 that the overall tax load on assets must be limited to 50% of the yield on those assets. This rule was understood by many as a general principle for taxation. The article first sketches the socio-political climate under which the rule originated: a rise of neo-liberal thought met with the inability of the political institutions to reform the German welfare state with its ever-growing expenses. The Constitutional Court's intervention is interpreted as a reaction to this stagnation in politics. An analysis from the perspective of Constitutional Law, however, reveals that the fifty-percent rule cannot be convincingly based on the German Basic Law, and instead must be seen as a political move of the Court. But this move did not follow an economic rationality, either; for an optimal government's share can only be determined in relation to the economic performance of a country and not by fixing it generally at a maximum of 50% of GDP. The demise of the fifty-percent rule already began four years later. In 2006, finally, the Senate moved away from the individual rights-based approach of 1995 to a more general assessment, taking also into account an increasingly globalized tax competition. The reason for this clear-cut change in the Court's juris-prudence can be found in a change of the socio-political and institutional parameters, thus witnessing to the effect of the political climate on court decisions. The analysis also shows that the rule was created and abandoned only on the basis of an "introverted" legal discussion, economic arguments hardly playing any role in the process. The new line of the Senate, however, might guarantee for a better integration of economic science into tax policy by exchanging fixed limits for a "discursive" model, demanding from the tax legislator better reasons for higher taxes.

JEL-Klassifikation / JEL-Classification: H11, H24, K34, P16

Schlagworte / Keywords: fifty-percent rule, constitutional decisions, optimal government's share

1. Introduction

Sometimes, it´s an odd thing with those numbers in politics. The poverty line is a good example: Since in the developed world nobody must suffer from hunger or thirst any longer, one has invented the *relative* poverty line: in the official European statistics (Eurostat 2000), people having at their disposal less than 60% of the national median income are defined as *relatively poor*. Surely, one cannot help asking how that figure possibly entered this world. Cynics would probably suppose that it was fashioned to guarantee employment of the “unemployment” or “poverty industry” (Moon/Richardson 1984): if the poverty line automatically grows with the average income, there will always be poverty guaranteeing for the turnover of such an industry. A less cynic approach might look back to Adam Smith’s equally dynamic notion of a minimum standard of living: to him “necessaries” were “not only the commodities which are indispensibly necessary for the support of life, but whatever the custom of the country renders it indecent for creditable people, even of the lowest order, to be without” (Smith 1852: 368; also von Arnauld 2009: 260-262,283-285). Anyway, the question then becomes why someone with 61% of average income ceases to be poor, or, more generally put: to whom this very number might have occurred – and why.

Even more enigmatic appears the following case: in the Maastricht Treaty, the EU member states agreed on so-called convergence criteria to be fulfilled by states wishing to introduce the Euro as their currency. At the EU summit in Dublin 1996, the Stability and Growth Pact then introduced two limiting numbers which were not to be exceeded after the introduction of the new currency: new governmental debt should be restricted to a maximum of 3% of Gross Domestic Product (GDP), and the total public debt (including central, regional and local authorities) should be limited to a maximum of 60% of GDP. As is well known not only from the Greek experience, this regulation caused a fierce competition in creative accounting among the member states. It remained mysterious, however, how these figures were determined. The former German Chancellor Helmut Schmidt (2005) put it in the following way:[1] “If a government takes out excessive loans, it drives up either the risk and, consequently, the long-term interest rate for its own loans, because every country is exclusively liable for the payment of its own debts. Or it drives up the interest-

[1] All translations of quotations are by the authors.

rate for the whole Euro-zone. In practice, both will occur at the same time. The Stability Pact wants to put a stop to that by way of two rather arbitrary standards. It is especially hard to understand that an annual net debt of 2.9% of GDP should be tolerable, 3.1%, however, unacceptable; it is equally incomprehensible not only to disregard the different purposes the borrowing might serve, but also that the macroeconomic aggregates of the State concerned should not play any role – the national savings rate no more than the investment rate of the budget, or the rates of growth, inflation, unemployment and social spending." Schmidt brings it to the point: These two criteria are arbitrary. They could also have been 2.5% or 65% or else, since they lack any politically or economically reasonable basis.

Another case might be added to this, though subject to further examination: the German Federal Constitutional Court's famous "half-division principle" (*Halbteilungsgrundsatz*) which saw the light of day in 1995. According to this principle first applied for the taxation of assets, the overall tax load on after-tax assets ("consolidated assets") must not exceed a 50-odd percent mark (BVerfGE 93:138). Extended to taxation and contributions in general, this leads to an upper limit of government's share of 50%, overall.

If a country's highest court constrains tax policy by "Regulating Government" (cf. Lee and McKenzie 1986) quantitatively, it is at least an innovative step, if not one close to a minor revolution. So, the question has to be asked whether, firstly, such a rule can be extracted from the Constitution and, secondly, if it has claim to any economic rationality concerning an optimal mix of private and public goods. As we will attempt to show, neither is the case – thus adding the half-division principle to the family of those arbitrary figures mentioned above. In order to get some insight into the genesis of such a figure, we will also focus on the conditions under which the principle emerged.

In the following we will

- at first (2) choose a historical perspective concentrating on the economic and political conditions for the gestation of the fifty-percent rule,
- turn (3) to the foundation or non-foundation of that rule in the German Basic Law,
- try to substantiate (4) the fifty-percent rule within an optimal social choice model of government's share of GDP along Samuelsonian lines,

- look at the career or better: demise of the fifty-percent rule (5) until its abolishment in 2006, and
- present some conclusions (6).

