

Public finance

Central, regional and local authorities

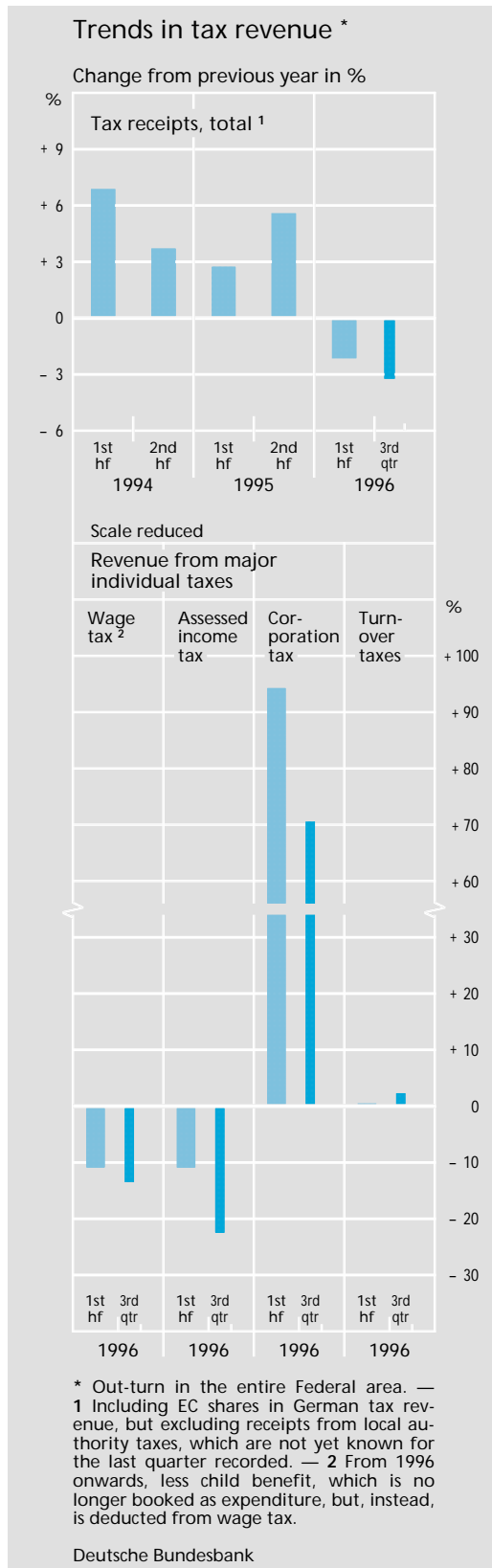
Trends in the third quarter

According to the data available so far, the deficits of the central, regional and local authorities in the third quarter exceeded the amount reached in the same period last year (DM 25 billion) by about DM 5 billion, whereas in the first half of the year, at DM 41 billion, they had been approximately as large as a year earlier. Although tax revenue continues to be disappointing, the central, regional and local authorities are making efforts to offset at least some of the shortfalls in receipts by adopting a strict retrenchment course on the expenditure side. In addition, the relatively low interest rates are restraining the increase in interest expenditure arising from the sharp rise in the debt level last year. However, trends at the various levels of government have developed along very different lines since the beginning of the year. Whereas the Federal Government – under the impact of additional special burdens – recorded a strong expansion of its deficit in the first nine months of the year, the deficits of the Länder Governments were approximately as large as a year earlier; in respect of the local authorities the deficits actually decreased considerably in the first half of the year (more recent figures are not yet available).

Basic trend

The decline in tax receipts, which is mainly attributable to measures which came into force at the beginning of the year, continued in the third quarter. In that period all-German

Overall taxes



tax revenue¹ was just over 3% below the result achieved last year; the trend was therefore even somewhat less favourable than in the second quarter (when it had decreased by 2½%). The economic recovery which started in the spring has thus not yet been reflected in a corresponding increase in tax revenue.

Revenue tended to be generally low in the case of income taxes in particular. This applied above all to wage tax, the tax which yields the highest revenue and which in the third quarter yielded 13½% less than in the corresponding period last year. It is true that revenue continued to be affected considerably by child benefit payments (which have been deducted from this tax since the beginning of the year). But even before deduction of these amounts (of just over DM 11 billion in the third quarter), wage tax revenue grew by no more than just under 3%, and thus considerably less than in the previous few months.² Revenue is now influenced more than previously by this year's moderate pay settlements; another factor is that a year earlier considerable repayments had been received as a result of the wage round concluded at that time.

Wage tax

An even sharper downturn in revenue was recorded in the case of assessed income tax

Assessed taxes

1 Including EC shares in German tax revenue, but excluding receipts from local authority taxes, which are not yet known.

2 In addition, revenue continued to be affected more than in the previous year by the raising of the basic allowance; on the other hand, revenue trends were influenced positively by the fact that the tax allowance for children – which since the beginning of this year has been granted only as an alternative to child benefit – is no longer deducted at source but, instead, under the income tax assessment procedure.

