

Public finance

Central, regional and local authorities

Trends in the fourth quarter of 1996

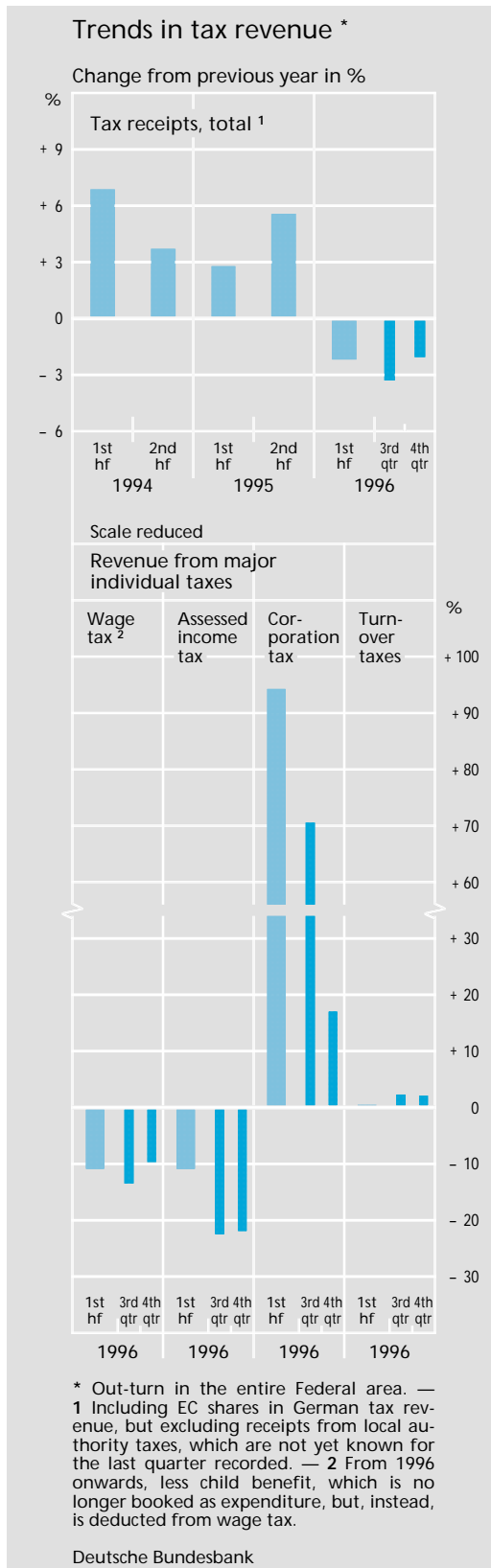
The financial situation of the central, regional and local authorities deteriorated in the last few months of 1996. According to the incomplete data available, the deficit was probably perceptibly higher in the fourth quarter than in the same period of the previous year, when it had come to DM 43 billion. In the first nine months, taken together, the deficit, at just over DM 70 billion, had been approximately as high as a year previously. Towards the end of 1996 the budget situation was again shaped by the persistently low level of revenue. On the other hand, the central, regional and local authorities made considerable efforts to limit the flow of expenditure and thereby counteract the expansion of the deficits. Trends were very different at the various levels of government. The more favourable financial position of the subsidiary budgets contributed most to offsetting the sharp increase in the deficit of the Federal Government.

Basic trend

Tax receipts¹ in the last quarter of 1996 continued to lag behind the corresponding result achieved a year previously (by 2%). This was particularly due to measures which came into force at the beginning of the year. Although revenue did not decline as sharply as in the third quarter (- 3%) as a result, this does not suggest an improvement in the trend, since at the end of the year additional

Overall taxes

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



one-off receipts of almost DM 3 billion arose from the shortening of the payment periods for mineral oil tax and tax on spirits. If these special factors are excluded, the fall in tax revenue in the last quarter was similar to that in the three previous months.

As before, the decline in revenue was caused primarily by wage tax, the receipts from which were considerably reduced by the raising of the basic allowance at the beginning of 1996 and, even more so, by the significant improvement in child benefit, which is now deducted from wage tax. In the last quarter of 1996 wage tax yielded 9½% less than in the same period of the previous year, whereas its revenue had decreased by as much as 13½% in the third quarter. The decline in receipts, which was somewhat less significant at the end of the year, is mainly attributable to the fact that child benefit reduced revenue (which in that period is influenced by "Christmas bonuses") relatively less than in the other quarters. Before deduction of the child benefit payments, wage tax receipts were 4% higher than a year before; in this context, however, it has to be borne in mind that the tax allowance for children – which since 1996 is granted only as an alternative to child benefit – is no longer deducted at source, but, instead, during the subsequent income tax assessment for the fiscal year concerned. For the rest, the trend in revenue from wage tax continued to be shaped by the moderate wage agreements of the past few years and by the higher level of unemployment.