2. The Dawn of the Fifty-Percent Rule: Socio-Political Backgrounds

There is one topic which keeps its position on the political agenda irrespective of time and age: the debate on *fair distribution of income and property*. According to sociological research, this is due to the fact that „in a monetary society the size of household income is the most important indicator of social differentiation and all forms of social inequality following from it"; thus, possession of property "besides the distribution of income represents the most important socio-economic factor of social differentiation in general" (Schäfers 1990: 204). The discourse on social justice is not limited to this distributional aspect, however. Also, the concept of *equal opportunity* is part of this debate. How these two topics relate to each other is being discussed controversially. Some hold that a redistribution of income and property should raise the chances for the non-privileged to develop their abilities. Via procurement of educational and job opportunities ultimately everyone should be enabled to attain a satisfactory level of welfare on his or her own. Levying property and inheritance taxes should improve the distribution of wealth; expending revenues purposively should reduce inequalities of opportunity. Guiding this argumentation is the idea that fair competition needs a comparable starting point for all competitors, thus reflecting an ideal of social justice.

But is this ideal more than an illusion? Can it be defined and operated for practical purposes? And if so, can it and should it be the basis for government action? Here, of course, the ideological debate sets in. Schäfer (2008) e.g. gives a negative answer, invoking Hayek's "Mirage of Social Justice" (1976): Because of different psychic and physical conditions there can never be the same chances for all at the beginning of the race. Besides, he criticises the focussing on income and wealth that leaves out other determining variables of the social environment; the critique of "envy taxes" presents this line of argument in a nutshell.

However, even if it should not be possible to define and implement social justice to the full, one must still face reality: The distribution of wealth has been investigated recently by the German

Institute for Economic Research (DIW). According to this study (Frick and Grabka 2009), German citizens obey the value of 5.4 billion Euro in financial and material assets, and the average value per household was numbered at 81,000 Euro. Still, according to the DIW 10% of the households in Germany have 67% of all assets at their disposal – with clear and ascertained disadvantages for immigrants, women and East Germans.

The 1980s and 1990s in Germany were characterised by a serious social policy backlog. Globalization and demographic change were challenging the traditional social system. The deceiving boom after the reunification of Germany in 1990 brought to a halt any intention of tackling the necessary reforms – these were, in fact, not addressed until chancellor Schröder's second term in office (2003-2005), and, therefore, almost twenty years later than in other, competing, countries. The reunion boom began to dwindle quickly. The Kohl administration reacted by externalizing the costs of national unity: increasing public debts, raising taxes and social security contributions. All in all, there was a substantial, nearly 4% Peacock-Wiseman (1961) displacement effect of government's share, and the 50% were to be expected soon.

The reasons for this backlog were complex and manifold. Partly, it might have been caused by the reluctance of the governing elite to confront the electorate with unpopular realities. Yet another interpretation was proposed by Katz and Mair (1995, 1996): The German political system in the mid-1990s was characterised by state-subsidised catch-all parties ("Volksparteien") with a tradition of inter-party cooperation and accommodation. According to Katz and Mair, this combination led to the emergence of "cartel parties", mainly interested in ensuring their own collective survival. With party programmes of Christian and Social Democrats becoming more and more similar and with campaigns "oriented more towards agreed goals rather than contentious means", they detected "a shrinkage in the degree to which electoral outcomes can determine government actions" (1995: 22). In substance, there was a lack of political competition, i.e. of that very element which, according to the theories of Schumpeter and Downs, connected the interest of politicians in gaining or preserving power with the public interest. A similar analysis was given by Bruno Frey around the same time (1994: 340): "The Schumpeter-Downs model of democracy needs to be complemented by a model in which (between elections) a *coalition of all (established) politicians and parties* stands against the voters and taxpayers"; he also explicitly spoke of a "cartel of politicians" (in 1994: 338). All these studies subscribed to the existence of a principal-agent problem where the voters as principals lost control over politicians and parties as their agents.

This analysis gave scientific expression to the then widely held view that the German parliamentary system was paralysed and unable to stop doing “business as usual”. It does not come as a surprise, therefore, that the introduction of plebiscites was broadly discussed in Germany at that time (Zimmermann and Just 2000): The change of voting procedures and decisions on political programmes is often seen as a way out of political backlog situations. On state-level, all *Länder* had introduced direct democratic instruments by 1996 (partly fuelled by the inclusion of such instruments in the constitutions of the new East German *Länder*) (Kost 2005). On federal level, however, the required two-thirds majority in *Bundestag* and *Bundesrat* remained prohibitive. The search for alternative actors to break up that “cartel” thus remained open. It is interesting that only recently von Arnim et al (2006: 60) called for an „especially intensive control“ by constitutional courts in times where competition between political parties is largely absent from a parliamentary system. The Federal Constitutional Court’s decision on the fifty-percent rule can be interpreted as following that line of thought: When the “cartel parties” were incapable of reform, levying ever more burdens on the citizens and taxpayers, the Court had to step in as an auxiliary institution to defend the principals against their agents.