(– 22 ½%), whereas in the previous quarter this tax had yielded slightly more than a year earlier. However, revenue from this assessed tax is quite a heterogeneous residual variable, which is affected particularly by extensive tax refunds to employees. This unfavourable result is obviously attributable to the fact that tax receipts were lower in previous years, while, according to the figures available so far, prepayments have risen. In contrast to assessed income tax, corporation tax, which increased by just over 70%, appeared in a very favourable light. This was attributable, on the one hand, to the good assessment results which were achieved in earlier years – particularly in 1994, a very “profitable” year – and which yielded substantially higher final payments. In the wake of the favourable profit trends, on the other hand, the upward tendency to make prepayments continued to prevail in respect of this tax.

Turnover tax

Trends in turnover tax revenue improved somewhat in the third quarter. Thus, in that period, receipts from that tax grew by just over 2%, whereas in the first half of the year they had only reached their level in the corresponding period last year. This reflects the fact that consumer demand has gathered pace recently; by contrast, the decline in government investment (subject to value added tax) and in the field of residential construction continued to have a retarding effect.

Federal budget

In the third quarter, the Federal Government incurred a deficit totalling DM 19 ½ billion and exceeding the corresponding amount reached last year by DM 5 billion. The key factor for this was that receipts declined by

9 ½%.³ In this context, tax revenue, especially as a result of the new regulation on the children's benefit system and of the raising of the basic allowance, declined by just over 6 ½%. Other receipts decreased by as much as approximately one-third, because high proceeds from sales of participating interests had accrued a year earlier, whereas in the third quarter of the current year no such receipts were recorded.

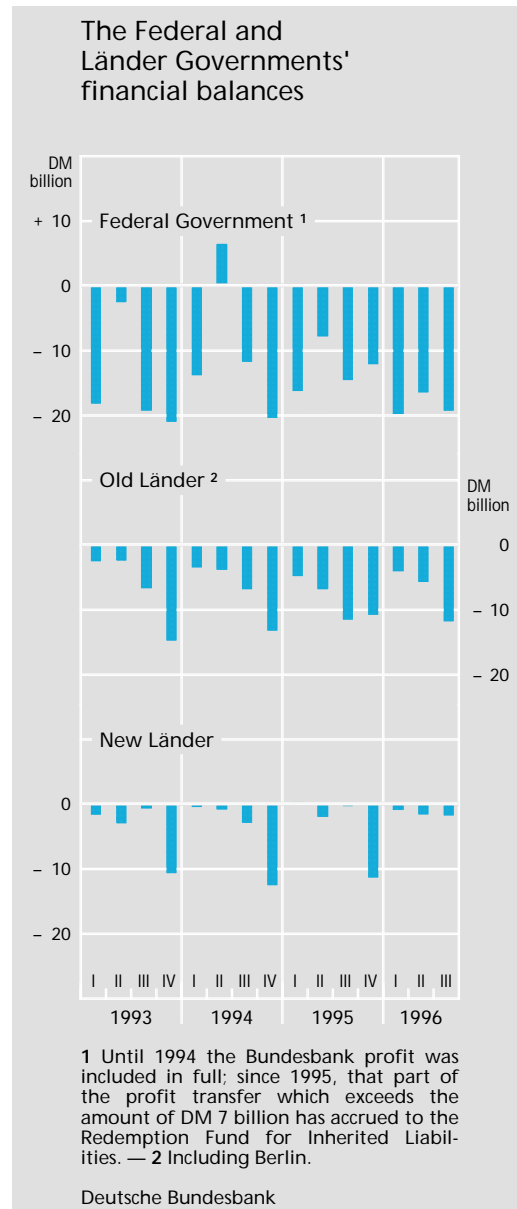
The expansion of the deficit was limited by the fact that expenditure also decreased considerably, viz. by 4 ½%. Even if child benefit, which is no longer booked as expenditure, but, instead, as a tax-reducing factor, is not taken into consideration, the decline still comes to ½%. Thus, the flow of expenditure, which was very rapid in the first half of the year, at a (likewise adjusted) growth rate of 6 ½%, decreased considerably. The fact that the grants to the Redemption Fund for Inherited Liabilities, which fluctuate strongly in the course of the year, lagged considerably behind the amount transferred in the same period last year was particularly evident here. In addition, interest expenditure declined by 7%, whereas it had increased by just over 3% in the first half of the year. Finally, fewer funds were spent on the granting of loans and for investment subsidies in the third quarter. By contrast, the Federal Government was substantially affected by labour-market-induced expenditure, which grew by just over

³ In contrast to the accounting rules applicable to the Federal budget, the supplementary Federal grants and the grants made to the Länder Governments for local public transport and financed by mineral oil tax revenue are recorded gross in the interim report here.

one-third. Thus, it had to pay DM 2½ billion to the Federal Labour Office for financing the latter's deficit, whereas a year earlier such a grant had not been necessary at all, and expenditure on unemployment assistance rose by one-fifth. The grants to the Federal Railways Fund also entailed considerable additional expenditure, since the latter's borrowing authorisation expired at the end of 1995 and the Federal Government has to close the resulting financial gap by making additional payments. Finally, other operating expenses grew by just under 8%; these were mainly attributable to military procurements.