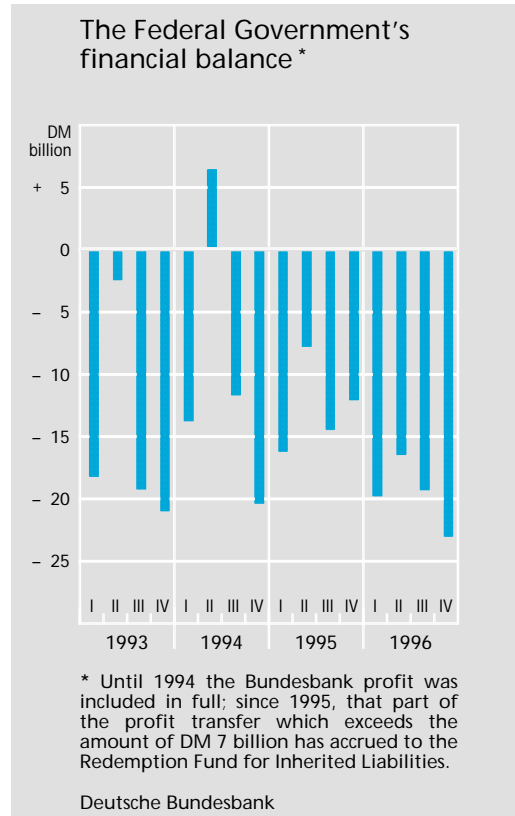
Wage tax

Assessed taxes

Receipts from assessed income tax were actually as much as just over one-fifth lower than the corresponding level reached in the previous year, which implied that the very unfavourable trend continued towards the end of the year. It is probably significant here that before the turn of the year many tax payers utilised the special depreciation allowances (of 50%) for investment in eastern Germany, which were granted without restrictions until the end of 1996, and had apparently already claimed them under the prepayment procedure.² It was probably private investors in east German rented housing construction – an area in which the special allowances will be reduced by half from 1997 onwards – who resorted most to anticipatory measures. It is possible, however, that these measures were also taken in the case of corporate investment as this type of investment, particularly outside manufacturing, was considerably affected by the reduction in tax-related incentives to invest in eastern Germany which came into effect at the beginning of 1997. This was probably one reason why at the end of the year the growth in revenue from corporation tax decreased even though receipts from that tax had been as much as 17% higher in the last quarter than a year before. Tax prepayments apparently developed less favourably, whereas final payments for earlier years – particularly 1994, a “profitable” year – continued to increase considerably, judging from present indications.

Turnover tax

Revenue from turnover tax continued to grow moderately in the last quarter (+ 2%). The economic recovery was reflected only



partly here since it was based to a considerable extent on tax-free exports. For the rest, the increase in turnover tax receipts was restrained by the fact that investment in the field of housing and on behalf of the government – which, apart from domestic final consumption, is ultimately also subject to value added tax – decreased compared with the corresponding period of the previous year.

Of the various levels of government, the Federal Government had a particularly unfavourable result in the fourth quarter. Its deficit came to DM 23 billion and was thus almost

Federal budget

² The opportunity to “save taxes” before the end of the year was also favoured by the regulation which enables advance payments effected before the turn of the year to be set against tax for 1996 – even if the investment object is completed at a later date.

twice as high as in the same period of the previous year. The crucial factor for this was the sluggishness of tax revenue, which decreased by just under 5%; adjusted for the net recording of child benefit, it grew by just under 2%. Other receipts decreased very sharply, particularly as a result of lower privatisation proceeds. Expenditure (also adjusted for the net recording of child benefit) grew by 5%, which is mainly attributable to the fact that the grant to the Federal Labour Office and unemployment assistance, taken together, required 75% more funds than a year before.

*Länder Govern-
ments*

By contrast, the deficit of the Länder Governments in the last quarter of 1996 was probably lower than the large amount incurred in the previous year, in spite of the fact that tax revenue continued to be disappointing. This applies particularly to the new Länder (excluding Berlin) where, as a result of the very uneven outflow of funds, the deficit in 1995 concentrated particularly heavily on the last quarter (DM 11½ billion, compared with an annual deficit of DM 13 billion). No data on the local authorities are so far available for the fourth quarter.