3. The Fifty-Percent Rule, Taxes, and the Constitution

To understand the stir caused by the German Constitutional Court’s decision of June 22, 1995 one has to look at the “orthodox” construction of the Basic Law with regard to tax law (for an outline Butzer 1999a:29-48). Up to then, the constitutional safeguards against taxes, according to the Court’s jurisprudence, had primarily been the equality of taxation and the principle of coherence, both deduced from art. 3 para. 1 (equality before the law) (BVerfGE 6:70-71; 66:223-224; in detail Tipke 2000:282-365). The Court had expressly rejected that taxes could be subject to judicial review relating to the right to property as guaranteed in art. 14. A clear distinction was drawn between property (*Eigentum*) and assets (*Vermögen*). Whereas property rights are conceived as relating to particular objects, the assets are “not a right, but the mere sum of all possessions of a person”. Since taxes and other public charges are not paid by handing over particular objects of property but are paid from the tax payer's assets, the right to property was not seen as pertinent (BVerfGE 4:17). The only exception was made for the – more or less theoretical case – of excessive tax burdens "strangulating" the tax payer or amounting to a confiscation (BVerfGE 38:102; 70:230; 78:243). Concurring, Hans-Jürgen Papier, President of the Court from 2002 to March 2010, has called the idea of containing "super-fiscalism", i.e. "the growing share of government in the national product" by recourse to the individual's right to property as product of the "dream factory of Constitutional Law" (Papier 2002:180). This jurisprudence had been criticized for long by more "adventurous" tax lawyers, for it had failed to discipline the legislator – German tax law being characterized by a multitude of different taxes, exemptions, reductions and other features adding to the complexity of the whole. Characteristically, they demanded from the Constitutional Court a more interventionist stance to compensate for the missing political will to reform. One of the foremost proponents of that line of critique was, and still is, Paul Kirchhof, Professor of Public Law at Heidelberg University (e.g. Kirchhof 1979, 1981, 2007). He was elected into the second of the Federal Constitutional Court's two senates in 1987 where he became reporting judge for tax and budget law.

The Second Senate's decision of June 1995 departed from the orthodox course by stating that after-tax ("consolidated") assets were protected by the right to property (BVerfGE 93:137-138; see Helbig 2002 for an in-depth discussion and contextualisation of that decision). Though this was perfectly in line with Kirchhof's previous writings, it still came as a surprise for three reasons: Firstly, because the case at hand did not necessarily give rise to the question (it concerned a different treatment of real estate and other assets) (Arndt/Schumacher 1995:2603-2604; Sauer 2006:131). Secondly, because measuring taxes on assets against art. 14 meant encroaching upon the jurisdiction of the First Senate. The Second Senate even avoided to call upon the judges' plenary, which it would have been obliged to do when departing from the other Senate's jurisprudence (this is why the Senate partly disguised the crucial passage as a *quasi-obiter dictum*: Butzer 1999b:228). Thirdly, few would have thought that Judge Kirchhof would succeed in convincing the majority of the Senate to adopt his line of jurisprudence. That he succeeded, might say as much about his personal charms and persuasive skills as about the general political climate of the time.

In the end, only one of the judges dissented. In his dissenting opinion, Judge Böckenförde, one of the doyens of German Constitutional Law, referred to the constant jurisprudence of the Court and sharply criticized the majority of the Senate. Rather unusual for the etiquette of that institution, he directed his critique – hardly hidden – against his fellow-judge Paul Kirchhof. He linked the decision to a "new concept in tax law" for which he solely cited publications by Kirchhof from 1977, 1979 and 1981, respectively, and called it a "theoretical and political concept" not backed by the Constitution (Böckenförde 1995:154-155). By this, Böckenförde suggested to the world outside the Senate that Kirchhof had finally succeeded to realise his long-held political ideas by using the Constitutional Court as a power base. To be fair, though, Kirchhof's views had been shared by other writers before (documented by Tipke 2000:441-444) – and he had managed to convince all but one member of a Senate of eight.

Having thus cleared the way for an application of art. 14, there now was need to find the point at which taxation becomes excessive. Usually, the Court would have applied a proportionality test balancing private and public interests and leaving wide discretion to the legislator defining "content and limits" (cf. art. 14 para. 1) of property. In its 1995 ruling, however, the Second Senate gave up judicial self-restraint and took up the mantle of the institutional *deus ex machina*. The judges demanded to leave the substance of "consolidated" assets untouched to avoid creeping expropriation, and they fixed a limit for taxing the yield on those assets: In overall perspective, this tax, in combination with other taxes on that yield (further elaborated by Rose 1999), was not to exceed a 50-odd percent mark (BVerfGE 93:138).

This "half-division principle" – an earlier invention by Kirchhof (1981:271-272; see Tipke 2000:445-446 for further references) which had been taken up by others (e.g. Friauf 1989:8-9) – was neither the result of "imported" economic wisdom (no experts were heard in the case, no economic publications cited) nor of complex legal reasoning. The judges simply based their position on an overly literal interpretation of art. 14 para. 2 of the Basic Law (defended by Kirchhof 2007:157-159). The English translation of that provision has it as "Property entails obligations. Its use shall also serve the public good", seeming to miss just the decisive point. The German original uses "zugleich" which means, properly translated, "also" or "at the same time". So there is not much more to it than "at the one hand / at the other hand" without hinting at which hand is to get which share. Still, etymologically, "zugleich" goes back to the word "gleich", "equal". This etymologic aura seems to be the nexus of the Constitutional Court's argument, disregarding the fact that "zugleich", as opposed to "gleich", is more a temporal and less a comparative expression (amusingly proven by Sendler 2000b against List 2000b). In the decision, the majority of the Senate just paraphrases the second sentence of art. 14 para. 2 and concludes without any further argumentation that "thus" a fifty-odd percent share marks the watershed between constitutional and unconstitutional taxation of assets.