*Länder
Governments*

In the third quarter the deficit of the Länder Governments came to DM 13½ billion, and was therefore DM 2 billion higher than the level reached in the same period last year. The expansion of the deficit was concentrated on the new Länder, which incurred a deficit of just over DM 1½ billion, whereas a year earlier they had ended up almost in balance. By contrast, the deficit of the old Länder (including Berlin), at just over DM 11½ billion, was approximately as large as in the previous year. The somewhat less favourable result of the Länder Governments was mainly attributable to the fact that receipts, at 2%, had increased only slightly. Owing to the low level of tax revenue, receipts in the new Länder were actually just under 1% below the level reached last year, whereas in western Germany they grew by 3%. The Länder Governments' expenditure exceeded last year's level by 3½% in the third quarter, the increase in the new Länder, at almost 6%, being considerably higher than in the old Länder (3%). This difference is also attrib-



utable to expenditure on staff, which in the old Länder lagged somewhat behind the level reached last year, whereas in eastern Germany it increased by almost 2½%. In this context, the adjustment of public service remunerations to western levels, effected in October 1995, was a significant factor. Generally, it has to be remembered that the increase both in expenditure and in revenue of the Länder Governments are inflated by

Net borrowing in the market by the central, regional and local authorities

DM billion

Period	Total	Of which		Memo item Pur- chases of public debt instru- ments by non- residents
		Secur- ities	Loans against bor- rowers' notes ¹	
1986	+ 38.0	+ 49.7	- 11.3	+ 37.2
1987	+ 50.0	+ 46.8	+ 3.6	+ 18.8
1988	+ 54.0	+ 42.1	+ 12.2	+ 6.6
1989	+ 25.8	+ 32.9	- 6.8	+ 18.8
1990 ²	+ 112.2	+ 90.9	+ 21.7	+ 15.1
1991 ³	+ 106.8	+ 71.3	+ 35.8	+ 50.9
1992	+ 102.4	+ 95.0	+ 7.9	+ 59.4
1993	+ 159.1	+ 120.3	+ 39.3	+ 109.1
1994 ⁴	+ 85.8	+ 45.6	+ 40.6	- 20.9
1995 ⁵	+ 97.6	+ 32.6	+ 81.4	+ 58.3
of which				
1st hf	+ 9.8	+ 15.2	- 4.4	+ 33.3
July/Oct. pe	+ 38.9	+ 9.3	+ 44.5	.
1996				
1st hf	+ 31.6	+ 25.8	+ 14.9	+ 10.9
July/Oct. pe	+ 56.4	+ 29.0	+ 34.1	.

¹ Including cash advances and money market loans. —
² Including GDR state budget (July 1 to October 2, 1990). — ³ From 1991 including east German Länder Governments and local authorities. Excluding the debt of the Federal Railways assumed by the Federal Government. — ⁴ From 1994 including Federal Railways Fund. — ⁵ From 1995 including Redemption Fund for Inherited Liabilities.

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about 2 percentage points as a result of the revision of the children's benefit system and the new regulation on financing local public transport.

*Local
authorities*

No data on local authorities are available yet for the third quarter. In the first six months, the deficit here came to just over DM 4 billion; thus, compared with last year, it decreased to less than half. An important factor for this was the retrenchment course which was necessitated by the extraordinarily large deficits incurred in the past few years and which was reflected particularly in expenditure on tangible fixed assets but also in expenditure on staff and other operating costs. In all, expenditure actually decreased by just under 1%. By contrast, receipts grew by just over 3%, which was not least attributable to

the steep growth in trade tax revenue. However, the budget volume is reduced by the further extraction of local authority services.

*Subsidiary
budgets*

Financial trends in the subsidiary budgets, which, as component parts of the central, regional and local authorities, are a very significant factor, developed along quite different lines in the third quarter. The surplus recorded by the Redemption Fund for Inherited Liabilities, at almost DM 1 billion, was considerably below the corresponding amount last year (DM 4½ billion). As already mentioned, however, this is solely attributable to the relatively low level of Federal grants. As in the first half of the year, interest expenditure, which is the only major expenditure item of the Fund, decreased considerably. By contrast, the Federal Railways Fund ended up more or less in balance, whereas a year earlier it had incurred a deficit of just under DM 1½ billion. The finances of the ERP Special Fund also improved substantially; in the third quarter, the Fund recorded a surplus of almost DM 1½ billion, compared with a deficit of DM ½ billion a year earlier. This was attributable to the fact that, on the one hand, the granting of loans had declined and that, on the other hand, loan repayments had increased very sharply, probably owing to the low level of market rates.