New borrowing

To finance their large deficits the central, regional and local authorities resorted to the credit markets to a large extent in the fourth quarter. According to the figures available so far, net borrowing came to DM 60 billion; it was thus about as high as in the first three quarters taken together. In the last quarter, approximately two-thirds of new borrowing were attributable to the raising of loans against borrowers' notes. Net sales of secur-

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 4th qtr	+ 56.9	+ 7.7	+ 49.6	+ 16.8
1996 pe	+ 126.5	+ 66.7	+ 75.6	...
of which 4th qtr pe	+ 60.2	+ 17.9	+ 47.1	...

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.

Deutsche Bundesbank

ities concentrated on the short and medium-term maturity areas, whereas bonds were redeemed, on balance.

In the last quarter of 1996, net borrowing by the Federal Government came to DM 32½ billion. Of that amount, DM 20½ billion was obtained through sales of securities; Federal Treasury notes and five-year special Federal bonds were in particular demand in addition to "Bubills". Loans of DM 5½ billion were raised against borrowers' notes, and, in addition, the Federal Government resorted to short-term bridging loans in the money market to the tune of DM 6½ billion. On the other hand, it also increased the cash resources it maintains in the money market, with the result that at the end of the year it had a credit balance of DM 3½ billion. The

Länder Governments (whose financial requirements are usually particularly high in the last few months of the year) also borrowed heavily, viz. to the extent of DM 26 billion net. Borrowing by the local authorities, at an estimated DM 4 billion net, was also relatively high. By contrast, the subsidiary budgets reduced their debt levels by DM 2³/₄ billion in the fourth quarter.

Preliminary result for 1996

Last year no progress in reducing the large budget deficits arising from German unification could be expected from the outset. The reason is that, owing to a ruling by the Federal Constitutional Court, it had become necessary to raise the income-tax-related basic allowance sharply and to expand the children's benefit system. In addition, the "coal penny" for financing hard coal subsidies, which had been levied up to that time, was repealed. In spite of the additional burdens of about DM 30 billion arising from these measures, the budget plans of the central, regional and local authorities provided for a deficit similar to that in 1995 (DM 110 billion). The difference was to be absorbed by sharply limiting the increase in expenditure.

According to the figures available so far, the budget deficits of the central, regional and local authorities have actually risen by up to DM 10 billion compared with 1995. According to the initial figures which the Federal Statistical Office has submitted for the national accounts and which are still partly based on estimates, the deficit of the public sector budgets (i. e. including the social insur-

ance institutions) came to 3.9% of GDP in 1996; thus the 3% limit laid down in the Maastricht Treaty was overshoot even more clearly than in 1995 when the deficit ratio came to 3.5%.

To finance the growing deficits the central, regional and local authorities, according to the figures available so far, borrowed to the tune of DM 127 billion net (compared with DM 98 billion a year previously). If other changes in the debt level are taken into account, total indebtedness came to approximately DM 2,135 billion³ at the end of the year; in terms of the debt level criterion of the Maastricht Treaty this implies a debt-to-GDP ratio of just over 60¹/₂%. Thus, the upper limit of 60% set for the debt level was overshoot for the first time.

The main reason for the expansion of the deficits was that receipts grew substantially less than estimated in the plans. According to the provisional figures, tax revenue in 1996 decreased by 1³/₄%; adjusted for the net recording of child benefit, it rose by ³/₄%. Thus, in terms of the comparable tax estimate of October 1995, which largely formed the basis of the budget plans, shortfalls came to DM 31¹/₂ billion. They are mainly attributable to the fact that overall economic growth was considerably lower than expected.⁴ In addition, the structure of economic growth was

*Net borrowing
and debt level*

*Large tax
shortfalls*

*Budget plans
1996*

*Deficit ratio
considerably
above 3% limit
in 1996*

³ This includes the old debt of social institutions at the local authority level of the former GDR to the tune of DM 8¹/₂ billion.