It is not without irony, that on the basis of such a super-literal reading of art. 14 para. 2 one would have to conclude that any taxation going markedly below the fifty percent rate was unconstitutional, too. Actually, the paragraph deals with the *obligations* entailed by property. Still, the "half-division principle" was widely understood as a means to defend private property interests – and thus only as the upper limit of taxation. The idea that it could also mark the minimum level has rarely been discussed (to some extent Butzer 1999b:241-242). Tellingly, when mentioning a "minimum level" of taxation, as opposed to the maximum level marked by the fifty-percent rule, Kirchhof (2007:154) refers to the minimum standard of living which has to be kept free from taxation. This, however, is not a minimum standard of taxation, but a minimal conception of its maximum level.

Summing up, in the 1995 landmark decision, the "half-division principle" was founded on little more than an overly literal, etymologically questionable and inconsequential reading of art. 14 para. 2 of the Basic Law. Still, the "*juge rapporteur*" could convince six other members of the Senate to adopt his line of argument. Taking all the oddities of the decision together – a question not begged by the case at bar, an intrusion into the First Senate's affairs, the avoidance of a plenary session, the use of a would-be *obiter dictum*, and a rather eccentric interpretation of art. 14 para. 2 – it is difficult not to see it as a political move very much in line with the *zeitgeist* of that time (cf. Butzer 1999a:61).

4. An Economic Evaluation of the Fifty-Percent-Rule

If the legal basis of the fifty-percent rule is at least doubtful – what about its economic rationality? The half-division principle applied to all tax payers individually, sums up to an overall government's share of 50%. Is that figure arbitrarily chosen from an economic perspective? Or does limiting government's share at that rate conform to the idea of economic optimality? To answer this question, we will have to develop a theoretical basis determining the optimal government's share and derived from private decisions on markets and public policy decisions. Since the problem of determining such an optimum share is primarily demand-sided, we first have to isolate supply and demand aspects from each other. To secure the neutrality of the production or supply side, we assume that the marginal production costs of private and public goods are identical and constant so that the relative price considering opportunity costs (as the marginal rate of transformation) is $p = p_{pr} / p_{pu} = 1$. Consequently, looking at the gross national product in our model economy $R = X_{pr} + X_{pu}$ holds, with R as a gross domestic product and X_{pr} or X_{pu} as the demand (or supply) of private and public goods.

Two further remarks are necessary: Firstly, we assume that those preferences which are decisive for an optimal relation of private and public goods at the individual level should also be valid at the societal level from an *individual view*. But the social preferences from the *collective view* do not coincide with the individual view because the preferences at the collective level are to be aggregated differently concerning private and public goods. Secondly, we presuppose that these preferences are identical for private and public goods (as well as the marginal production costs which we will ignore here[2]) to keep the analysis simple, but that is not the only reason: Wagner's Law of the growing expansion of the state activity (1983) originally had to postulate public goods as superior in the growth process; nevertheless, his hypothesis is not supported empirically, because the income elasticities of public goods[3] oscillate around 1 which means that, actually, government's share should remain constant. Thus, due to the principle of insufficient reason we can proceed from the fact there will be no systematic differences in the demand of an individual for public and private goods.[4]

[2] The costs side plays only a minor role in this kind of analysis: if we assumed that marginal costs were identical for private and public goods and constant too, there would be no allocative effect. In any case, they should be sufficiently low to induce a trade-off between private and public goods.

[3] For instance Borcherding and Deacon (1972), Bergstrom and Goodman (1973), Pommerehne (1978) or in an overview of the empirical studies Blankart (2003, 199).

[4] Furthermore, due to practical reasons we assume that (1) the marginal utilities have the same starting point on the ordinate to avoid kinks in the aggregate curve, (2) there will be a negative marginal utility after trespassing the utility maximum of public goods due to the same reason, and (3) the resources R of the society are given and constant.

Under these conditions and in a simple linear approach the identical marginal utility functions of the private and public goods are $p = a - bX$. In the following, we will treat our problem with the help of an analytical tool known from foreign trade theory (Mussa 1979) and resource economics (McInerney 1981). Therefore, in constructing the marginal utility function of the public goods we have to take into account that it has the same absolute gradient as the private good, but another intersection with the ordinate, because functional representations occur in X unities and the resource constraint R determines the width of the diagram. Considering this, the marginal utility function of the public good is $p = b (X-R) + a$.