Total borrowing

After the middle of the year, the central, regional and local authorities resorted to the credit markets to a considerable extent. In the third quarter new borrowing came to DM 34 billion, and if October is included, to as much as DM 56 billion; in the period between July and October 1995, at DM 39 billion, it had

been perceptibly lower. About one-half of the loans was obtained through sales of securities; in this context, Treasury discount paper with a maturity of less than one year (Bubills) and two-year Treasury paper, which are new financial instruments of the Federal Government, played an important role. DM 34 billion was acquired through raising loans against borrowers' notes. On the other hand, other debt was redeemed to the amount of DM 7 billion net.

*Federal
Government*

In the period between July and October, the Federal Government was the largest borrower and raised DM 38 billion net. This amount includes just under DM 6 billion in the form of short-term cash advances in the money market. The Federal Government's net borrowing in the capital market for financing the budget came to DM 32 billion. If the considerable financial requirements for redemptions are included, gross borrowing by the Federal Government amounted to DM 60 billion, DM 54½ billion of which was attributable to sales of securities, and DM 5½ billion to loans against borrowers' notes.

*Länder
Governments
and local
authorities*

In the four-month period, the Länder Governments, too, resorted to the credit market to a considerable extent, at DM 26½ billion net, just over DM 20 billion of which was attributable to the old Länder (including Berlin), and DM 6 billion to the new Länder. As usual, the Länder Governments preferred raising loans against borrowers' notes (DM 23 billion net). In addition, DM 3 billion was acquired through sales of securities; in this context, seven Länder Governments jointly launched Länder Treasury paper with an issue volume

of DM 4 billion for the first time in August. New borrowing by the local authorities came to an estimated DM 2 billion.

In the period between July and October, the subsidiary budgets reduced their debt by a total of DM 10 billion; just under DM 8½ billion of this amount was attributable to the Redemption Fund for Inherited Liabilities alone. At DM 6½ billion, the bulk of the Fund's repayments concerned liabilities which it had assumed from east German housing enterprises in 1995. Thus, this component of the debt inherited from the GDR has been entirely redeemed, except for a small residual amount. The ERP Special Fund, the "German Unity" Fund and the Federal Railways Funds repaid loans, on balance.

*Subsidiary
budgets*

Outlook for 1996 as a whole

The financial trends recorded by the central, regional and local authorities in the current year have been shaped by the fact that receipts have continued to be low. The measures included in the 1996 Annual Tax Act (principally the improvement in the children's benefit system and the raising of the basic allowance) are leading to tax shortfalls of about DM 21 billion, seen over the entire year. In addition, the economic recovery has not yet been reflected in a corresponding reaction in respect of tax revenue.

Low receipts

On the contrary, the Working Party on Tax Estimates forecast in November that the shortfall would be DM 5 billion greater than the estimate in May although the nominal growth of gross domestic product was esti-

mated somewhat higher (2.5%, compared with 2.1% in May).⁴ Particularly turnover tax revenue has so far been disappointing; this was largely attributable to the decline in government investment and to a downturn in residential construction (which are subject to taxes). Further losses in assessed income tax were also a relatively significant factor. These losses are influenced by the continuing decline in tax revenue for earlier years, not least because considerable use has been made of various tax allowances. One "economic ray of hope" for tax revenue is the fact that the prepayments in respect of assessed income tax, and particularly in respect of corporation tax, show an upward trend. In all, tax revenue will be just over 1% lower than in 1995, according to the most recent official forecast; if adjusted for the revision of child benefit, this would correspond to a growth of 1¼%.

*Retrenchment
in expenditure*

The central, regional and local authorities are making efforts to absorb shortfalls on the receipts side as far as possible by adopting an expenditure retrenchment course – including limitations in the implementation of the budget. From the present perspective, expenditure – adjusted for the revision of child benefit – will probably grow by no more than approximately 1½% (such a low growth rate was last recorded in 1983). However, this mainly affects expenditure on investment, which in 1996 will probably lag considerably behind the level reached last year. For the rest, pressure was taken off the budgets of the central, regional and local authorities by the fact that since autumn last year interest rates have been running at a very low level. For that reason, interest expenditure is rising

only moderately in 1996, in spite of the high level of new borrowing recorded last year.

The retrenchment efforts of the central, regional and local authorities will probably not be sufficient to avoid another expansion of their deficits, which last year came to DM 110 billion. The social security funds, too, will probably record less favourable results than in 1995. The public sector deficits, as defined in the national accounts, that are relevant for compliance with the criteria spelled out in the Maastricht Treaty, at 3.5% of gross domestic product, had been perceptibly above the prescribed 3% limit in 1995. In 1996 the deficits will overshoot the Maastricht limit even further. At present the Federal Ministry of Finance is assuming that there will be a deficit ratio of 3¾% of GDP. At the end of 1996, the debt level of the public sector budgets is likely to reach the 60% limit, or will slightly overshoot it.

*Growing
deficits*

Budget for 1997

The deficits, which in 1996 have been larger than originally estimated, have given rise to additional needs for consolidation. When the 1997 budget was set up, retrenchment efforts had to be reinforced, if only for that reason, after important signals had been set with the "Programme for more growth and employment" submitted by the Federal Government in April and already partly implemented.