⁴ Whereas the tax estimate of October 1995 was based on a growth in nominal GDP of just over 4¹/₂%, the surplus ultimately came to no more than just under 2¹/₂% (the increase in real GDP came to just under 1¹/₂%, compared with the forecast 2¹/₂%).

hardly remunerative, particularly in view of turnover tax, since the growth process was largely fuelled by tax-free exports, on the one hand, and since taxable investment in the field of housing construction and on behalf of the government stagnated or even declined considerably, on the other. Total gross wages and salaries, on which wage tax revenue depends, increased only slightly, not least as a result of the disappointing trend in employment. The large extent to which tax concessions were claimed, particularly towards the end of the year (as mentioned above), played a part in addition to cyclical factors. Although these tax concessions also influenced corporation tax (in addition to assessed income tax), corporation tax was the only major tax which had a more favourable result than expected; this was mainly attributable to the fact that since 1994 the profitability of the enterprises which are liable to corporation tax has improved considerably. The overall tax ratio decreased by 1 percentage point (to 22.6% of GDP), but about one-half of this was attributable to the net recording of child benefit. For the rest, the relief granted to tax payers, which came into force at the beginning of 1996, played a part. However, the effective tax relief was offset by a further increase in the ratio of social security contributions from 19.4% to 19.8% of GDP, with the result that the overall burden of taxes and levies hardly changed at all.

*Trend in
expenditure*

However, part of the tax shortfalls could be absorbed by the fact that the expenditure appropriations (with the important exception of labour-market-induced expenditure to be borne by the Federal Government) were not

fully utilised. The burden was eased by the persistently low interest rate level as well as the moderate wage agreement in the public sector. In contrast to the 3.2% increase in wages and salaries arising from the previous "wage round", which made itself felt until the end of April, only a "one-off payment" of DM 300 for each employee was agreed for 1996. In addition, expenditure freezes were imposed at all levels of government in order to take account of the shortfalls in receipts which became increasingly apparent in the course of the year. Overall, expenditure of the central, regional and local authorities (adjusted for the net recording of child benefit) probably increased by no more than about 1½%. However, expenditure of the social security institutions grew far more sharply, with the result that the government ratio increased again. Although, according to the provisional figures for the national accounts, the government ratio comes to no more than 50.5% of GDP, compared with 50.6% last year, this is also due to the net recording of child benefit. Adjusted for this factor, the government ratio would have reached a peak of 51%.

Last year the financial trends of the central, regional and local authorities continued to be shaped largely by the exceptionally sharp expansion of the deficit of the Federal Government. In the 1996 budget, the deficit, at DM 60 billion, had already been put just under DM 10 billion higher than the amount incurred in 1995, which owed much to several additional burdens. Apart from the shortfalls arising from the increase in the basic allowance, which affected all central, regional and

*Financial
position of the
Federal budget*

local authorities, in accordance with the income tax distribution scheme, the Federal Government, in fact, had to bear a major part of the burdens associated with the improvement in the children's benefit system by forgoing part of the revenue from turnover tax. Moreover, after the abolition of the "coal penny" the Federal Government had to assume the subsidies financed by this levy as well as additional transfers to the Federal Railways Fund, whose credit authorisation had expired at the end of 1995.

In fact, in 1996 the deficit, at DM 78½ billion, still exceeded the estimated amount considerably. Apart from a shortfall of DM 17 billion in tax revenue, the fact that the labour-market-induced expenditure of the Federal Government overshoot the estimates by DM 16½ billion made itself felt; DM 9½ billion of that amount was attributable to a higher grant to the Federal Labour Office, and just over DM 7 billion to additional expenditure on unemployment assistance. In addition, the Federal Government could realise only about DM 2 billion of the privatisation proceeds estimated at DM 9 billion. However, there was also some relief in the form of lower expenditure than estimated. For example, the Federal Government had to pay just over DM 4 billion less to the European Union, and in respect of interest rates and guarantees, expenditure was DM 5 billion lower than expected; in addition, expenditure was reduced, on balance, by another about DM 7 billion, particularly as a result of the early introduction of a budget freeze. Finally, other receipts, too, yielded DM 5½ billion more than estimated, on balance.

In spite of the high additional expenditure arising from the trend in the labour market, expenditure ultimately overshoot estimates by no more than just under DM 4½ billion. The overshooting of the planned deficit was thus caused mainly by the receipts side of the budget.

The Länder Governments, taken together, slightly reduced their deficits compared with last year (just under DM 47 billion). Nevertheless, the estimates in the budget plans (just over DM 39 billion, if one includes the supplementary budgets) have probably been exceeded. The main reason for this was the unsatisfactory trend in tax receipts, which – compared with the tax estimate of October 1995, which largely formed the basis of the original budget plans – were about DM 12 billion lower. Tax shortfalls were counteracted particularly by limiting expenditure, *inter alia*, by imposing budget freezes and adopting supplementary budgets. Overall, the expenditure of the Länder Governments, adjusted for special factors,⁵ probably reached more or less the previous year's level.