But let us recur to Wagner's Law and his way of thinking first (Dluhosch and Zimmermann 2009a) because, in principle, the expansion of the state is a process that can take part in the domains of low or high government's shares – below or beyond 50% of GDP. Wagner believed in a "law of development" (*Entwicklungsgesetz*) of industrializing nations and founded his "law" exactly in this context. He postulated a growing importance of the complementary function of the state *vis à vis* the economy and society which, in his view, also legitimized a rising centralization of policies and expenditures. The reason lies, on the one hand, in the progress of natural science and technology, and, on the other hand, in more complicated legal relationships originating from the division of labour and an increasing need for clear rules. This, in sum, leads to a growing activity of the State in both its "organic" purposes – law and power as well as culture and welfare. Since it has not found its way into the English-speaking literature, it should be added that this law of expansion of the state is additionally supported by the change from the repression to the prevention principle. This requires at first rising and then permanently raised state budgets. It should be noted that, according to Wagner, all these forces at work are due to the *Entwicklungsgesetz* and not to changes in demand. Actually, people are regarded as powerless *vis à vis* the *Entwicklungsgesetz.* No one here is "free to chose" (Friedman). Even the statesman – as the personal incarnation of this optimality – is only fulfilling the *Entwicklungsgesetz*. Wagner conceives the statesman as an individual deciding alone and authoritatively, legitimized by his knowledge of the *Entwicklungsgesetz* and the optimal relation of public to private goods. Political or collective processes of decision-making hardly play any role in his writings. The problem of social aggregation of single preferences is blocked out, hence the solution becomes trivial: As the enlightened representative individual, the statesman will choose exactly that structure of private and public goods where the marginal utilities are identical – but under the premise that, according to the *Entwicklungsgesetz*, the marginal utility of the public good becomes more and more flat. Formally, with b_{pr} and b_{pu} as the marginal utilities of private and public goods: a - b_{pr} X = b_{pu} (X-R) + a, which leads to the optimal amount of private goods X* = b_{pu}R/ (b_{pr}+b_{pu}) and to (R-X*) as the optimal supply of public goods. The optimal government's share then is

$$(R-X^*) / R = b_{pr} / (b_{pr}+b_{pu})$$

Quite obviously, government's share rises if b_{pu} decreases, and 50% would be exactly reached when both marginal utilities were just identical – and, of course, 50% would be trespassed if b_{pu} would shrink further. On the other hand, government's shares were still very low at Wagner's time at the end of the 19th century, and he probably could not have imagined that a 50% limitation would ever be a political or economic topic. It must be admitted, though, that Wagner's Law is in some sense treated as "timeless" – it may well be that there are new delevopemets like globalization or economic and financial crises calling for an expansion of the state beyond the 50% threshold even if Wagner himself could not envision such a figure. It also has to be added that he was remarkably unclear about the limits of government's share and taxation: the only guideline is his demand for an optimal complimentarity of the state and the economy or society, or said in a modern way: of private and public goods.

Now, let us move forward from this essentially autocratic thinking and approach the modern world of markets and democracy. Here, the single individual takes centre stage. It decides on the amount of private goods for a given price, hence co-determining total demand, and it decides on its willingness-to-pay for a given amount of public goods, and hence on the total demand of society – of course with reference to the marginal costs. This "Samuelsonian" world is an individualistically straightened world in which, in the end, *everybody* decides for *everybody*, instead of *one for everybody* – collectively (total demand, total willingness-to-pay), but on an individualistic basis and with individual consequences (individual demand for private goods, Lindahl-prices of public goods). Within such a world we have to remember that individual preferences for private and public goods are to be aggregated in a different manner:[5] In the case of private goods the demands at a given price are to be aggregated horizontally and in case of public goods the Lindahl prices at a given amount of public goods are to be aggregated vertically (in detail: Dluhosch/Zimmermann 2009b).

If we now extend our approach to n individuals, but maintain the twofold identity assumption – identity of the individuals, identity of the preferences for private and public goods –, we get for the aggregate marginal utility of private goods p = a - bX/n and for the aggregate utility of public goods p = (X-R) nb + na. The optimal governmental share X_{pu}*/R is then:

$$X_{pu}/R^* = [1/(n^2+1)] + an(n-1)/bR(n^2+1).$$

For all parameter constellations of a, b and R government's share starts at n=1 with 0.5, and decreases with rising n "usually"[6] first to a minimum, only to grow for large n against a/bR. For n>1 the size of government's share depends on the country-specific parameters a and b as well as n and R, and it *definitely decreases with a growing R*. We will refrain from an intense discussion of that term here, referring instead again to Dluhosch and Zimmermann (2008, 2009b) for details, but have to state that on logical grounds and in a market economy government's share cannot be higher than 1 so that R should be larger than a(n-1)/bn with (n-1)/n approaching 1 from below if n becomes large.

Now, what does all this mean for the fifty-percent rule? In general, the problem to be solved for *every upper limit* of the expansion of the state and with GS (government's share) = X_{pu}/R in decimal notation is based on the following form

$$GS \leq [1 + an\,(n-1)\,/bR] \,/\, (n^2+1)$$

which leads to

[5]That is why we call it a Samuelsonian world: Samuelson was the first to develop the efficiency conditions for a world with private *and* public goods (Samuelson 1954/55).
[6] A limiting case is given by a/bR = 1: Here, government´s share grows degressively from 0.5 towards the value of 1, and a/bR > 1 can be excluded for government´s share being larger than 1. In the usual cases the minimum is given at $n = (bR-a)/a \; +/- \; \{1 + [(bR-a)/a]^2\}^{0,5}$.

$R \geq an\,(n\text{-}1) / b\,[(GS\,(n^2{+}1) - 1]$,

and for the half-division or fifty-percent rule (GS = 0.5) to

$R \geq 2an / b\,(n{+}1)$

with n/(n+1) approaching 1 from below if n gets large.

It is obvious that – besides the marginal utility parameters and with n assumed constant for a certain country at a time – the optimum size of government's share predominantly depends on the resource base R, the economic performance of a country. Also, according to the initial term above a certain R can only be associated to one and only one optimal government's share. This of course holds the other way round, too: only one size of GDP fits to a certain optimal share. This implies that a 50% government's share can be met only by chance in reality. Obviously, the fifty-percent rule was understood by the Federal Constitutional Court only as an upper limit of taxation. But still, such an *upper limit of government's share* would also have to correspond to a *minimum size of GDP* as shown in the last term above. If such a minimum size of GDP is not given, an optimal government's share may well lie *beyond* the 50% mark[7]; exactly this connection is disregarded by the Court.