*Considerable
need for
consolidation*

⁴ The revenue expectations of autumn 1995, which had virtually formed the basis of the 1996 budgets, had already been revised downwards by almost DM 22 billion for 1996 in the May estimate.

*Further tax
shortfalls,
according to
tax estimate*

The budgets had to take the fact into account that expectations concerning tax revenue had to be further revised downwards. In November the Working Group on Tax Estimates reduced the figures forecast in May 1996, on which the drafts were largely based, by just over DM 10 billion; this was done on the basis of existing tax legislation. As a result, the differentials in the tax shortfalls in 1996 and 1997 now seem likely to be greater than in the May estimate. This is attributable, on the one hand, to the fact that the forecast for the coming year assumes a somewhat slower nominal economic growth than supposed in the spring; on the other hand, the expected structure of the growth process is less "tax-yielding" than assumed at that time.⁵ If, in addition, the changes in existing tax legislation are taken into consideration, it seems likely that in 1997 tax revenue will increase by about 3¼%, and thus somewhat less than the expected nominal economic growth. As far as tax measures are concerned, shortfalls arising from the *de facto* abolition of property tax and some minor tax relief measures will more or less offset additional receipts incurred on the other side (particularly as a result of the steep increase in the tax on the acquisition of land and buildings and the reform of inheritance tax).

*Retrenchment
in expenditure*

According to the present state of budget plans – the Federal Government's budget was adopted by the Bundestag at the end of November, whereas the deliberations on the Länder budgets have not yet been finalised – it appears likely that the overall expenditure of the central, regional and local authorities will only slightly exceed the volume reached

in 1996. Thus, the plans are geared to reducing the deficit of the central, regional and local authorities, compared with 1996. In addition, the public sector as a whole will experience a reversal from deficits to surpluses in respect of the social security system. This reversal is mainly attributable to the fact that the reduced reserves in the statutory pension insurance scheme will have to be built up to the prescribed target again. The high financial requirements of the pension insurance system have made it necessary to raise the contribution rate from 19.2% to 20.3% of eligible income. However, this implies that the macroeconomic burden of levies, in relation to GDP, will slightly increase in the coming year, whereas it was reduced somewhat in 1996.

However, the plans and the estimates of budget trends in respect of the central, regional and local authorities and the social insurance system are subject to some uncertainties and risks. In order to avoid the risk that in 1997 the public sector deficit (in the ESA definition) – which will form the basis for the examination deciding on entry into the final stage of monetary union – exceeds the limit imposed by the Maastricht Treaty (3% of GDP), it is important that steps are taken to ensure that the envisaged expenditure ceiling is not exceeded when the budget of the central, regional and local authorities is im-

*Improvement in
public finance
as a whole*

Risks

⁵ The new tax forecast for 1997 is based on an expected economic growth of just under 4% in nominal terms (compared with just over 4% in May) and 2½% in real terms (compared with 2% to 2½% in May). Compared with the spring, a lower growth rate of total gross wages and salaries and a sharper increase in the foreign balance are expected, and this will be reflected in additional shortfalls in respect of wage tax and turnover tax.

Federal budget

DM billion

Item	1995	1996	1997	
	Out-turn	Plan 1	Draft	Plan
Receipts ²	414.1	391.2	383.6	386.5
of which				
Taxes	366.1	351.2	350.3	345.7
Expenditure ²	464.6	451.3	440.2	439.9
of which				
Investment	66.5	66.3	60.6	59.6
Deficit	- 50.5	- 60.1	- 56.6	- 53.4
Net borrowing	50.1	59.9	56.5	53.3

¹ From 1996 onwards, child benefit is no longer booked as expenditure, but, instead, is deducted from tax receipts. — ² After deduction of the supplementary Federal grants and, since 1996, of the transfers from mineral oil tax revenue for financing local passenger transport.

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plemented. In addition, it is imperative to ensure the sustainability of the consolidation process and to achieve further progress over the medium term.

*Consolidation
course is
confidence-
building*

At the same time reducing the public sector deficit in the coming year is an important element of a strategy for improving the underlying macroeconomic conditions in Germany. It strengthens confidence in the fact that the fiscal policy course aimed at over the medium term will really be enforced; apart from limiting the large public sector debt, however, this course also requires a reduction in the heavy burden of levies. The positive impact of these expectations on the economic climate provides a counterbalance to the shortfall in public sector demand.

The Federal budget was adopted by the Bundestag at the end of November. It provides for a 2½% decline in expenditure to DM 439.9 billion and for net borrowing to the tune of DM 53.3 billion. Thus, new borrowing could be kept below the amount envisaged in the draft budget which was adopted in July and which provided for DM 56.5 billion, although the final plan had to take account of additional budget gaps to the tune of DM 13 billion.