*Länder
Governments*

The figures for the local authorities' budgets available so far cover only the first three quarters, in which the deficit decreased by DM 7½ billion to just under DM 5 billion. Thus, it appears likely that in the whole of 1996 the financial positions will be perceptibly more favourable than in the previous year, when,

*Local
authorities*

⁵ Both expenditure and receipts of the Länder Governments were inflated by about 2 percentage points, particularly as a result of the reorganisation of the child benefit system and the new regulations governing the financing of local public transport.

at a total of DM 14 billion, the deficit recorded had been very large. On the one hand, this was attributable to the retrenchment efforts in respect of expenditure on staff, other operating expenditure and, particularly, investment expenditure. On the other hand, social assistance reflected the relief effects triggered by the second stage of the nursing insurance scheme (which came into force in the middle of the year) and the expenditure-limiting measures which had been initiated by the Social Assistance Reform Act adopted in July. In addition, local authority receipts were reinforced by a considerable increase in trade tax, which is particularly attributable to the favourable trend in corporate profits in the previous few years and which was also influenced by the fact that for the first time trade tax was paid by the successor enterprises to the post office.

*Subsidiary
budgets*

The financial trend in the subsidiary budgets also curbed the increase in the deficits of the central, regional and local authorities. It was of particular importance here that, in contrast to the corresponding deterioration in the Federal budget, no deficit was incurred by the Federal Railways Fund, whereas a year before expenditure had still exceeded receipts by DM 7 billion. The deficit of the ERP Special Fund, too, was probably smaller, particularly as a result of large loan repayments, than in the previous year, when it had come to DM 2½ billion. Finally, in respect of the "German Unity" Fund and the Redemption Fund for Inherited Liabilities, the surpluses, which are used for repaying debt, probably still increased somewhat compared with 1995 (just

under DM 10 billion), owing to the low level of interest rates.

Budget plans for 1997

It seems likely on the basis of the budget plans of the central, regional and local authorities that the deficits will decline in the current year. The retrenchment course pursued last year will probably tend to be reinforced. Overall, expenditure is expected to overshoot the levels reached in the previous year only slightly; in respect of the Federal budget alone, the envisaged expenditure volume undershoots the amount envisaged for 1996 by as much as 2½%. Although only a moderate increase is expected in tax revenue, this implies a noticeable improvement, compared with last year. It is important here that in addition to the faster economic growth expected the increase in revenue in 1997 will be only slightly affected, on balance, by the changes which came into force at the beginning of the year (notably, the further increase in child benefit and the abolition of property tax, on the one hand, and the increase in inheritance tax and in the tax on the acquisition of land and buildings, on the other), whereas in 1996 large tax-related shortfalls in revenue had to be tolerated.

*Central,
regional and
local authorities*

However, overall financial trends in the public sector budgets are shaped even more strongly by the fact that in respect of the social security institutions the large deficits recorded in 1996 as a whole will be replaced by surpluses in the current year. The main reason for this is the reversal in the pension insurance scheme, although this has to be paid for by another

*Social security
institutions and
public sector
budgets, total*

sharp increase in the contribution rate. In its projections submitted to the Financial Planning Council in November the Federal Government assumed that the public sector deficit, including those of the social security institutions, could be reduced to 2½% of GDP in 1997, which would imply a safety margin in respect of the deficit ceiling of 3% of GDP laid down in the Maastricht Treaty. However, owing to the fact that the trend in tax revenue (which in the whole of 1996 undershot the official tax estimates of November 1996 by almost DM 5 billion) has been disappointing so far and in view of the fact that the situation in the labour market continues to be very unfavourable, it appears likely that budget plans will be put at risk and that this will threaten to wipe out the safety margin. In its 1997 Annual Economic Report submitted at the end of January the Federal Government put the prospective deficit at 2.9% of GDP. In view of the consequent uncertainties concerning compliance with the deficit criterion, it is now all the more important to make every effort in the implementation of the budget to ensure that the expenditure ceiling provided for in the plans is not exceeded overall, even if additional expenditure becomes necessary, and that, instead, this ceiling is undershot as far as possible, even in the event of imminent shortfalls in receipts.