To sum it up, there is little sense in fixing such a limit without taking regard of a country's economic performance. The problem of such a figure is that it is not derived from any substantial theory, at least no substantial economic theory which would take this specific nexus into account so that the fifty-percent rule cannot satisfy any rationale of optimality. This does not mean that there might not be good other reasons to limit government's share to a certain percentage and among the first candidates will be political reasons, but within an ecoomic context the fifty-percent rule definitely cannot be legitimized.

[7] According to Tanzi and Schuknecht (2000) the growth-optimal share of government should be in the range from 25 to 35% depending mainly on county-specific cultural factors which would perfectly fit into Kirchhof's thinking. On the other hand, growth maximizing is a different goal from the one pursued here: talking about government's share should be oriented towards an equilibrium of private and public goods.

5. The Twilight of the Fifty-Percent-Rule: Demise and Abandonment

Surprisingly or not – such economic reasons hardly played a role in juridical discussion of the "half-division principle". In a highly politicized atmosphere, the 1995 decision met with a controversial reception. By some it was hailed as a major break-through in the domestication of the notoriously byzantine German tax law (e.g. Leisner 1995, Vogel 1996), others spoke of flagrant judicial self-empowerment and criticized an unnecessary obstruction of the legislator (e.g. Bull 1996, Weber-Grellet 1996). The 1995 ruling was one of a number of decisions, mainly by the Second Senate, that fuelled the general discussion on the role of the Federal Constitutional Court as an *ersatz* legislator (e.g. Guggenberger/Würtenberger 1998, with an essay by Joachim Wieland especially on this decision).

Since the constitutional basis for the fifty-percent rule as designed in the 1995 decision was shaky, there were attempts to bolster it with further arguments (exhaustive Pausenberger 2008:306-360). Some argued that the primacy of individual freedom, as laid down in the Basic Law, would be overturned if the tax load exceeded the fifty-percent mark; additionally, the idea of subsidiarity was mobilized for support (Butzer 1999a:77-82; Butzer 1999b:239-241; Seer 1999:1284-1286; Lang 2000a:181-184). Granted, that this line of argument is more convincing than the logomachy presented by the 1995 decision, it is still doubtful whether the primacy of freedom translates that easily into tax arithmetics (Beyer 2004:148-151). That the Basic Law institutes individual freedom as the rule, its limitation as exception, primarily seeks to oblige the State to justify any encroachments upon fundamental rights and freedoms (von Arnauld 1999:38-40). A constitutional commitment to liberal society notwithstanding, the question of limits to individual freedom is more entangled than an undercomplex fifty-percent rule might suggest. Paul Kirchhof himself added to the foundations of such a rule by embedding it "in the tradition of political philosophy", tracing it back to the Second Political Testament (1768) of Frederick the Great (Kirchhof 2007:149, 159). Interesting as this genealogy may be, it does not explain why today, in a parliamentary democracy, we should accord any legitimizing power to this tradition. That a fifty-fifty rule evokes a general idea of equilibrium and might appeal to a "feeling" for justice (cf. Vogel 1996: 1258) is also not enough to turn it into a compelling legal argument.

Even the Court's supporters had to admit that the case for the "half-division principle" had been less than cogently made. Instead, they emphasized that the question of limits was to some extent contingent and a decision had to be taken (Vogel 1996:1258; Lang 2000b:458-459). True, but had it to be taken by the Court on a general basis instead of deciding just the case at hand? The gains in clarity and reliability by a set limit (Butzer 1999b:237, 239; Tipke 2000:451) should be outweighed by the need to leave political leeway to the legislator, and also by the need for flexibility to account for a changing economic environment (Beyer 2004:151-153).

The search for the constitutional foundation also had an impact on the debate where the new principle should be applied. Those sceptic of the rule in general tried to confine it to the taxation of assets. Others, encouraged by attempts to root it in concepts of social justice or a general conception of freedom and property, widened its scope (e.g. Pausenberger 2008, celebrating the rites of republicanism). Some regarded the fifty-percent rule as a general principle of tax law (Seer 1999: 1286-1289), some even as a principle governing all forms of public charges, including social insurance contributions (Leisner 1996:72-75; Butzer 1999a:87-130; Butzer 1999b:230-231).

The scene was shaken when in August 1999 the Federal Finance Court (*Bundesfinanzhof*) denied to apply the "half-division principle" to an income tax case. The Court bluntly declared that the Constitutional Court's reasoning in the 1995 decision was neither convincing nor binding and did not cover the income tax, after all (BFH 1999). This lack of deference earned sharp criticism from some commentators, e.g. from Seer (1999) and from the Federal Finance Court's own former president (List 2000a); Kirchhof himself, just about to leave the Constitutional Court, intervened by way of an article in the *Frankfurter Allgemeine Zeitung*. Applause came, among others, from the Federation of Financial Court Judges (*Bund der Finanzrichter*) (see Sendler 2000a:483). The dispute centred around the question if the Court's reasoning was binding on other Courts according to art. 31 of the Law on the Federal Constitutional Court (List 2000a; Butzer 1999b:233-234; Lang 2000b:457-458). It resulted from the "disguise" chosen by the Senate for the crucial section on art. 14. In order to avoid the necessity of a plenary session, the judges had deliberately excluded it from the operative paragraphs which thus only referred to the principles of equal taxation (art. 3 para. 1). Anxious that their new invention might be set aside as a mere *obiter dictum*, however, the Senate's majority had expressly marked that passage as part of the *rationes decidendi* (BVerfGE 93:136).