*Benchmarks of
the Federal
budget*

On the strength of the most recent tax estimates, the Federal Government therefore had to budget for shortfalls which were DM 4½ billion greater than in the draft based on the May estimates. The government's calculations took due account of the lower transfers to the EC budget and of adjustments to the present state of the planned amendments to tax legislation. An even more significant factor was additional expenditure to the tune of DM 6½ billion, which results from the fact that, contrary to the original intention, provision had to be made in the budget for a grant to the Federal Labour Office of DM 4.1 billion and for higher appropriations for unemployment assistance and other labour-market-related expenditure. Apart from further additional requirements, it was also necessary to increase the grant to the pension insurance scheme by just over DM 1 billion, since this is also linked to the trend in the contribution rate, which had to be raised more sharply than initially expected.

*Additional gaps
compared with
the draft ...*

To close these budget gaps, it was possible, on the one hand, to increase estimated receipts by DM 4½ billion (particularly as a

*... and
measures to
close them*

result of the DM 1½ billion estimated from Telekom licence fees, loan repayments by former Treuhand enterprises to the tune of just under DM 1½ billion and proceeds from sales of property, which were DM 1 billion higher than expected). On the other hand, it is assumed that requirements in respect of interest expenditure and guarantees will be reduced by just over DM 3 billion, in all. In addition, a blanket cut of DM 2 billion in expenditure, spread over the various government departments, was included in the budget. A number of other cuts totalled DM 3½ billion. Furthermore, net borrowing was reduced to a level below the estimates in the original draft by including private proceeds which had not been realised in 1996 and which amounted to just over DM 3 billion.

*Consolidation
a priority*

Both the decline estimated on the expenditure side and the substantial reduction of the envisaged net borrowing – when compared with the target figures, and even more so when compared with the actual figures likely for the current year – emphasise the high priority given to the consolidation of the Federal budget. This is also reflected in the fact that the expenditure volume, despite considerable additional labour-market-induced expenditure, is about DM 18 billion less than the appropriations which were envisaged in the medium-term financial plan for 1997 drawn up in the summer of 1995. However, particularly in respect of the grant to the Federal Labour Office and of unemployment assistance, it cannot be ruled out that the ceiling will be overshoot when the budget is implemented. In addition, it has to be borne in mind that the higher estimates for other

receipts are mostly of a one-off nature. Hence, the consolidation requirements remain high and will continue to be so over the medium term.

The budgets of the Länder Governments (most of which have not yet been finalised) also provide for a considerable overall reduction in deficits in 1997. These deficits are put at approximately DM 40 billion for the current year. The most significant factor here is the efforts to cut expenditure, which, according to the plans, is expected to increase only slightly. In this context, the wage agreement in the public service and the envisaged reduction in staff numbers are of particular importance. On the receipts side, sales of property will probably also be a significant factor in the case of some Länder in the coming year.

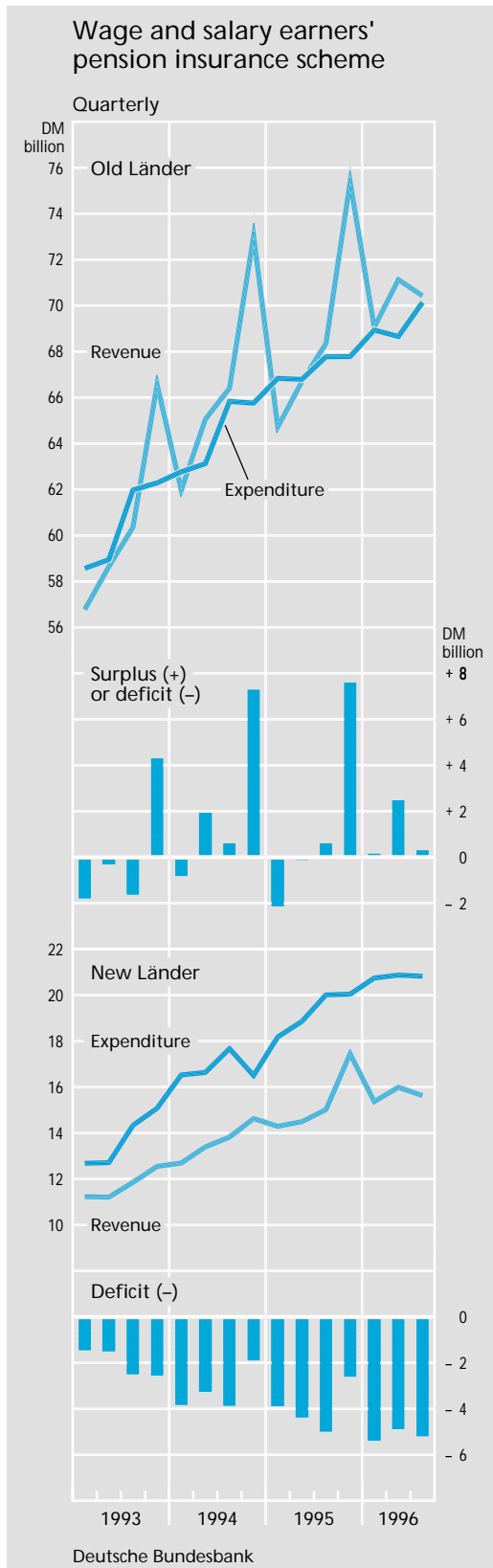
*Budgets of the
Länder
Governments*

Social security funds

In the third quarter of 1996, the finances of the statutory pension insurance scheme deteriorated somewhat, compared with the first half of 1996. At almost DM 5 billion, the deficit was DM½ billion higher than in the third quarter last year. A 3¾% increase in expenditure was accompanied by an increase of just under 3½% in revenue. In this context, revenue from compulsory contributions increased by no more than 3%, compared with the previous year; without the increase in the contribution rate from 18.6% to 19.2% at the beginning of 1996, it would actually have declined somewhat. This reflects the unfavourable employment trend and the moderate increases in wages and