*Federal
Government*

The budget of the Federal Government, which was adopted by the Bundestag at the end of November and which came into force at the beginning of the year, as scheduled, provides for a deficit of DM 53½ billion. The fact that the 1996 budget position, owing

to reduced tax revenue and higher labour-market-induced expenditure, is even more unfavourable than assumed during the final deliberations on the 1997 budget plan, also implies that the implementation of the budget in the current year will be adversely affected from the outset. Whether the estimated deficit ceiling can ultimately be observed will depend on the extent to which additional burdens can be offset.

The budget plans of the Länder Governments provide for a considerable reduction in the financial deficits (to about DM 32 billion) in 1997. The main reason for this is that expenditure is not supposed to exceed last year's level by more than a small margin. The increase in expenditure on staff, the most important expenditure category in the Länder budgets, is to be limited by further restrictions in respect of personnel policy. In accordance with wage agreements concluded in the public sector, the negotiated wage rates increased by 1.3% at the beginning of the year; the remunerations of civil servants will be increased by the same percentage from March and July.⁶ For the new Länder, another increase, viz. from 84% to 85% of west German levels, was agreed as of October. In addition, the sharply increased social security contributions are also leading to increases in expenditure on staff. On the receipts side, it is assumed that tax revenue will rise by around 4%, since the shortfalls in tax

*Länder
Governments*

⁶ The one-off payment of DM 300 for each employee in 1996 is not included in the 1.3% wage increase. Overall, the increase in expenditure on staff as a result of the wage agreement will amount to less than 1% for the whole of the year.

revenue in the Länder arising from the abolition of property tax were largely offset in the framework of the 1997 Annual Tax Act. The sales of assets also figure prominently in the plans of some Länder Governments. Although in this way it will be possible to bridge gaps for a short period, this hardly alters the fact that consolidation is necessary over the medium term.

*Local
authorities*

Given declining receipts and expenditure, the local authority central associations expect a slight deterioration in their overall financial situation in the current year; this applies particularly to the new Länder. On the expenditure side the sustained retrenchment efforts will also be reflected in investment. The social benefits provided by the local authorities – in spite of additional labour-market-induced expenditure – will probably not increase, owing to the fact that the second stage of the nursing insurance scheme will affect the entire year for the first time and as a result of the expenditure-limiting effects of the Social Assistance Reform Act. On the other hand, local authority receipts will probably be restrained by the fact that the retrenchment requirements at the Länder Government level will also affect the transfers granted under the local authority revenue-sharing scheme.

Social security funds

*Sharp
deterioration in
the financial
situation of the
Federal Labour
Office*

In the last quarter of 1996 the Federal Labour Office incurred a deficit of DM 3 billion, whereas in the corresponding period of the previous year it had obtained an almost balanced result. Expenditure rose by 13½%,

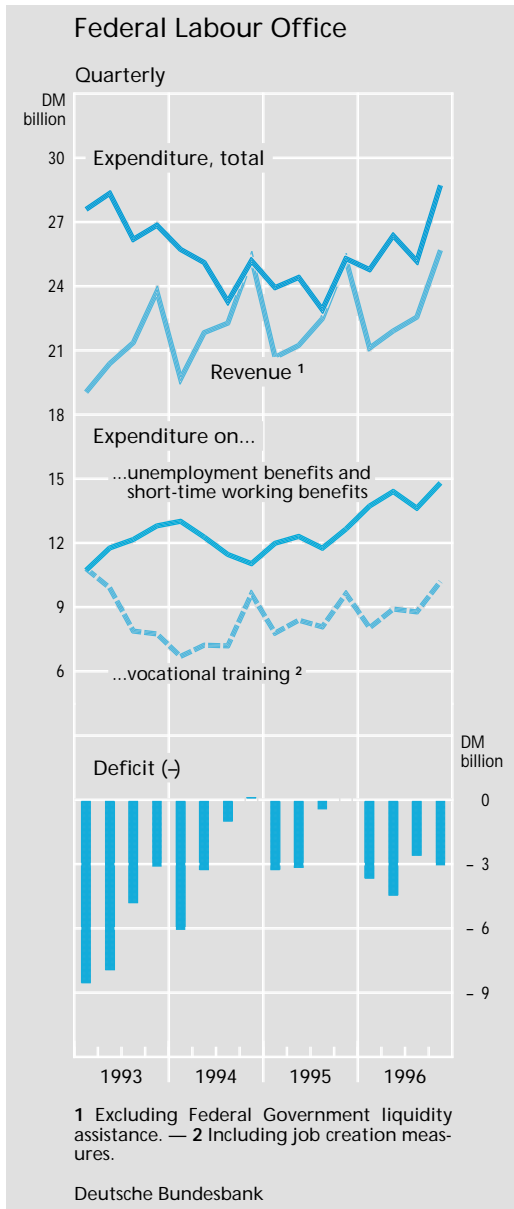
whereas contribution receipts, owing to the decline in employment and the moderate wage trend, hardly grew at all. As a result of the unfavourable trends in the labour market, payments of unemployment benefit and short-time working benefits rose by 17% in the fourth quarter, compared with the same period in 1995. Expenditure on vocational training also increased by 10%. By contrast, expenditure on job creation measures declined slightly (– 1½%). The increase in the contribution rates to the statutory pension, health insurance and nursing insurance schemes in the course of 1996 also triggered an increase in the contributions the Federal Labour Office had to pay in respect of wage substitutes.