The Federal Finance Court's *acte de résistance* heralded the demise of the "half-division principle". Paul Kirchhof had left the Federal Constitutional Court in December 1999 after expiration of his twelve years of office (a re-election is not possible), and the political climate had changed, too: In 1998, after 16 years in power, Helmut Kohl had been replaced as Chancellor by Gerhard Schröder, presiding a coalition of Social Democrats and Green Party. Another less political but especially important factor should not be overlooked, either: Since the legislator had done practically nothing to reform the multi-tax system lying at the heart of the problem that Kirchhof *et al.* tried to solve in 1995, thereby again witnessing to the lack of political will to reform, the financial courts were threatened by a flood of actions by tax payers and their lawyers claiming a violation of the fifty-percent rule (Lang 2000b:458-459). So, the rebellion was also an act of self-defence of those who had the lion's share in correcting the shortcomings of German tax law.

Throughout, the Constitutional Court's First Senate had remained unimpressed and continued to hold that assets generally were not protected by the right to property (BVerfGE 95:300; 96:397), denying thereby the possibility of a fifty-percent rule based on art. 14 para. 2 of the Basic Law. That the Second Senate was also about to separate from that rule could already be seen as early as 2002 and 2003 (BVerfGE 105:32; 108:233) when the judges returned to the old formula that art. 14 in general gave no protection against tax demands unless they entailed "strangulating" effects, tellingly leaving open the question of further constitutional constraints for tax legislation. The Senate did not abolish the doomed rule, however, before January 2006. In reviewing the Federal Financial Court's August 1999 judgment, the Second Senate itself (though by now with totally new staff) took the side of those who had tried to reduce the impact of the rule by stating that the 1995 decision had exclusively referred to cumulative taxation of assets (BVerfGE 115:108-109; see commentaries by Gas 2006; Sacksofsky 2006; Sauer 2006; Wernsmann 2006). To those who still believed there was at least some room left for the "half-division principle", two more blows were to come. In its ruling, the Court also denied the binding force of the relevant passage – thus voiding its own earlier attempt to label it as part of the *rationes decidendi* (BVerfGE 115:109-110): The "half-division principle" had been officially declared as nothing but a mere *dictum* of the Court. Finally, the judges denied that any fixed limit of taxation could be derived from art. 14

para. 2 and in particular rejected a fifty-percent rule based on the word "zugleich" (BVerfGE 115:114). This unusually clear distancing from the earlier decision is all the more remarkable since, once more, the Court's statements were not necessary for deciding the case. This could have been dismissed as inadmissible before turning to the merits (Sacksofsky 2006:662; Wernsmann 2006:1169).

In one important point, however, the Second Senate went back to its 1995 ruling and even widened its scope. Only verbally, it left unanswered whether art. 14 grants protection against taxes in general; by including income and business tax into those taxes encroaching upon property rights it pointed the way to a general extension of art. 14 (concurring Kirchhof 2007:160). While in 1995, the judges had been anxious to prove the property status of "consolidated" assets as an exception to the rule, their successors generously granted protection to all taxes relating to money already earned (BVerfGE 115:112-113). By exchanging the question *with* or *out of what* taxes are paid for the question *why* specific taxes are demanded, the Second Senate clearly departed from the jurisprudence of the First Senate (Wernsmann 2006:1170-1173). The Plenary could be bypassed this time as the claim was unsuccessful; the different views therefore remained without consequences.

We shall not comment here on all the loose ends the 2006 decision left behind (for this, see Wernsmann 2006). A final glance, though, shall be given to how government's share is regulated according to this new line of judgment. Having discarded any fixed general limit of taxation, the Senate now applies the principle of proportionality, common feature of all rights and freedoms guaranteed in the Basic Law. This demands that any interference with rights and freedoms of the individual must be able to serve its purpose, be necessary (in the sense that there is no less intrusive means equally serving that purpose) and adequate, the latter condition implying a balancing of interests (von Arnauld 1999:219-222). Applying this standard to taxation, however, entails difficulties (first explored by Papier 1973:76-80). Since taxes are collected for the general financing of government activities, the ability to serve the purpose is always given. It is also difficult to name a less intrusive means equally fit for serving that purpose since higher taxes also mean more money for government activities. The macroeconomic perspective suggested by Lang (2000a:182), assessing the general quota of public charges also in international comparison, has nothing to do with "necessity" in that sense, but may be taken into account in the final balancing of interests. This, however, becomes difficult for very much the same reasons: It is possible to find a balance e.g. between the property rights of a house-owner and the need for building a road on his piece of land. It is difficult, though, to balance the unspecified need to finance government against the economic impact the tax load has on the tax payer. Without comprising for which end the money will be spent, it is difficult to apply a standard relying on assessing and weighing purposes. This, however, runs counter to the fact that taxes are generally neutral as to their political purpose (for a deeper analysis Musil 2007). After all, Wernsmann seems to be right if he concludes that the principle of equal treatment in art. 3 para. 1 of the Basic Law, not art. 14 is the “Magna Charta of tax law” (Wernsmann 2006:1173).