*Statutory
pension
insurance
scheme*

Revenue



salaries in the course of the year. The transfers of the Federal Government – which are also linked to the trend in the contribution rate – increased by just over 6%.

Compared with the previous year, expenditure on pensions increased by 3½%. The increase in the west, at 3¼%, was perceptibly above the 1% pension adjustment on July 1, 1996, owing to the fact that the number of pension recipients continued to increase substantially. However, expenditure on pensions in the east, at 4%, increased somewhat less rapidly than would have been consistent with the pension adjustment of almost 4½% on January 1, 1996 and another of just over 1% in mid-1996. This is mainly attributable to the fact that the replenishing amounts granted to east German pensioners have been gradually reduced since the beginning of 1996 by offsetting them against the pension adjustments.

Expenditure on pensions

Both in the east and the west, contribution transfers from the pension insurance institutions to the pensioners' health and nursing insurance scheme, at a total of 11%, increased sharply, compared with last year. This is mainly attributable to the increase in the contribution rate for the nursing insurance scheme, which rose from 1% to 1.7% when the second stage of that scheme came into force on July 1, 1996. In addition, there was an increase in the contribution rate for the pensioners' health insurance scheme (from 13.2% to 13.4% in the west, and from 12.8% to 13.3% in the east).

Pensioners' health and nursing insurance

Prospects for
the whole of
1996 and 1997

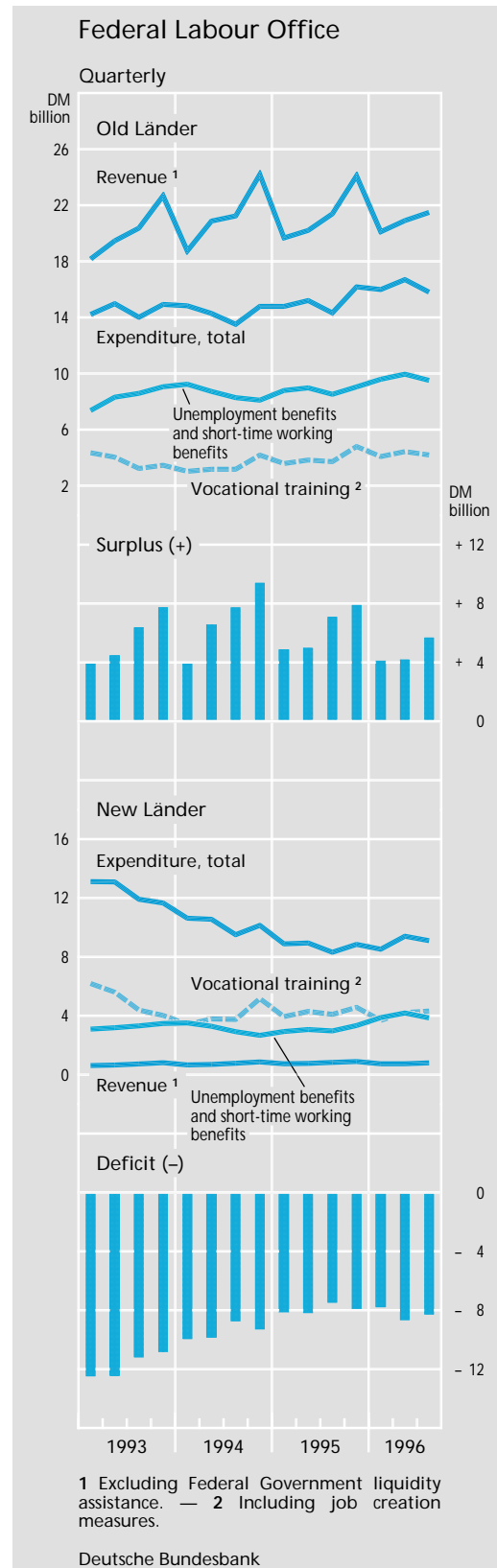
In its 1996 Pension Insurance Report submitted in July, the Federal Government assumes that the deficit will reach DM 5 billion in the current year. It now seems likely that the deficit for 1996 will be higher, mainly as a result of the subdued trend in receipts. As, moreover, assumptions concerning trends in employment and in wages and salaries have been revised downwards for 1997, the funds required to bring the fluctuation reserve up to the target of one month's expenditure by the end of 1997 have increased considerably. In order to comply with this statutory requirement, a surplus of about DM 12 billion is necessary for 1997. Hence, the contribution rate has to be raised to 20.3% at the beginning of 1997, whereas the increase had originally been limited to 19.9%. This calculation takes into consideration the relief measures provided for in the Growth and Employment Promotion Act, which was adopted by the Bundestag in September.