In the new Länder, expenditure grew significantly more sharply than in the west. On the one hand, expenditure on unemployment benefit and short-time working benefits in the fourth quarter rose by 25½% in the east, compared with 13½% in the west. On the other hand, expenditure on vocational training and job creation measures, taken together, increased by 11% in the east, whereas it rose by no more than 1% in the west; by contrast, in the period between January and September this expenditure had expanded sharply in the west and had slightly declined in the east, albeit starting from a relatively high level there.

*Differences
between west-
ern and eastern
Germany*

In the whole of 1996 the deficit to be met by the Federal budget came to almost DM 14 billion, which means that it was twice as high as in 1995. Thus, the need for grants estimated in the budget for 1996 at just under

*Financial
position in the
whole of 1996*



DM 4½ billion was exceeded by DM 9½ billion. Expenditure on unemployment benefit and short-time working benefits had to be raised by 16%, compared with 1995, and in the east the increase was even greater. Expenditure on vocational training grew by 9%, the increase in the west being above average. Compared with the previous year, expenditure on job creation measures hardly changed at all in either the east or west.

Overall, expenditure overshoot the level reached in the previous year by just over 8½%, whereas receipts grew by no more than just under 2%.

For 1997 the budget of the Federal Labour Office provides for a Federal grant of only DM 4.1 billion to meet the deficit. Measures taken within the framework of the Growth and Employment Promotion Act are helping to limit the need for grants. In addition, the Federal Government imposed considerable retrenchment measures on the Federal Labour Office during the budget approval procedure. At the end of January the Bundestag adopted the Work Promotion Reform Act, which is expected to take pressure off the budget. The budget is primarily at risk from the trends in employment. When the budget was prepared, it had still been assumed that the average number of unemployed persons in 1997 would persist more or less at the level reached in 1996; by contrast, the 1997 Annual Economic Report expects an increase of about 200,000.

*Prospects
for 1997*

In the last quarter of 1996 the wage and salary earners' pension insurance scheme recorded a surplus of almost DM 3½ billion, but this was simply attributable to seasonal factors; compared with the previous year, the result of the pension insurance scheme was DM 1½ billion lower. The increase of just under 2% in contribution receipts is attributable solely to the raising of the contribution rate at the beginning of 1996. Pension expenditure grew by 3½% both in the east and the west. In the old Länder the increase was perceptibly higher than the pension ad-

*Statutory
pension insur-
ance scheme*

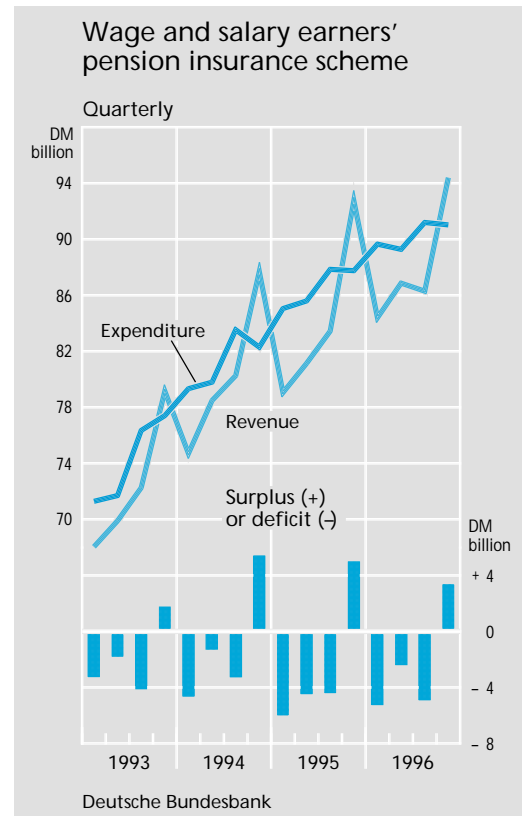
justment of 1% which came into effect in mid-1996, the reason being that the number of pensioners continued to rise substantially. In the east two pension adjustments – the first by almost 4½% on January 1, 1996 and the second by just over 1% in mid-1996 – made a difference from the previous year, but their effect was diminished by the fact that the replenishing amounts had been reduced gradually since the beginning of 1996. At present, the basic pension⁷ in the east is 82.3% of that in the west. In the new Länder, however, average pensions are higher, owing to the fact that, as a rule, the periods of employment are longer, particularly in the case of women.