In its 2006 decision the Constitutional Court admits to these difficulties (BVerfGE 115:115-116). However, it sees “the possibility to demand from the legislator particular justifying reasons for an unusually high tax burden, if all tax payers or at least a majority of them is confronted with an increasing tax load, especially when such a burden appears as a precarious development not to be detected elsewhere in international comparison.” This passage (a rather convoluted sentence already straightened here) contains the competing paradigms in a nutshell: The reference to international comparison does not only admit to an increasingly globalized tax competition (see Di Fabio 2007:753-754, as one of the co-authors of that decision), but also evidences the difficulty to find a standard for appropriate taxation.

A comparative perspective is typical of rights concerning equality, not liberty; for tax payers under the same law, it is the perspective of art. 3 para. 1, not of art. 14 of the Basic Law. One can only derive a tangible standard from art. 14 when the right to property is taken serious as an individual negatory (or negative) right. It was this individual perspective on taxation that Kirchhof tried to introduce: the move from an objectively conceived protection of property to a subjectively conceived protection of the property-owner (Lang 2000a:179). Though nominally subscribing to this paradigm the Second Senate now seems to be eager to take the edge off it (critical therefore Kirchhof 2007:160-162). When describing the protective function of the proportionality test, the judges no longer refer to the individual tax payer, but to “all tax payers or at least a majority of them”. This generalizing perspective points to an objective conception of property being introduced into the art. 3 para. 1 test for realizing the idea of distributive justice. It is, however, not typical of the individual subjective right to property which Kirchhof saw as the Archimedean point from which he intended to reinvent tax law against the legislator. This newly strengthened role of Parliament is highlighted when, finally, the Court no longer speaks of absolute limits, but only demands better reasons for higher taxes. Within such an open concept of how to regulate government's share, there should be, once again, room to introduce the economic rationale into the Constitutional Law game.

6. Conclusions

What lessons, now, can be learned from the case study presented here? How did the fifty-percent mark come into existence, how did it vanish again, and how were judicial and economic reasoning linked with each other during this process?

At the birth of the fifty-percent rule, in 1995, we have, socially, a *zeitgeist* challenging etatist orthodoxy. There was a political climate less sympathetic with the welfare state and more concerned with the *homo faber* (Butzer 1999a:60-61), coinciding, perhaps, with an upswing for neoliberal theory at the time (Schüßler 2002; see also Lang 2002a:173 and Helbig 2002:50-55, with special reference to Brennan/Buchanan 1980). The negative counter-image of the industrious citizen is the free-rider of the welfare state, and mass media then very much took the side of the "small" tax payer (cf. Kirchhof 2007:151-152: tax payers are always those who possess, not those who don't). In institutional terms, a publicly voiced demand for change in tax legislation – unanswered by the political system – met with a phase in which the Constitutional Court was generally prone to pro-activity, compensating for a widely perceived stagnation in politics. According to the parliamentary rules of the game, the Court was taking a counter-majoritarian position here; with view to publicised opinion, though, it presented itself as protector of the voters and tax payers against the "cartel" politicians (Kannengießer 1995). This institutional situation combined with a "man with a mission" capable of convincing his fellow judges, turned out a decision which was legally disputable (if not doubtful) and economically ill-founded. Still, it very much was in line with the expectations of a general tax-paying public (cf. Schaal 2004:114-144 for trust and responsivity as latent factors in court decisions).

The demise of the "half-division principle" was accompanied by a change of these very parameters: Institutionally, we have a rebellion of the Financial Courts and a new line-up in the Second

Senate. The leading judge, Paul Kirchhof, had left the Court. By now and in general, the Second Senate had returned to more self-restraint. It is difficult to say if this new line of jurisprudence was only due to the parting of an uncommonly “enterprising” judge or whether it also was a reaction to the new political climate: The red-green coalition started with the promise of a policy of reforms, and there was a general sense of dawn (even if not all may have agreed with the Government’s political aims). Ideologically, the neoliberal beliefs of the Kohl/Genscher government were, for the moment, exchanged by Schröder’s emulation of “New Labour”. Even if this did not mean a return of the old welfare state model (which was supplanted by the idea of “workfare”: von Arnauld 2009:285-291), the focus was less on the *Besitzbürger* (“citizens who possess”) for whom the fifty-percent rule had been tailored. The rule had become inconvenient and finally was dropped in 2006.

Throughout this process, the legal discussion of the rule was limited to intra-systemic questions: formally, of methods of interpretations, institutionally, of the relation between Constitutional Court and Parliament, materially, of the antagonisms between *Rechtsstaat* and *Sozialstaat* (i.e. the state based on the rule of law and the welfare state). Throughout, the legal debate went on practically without any reference to economic science (staunch Luhmannians would have a field day here). To us, it seems obvious that this should have been different: Fixed limits like the fifty-percent rule may facilitate orientation and may thus contribute to legal certainty (see von Arnauld 2006:226-240 for this aspect), but they also should be based on economic reason. They should not straitjacket economic policy which has to respond to changing framework conditions, especially, as has been shown above, the economic performance of the country. Those who decide on tax policy should engage in a dialogue with economic science. For this dialogue, government (via the ministerial bureaucracy) and parliament are better equipped than a court that is meant to decide according to the law, and on a case-by-case basis. Therefore, the Second Senate’s new line of jurisdiction points into the right direction: Not only does it refrain from arbitrarily creating numbers; by connecting the level of taxation with the burden of argument, it also puts pressure on the tax legislator to comprise scientific expertise into the legislation process. Looking back, the rather short-lived fifty-percent rule, arbitrary as it was, might have opened our eyes for the better way to link law, politics and economic science in the field of tax law.

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