Federal Labour
Office

In the third quarter, the Federal Labour Office incurred a deficit of just over DM 2½ billion, which is slightly more than DM 2 billion higher than in the corresponding period last year. In the west the surplus declined by almost DM 1½ billion to just over DM 5½ billion, whereas in the east the deficit increased by almost DM 1 billion to DM 8¼ billion. While receipts hardly exceeded the level reached last year, expenditure grew by 10% (the increase in the old Länder and in the new Länder being approximately the same).

Expenditure

Expenditure on unemployment benefit grew by a total of just over 15%, and thus



approximately as steeply as in the first half of the year. It was not only the further increase in the number of recipients, particularly in eastern Germany, that made itself felt. The Federal Labour Office also had to pay higher contributions towards the statutory pension, health and nursing insurance schemes for the recipients of unemployment benefit. Expenditure on active labour market policy (which, apart from vocational training, also includes measures to create jobs) grew by 8½%; its increase has accelerated continuously since the beginning of the year. In eastern Germany this type of expenditure again increased perceptibly in the third quarter (by 5¼%), whereas it had decreased in the first half of the year. In the old Länder, by contrast, the previously very sharp increase slowed down somewhat; however, in the third quarter, at 12%, it far exceeded that in eastern Germany. In absolute terms, the amount spent on active labour market policy measures in western and eastern Germany was almost the same, at DM 4½ billion.

*Trends in 1996
as a whole*

In the first three quarters of the year, the deficit of the Federal Labour Office totalled just over DM 10½ billion. Even if it is to be expected that the deficit in the fourth quarter will be relatively low, owing to seasonal factors, the deficit to be financed by the Federal Government in the entire year will be approximately three times as high as the amount envisaged in the Federal budget (DM 4.3 billion).

*Prospects for
1997*

The 1997 Federal budget provides for a grant to the Federal Labour Office amounting to DM 4.1 billion. In this context, it is assumed

that the number of unemployed persons, taking the average of the year, will persist approximately at the 1996 level. Plans include substantial financial relief on the basis of the Growth and Employment Promotion Act. The limitation of the Federal grant envisaged by the Federal Government, however, requires further considerable retrenchments in the Federal Labour Office's budget, compared with the version adopted by the administrative committee. The adoption of the Federal Labour Office's budget by the Federal Government is subject to certain conditions which are meant to ensure that the level of grants needed in 1997 will not exceed DM 4.1 billion. This is to be achieved mainly by spending less on vocational training and job creation measures.

In the first three quarters of 1996, the statutory health insurance institutions incurred a deficit of almost DM 8¾ billion; it was thus larger than in the corresponding period last year (DM 7½ billion). In western Germany the deficit came to almost DM 7 billion between January and September, and in eastern Germany it reached about DM 1¾ billion. In the third quarter, the all-German deficit, at just under DM 1½ billion, was just over DM ½ billion lower than a year earlier, however. It was also as a result of increases in the contribution rate that the receipts of the health insurance institutions (adjusted for the risk structure compensation) increased by 3½% in the period between January and September, compared with the previous year. By contrast, expenditure rose by 4%. Spending on pharmaceuticals as well as on health appliances and health aids rose excep-

*Statutory
health
insurance
institutions*

tionally sharply (+ 9½%). It is likely that in the fourth quarter there will be a surplus, owing to the impact of contribution receipts which will be higher for seasonal reasons. For the entire year, however, the out-turn is expected to be still somewhat less favourable than in 1995, when the deficit had come to DM 7 billion.

*Legislative
projects*

In view of the large deficit and the trend towards a continuation of the steep increase in expenditure, a reform has become all the more imperative. Initially, the Contribution Relief Act provided for a set of retrenchment measures, on the one hand; on the other hand, it prohibited contribution rate increases for the rest of 1996 (after May 10), as a rule, and prescribed that, as of the beginning of 1997, all health insurance institutions had to lower the contribution rate by 0.4 percentage point. However, in November most "substitute" health insurance institutions had to be

granted the right to raise their contribution rates on December 1, 1996, owing to unforeseen additional burdens arising from the risk structure compensation scheme. In addition, in November the Bundestag adopted the "First Act on the New Regulation of Autonomy and Responsibility in the Statutory Health Insurance System". It envisages higher payments to be borne automatically by the insured persons themselves in the case of increases in the contribution rate which are not motivated by the risk structure compensation scheme; it also provides for an extraordinary right of the insured person to give notice whenever contribution rates are increased. The draft of the "Second Act on the New Regulation of Autonomy and Responsibility in the Statutory Health Insurance System", which includes many additional amendments to the legal framework, is now being discussed in the Bundestag.