Annual figure for 1996 and increase in contribution rate for 1997

In the whole of 1996 the deficit, at about DM 10 billion,⁸ was almost as high as a year earlier; by contrast, a small surplus had been envisaged originally. In view of the reduction in the reserves and the deterioration in the employment situation, the contribution rate was raised from 19.2% to 20.3% of eligible income on January 1, 1997. According to the calculations prepared in the autumn of 1996, the contribution increase was gauged in such a way that it is sufficient for financing further increases in pension expenditure and, in addition, for achieving the surplus of about DM 12 billion necessary for replenishing the statutorily prescribed fluctuation reserve.

Additional legal changes in 1997

For the first time pensions in the new Länder in 1997 will be raised only in the middle of the year, at the same time as pensions in western Germany. Under the Growth and Employment Promotion Act, a series of other new regulations came into force at the begin-



ning of 1997. The raising of the retirement age for men owing to unemployment or after a period of age-induced part-time work has been introduced ahead of schedule, reductions have been made in the extent to which periods of training may be taken into account when assessing pension rights, and restrictions have been provided for in the field of rehabilitation services. In addition, the Federal Insurance Office for Salaried Employees has been placed under an obligation to sell participating interests and real property in order to mobilise illiquid assets which are now

⁷ That is the pension received by an average wage or salary earner after 45 years of insured employment.

⁸ The increased valuation (by almost DM 2 billion) of the participating interest of the Federal Insurance Office for Salaried Employees in the Gemeinnützige Aktiengesellschaft für Angestellten-Heimstätten (non-profit public limited company for employees' housing) was not included here as receipts.

counted towards the fluctuation reserve. Moreover, an additional one-off receipt has been created by the fact that the periods for transferring social security contributions have been reduced. Relief will be brought to the pension insurance scheme over the medium term, notably as a result of the fact that the regular retirement age for women and insured persons with long insurance periods will be raised to 65 at an earlier date and more rapidly than this had been planned in the 1992 Pension Reform Act.

*Continuation
of the reform*

In view of the serious longer-term problems which seem likely to arise in the statutory pension insurance scheme as a result of demographic trends, it was agreed within the framework of the "Programme for more growth and employment" to establish a commission to seek ways to extend the development of the "contract between the generations" for the future. The Federal Government has set itself the target of finalising the legislative procedure by the end of 1997. The commission submitted its proposals at the end of January. One of the main elements of the concept is to supplement the pension scheme by a demographic factor. The latter is meant to take account of the longer period of entitlement to pensions – resulting from the increase in life expectancy; however, this period of entitlement is meant to diminish the pension adjustment by only 50%. In this

context, the increase in the pensions has been calculated to slow down in a way that ensures that the level of pensions, in terms of the pension of an average wage or salary earner with 45 years' insured employment and in relation to the average net earnings of employed persons, will gradually decrease from about 70% to 64% in the year 2030. In addition, the commission argues in favour of a reform of the pensions granted in the case of reduced working capacity; this reform has the purpose, *inter alia*, of ensuring that the labour market situation is no longer taken into consideration when such pensions are granted and of attributing the risk of unemployment to the Federal Labour Office here. Finally, it is proposed to establish a family scheme which should make regular contributions to the pension insurance scheme during periods of child-rearing. Such a pay-as-you-go system would directly ease the financial burden on those paying contributions. Admittedly, the family scheme would need to be appropriately financed. If these financing needs were covered by increased taxes, the result would be a process of "refinancing" within the public sector budget; such a refinancing process would not be enough on its own to ease the burden of overall levies, which is necessary over the longer term if conditions in Germany as an industrial location are to be improved.