

Public finance

Central, regional and local authorities

Trends in the third quarter

In the third quarter, the central, regional and local authorities incurred a deficit of DM 23 billion, against DM 21½ billion in the same period of last year. This slightly less favourable trend was mainly attributable to the decline in receipts from privatisation, which had been exceptionally large a year before. By contrast, the central, regional and local authorities' cumulative deficit from January to September, at DM 45 billion, was considerably lower than a year earlier (DM 70 billion). Of particular importance in this context was the exceptional Bundesbank profit of DM 24 billion, which was mostly transferred to the Redemption Fund for Inherited Liabilities. However, the improvement also owed something to the favourable trend in tax revenue and the limitation of the growth of expenditure (to just over 1½ %).

Overview

The more favourable trend in the central, regional and local authorities' tax receipts, which had been evident since the spring, persisted. Overall, tax revenue¹ in the third quarter was almost 6½ % higher than a year before, thus rising even faster than in the previous quarter (+ 5¾ %). The strong growth owed a great deal to the improved profitability of enterprises, while the more favourable trend in employment and the increase in turnover tax also exerted an impact.

Overall taxes

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

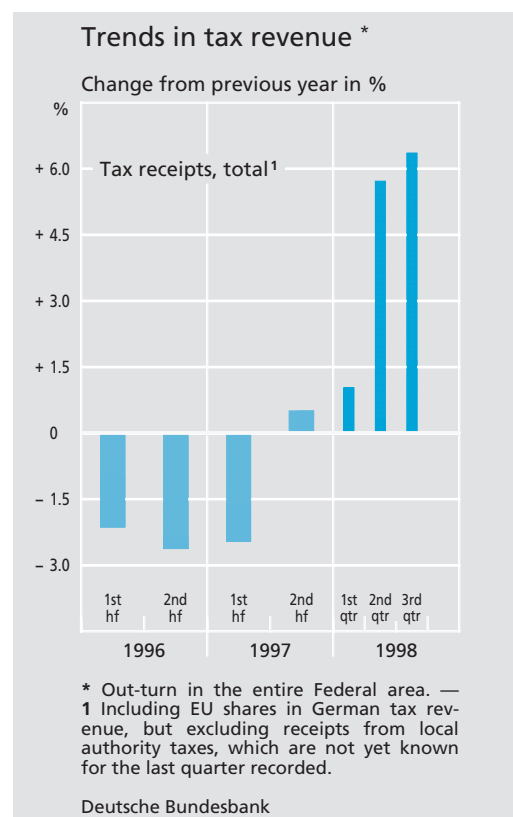
Wage tax

Among the income taxes, the revenue from wage tax rose by a good 5% and therefore distinctly more than in the preceding quarter (+ 3¾%). This was partly due to the growth of employment. In addition, this year's slightly higher pay settlements were a significant factor. The resultant back payments mostly failed to affect revenue until the third quarter.

Assessed taxes

Assessed income tax yielded DM 3½ billion in the third quarter, whereas receipts in the corresponding period of last year came to barely DM ½ billion. Admittedly, this tax is a fairly heterogeneous statistical "residual", which is influenced by trends in various types of income and reduced by a variety of refunds. The sharp rise in such receipts was partly due to the marked fall in tax refunds to wage and salary earners. This, as in the case of the refunds to other tax-payers (which are not shown in the statistics), apparently owed something to the fact that tax shortfalls on account of investment promotion in the new Länder are now starting to decrease. This suggests that a major factor which has contributed materially to the increasing erosion of the tax basis over the past few years is diminishing in significance. Moreover, the improved overall trend in enterprises' profitability, which has resulted both in larger tax prepayments and in increased payments of arrears for earlier years, made itself felt.

Corporation tax was also affected by this, although receipts of that tax (at DM 4¾ billion) were 27% lower than in the third quarter of 1997. However, that was entirely due to the fact that some major enterprises availed themselves of the option existing until the



end of this year of reducing their tax burden by disbursing retained profits accumulated in earlier years (and subject to tax at the rate of 50%)². At the same time, owing to these extensive special disbursements, non-assessed taxes on earnings, which mainly comprise investment income tax on dividends, yielded almost DM 4½ billion more than in the previous year, at just over DM 9½ billion. Aggregate revenue from corporation tax and from non-assessed taxes on earnings, which is

2 The disbursement of retained profits accumulated in earlier years and subject to tax at a rate of 50% ("own capital 50") is accompanied by a reduction in corporation tax of 20 percentage points (on the disbursement rate of 30%); however, there will be a positive countereffect of 17½ percentage points on investment income tax, which is collected at a rate of 25% on the remaining dividends. At the turn of 1998-9, "own capital 50" will be converted into "own capital 45", thus reducing the decrease in corporation tax by 5 percentage points for later disbursements.

Trends in the revenue from major taxes

| Type of tax | Revenue in DM billion | | Change from previous year in % |
|-------------------------|--------------------------|-------|--|
| | 1997 | 1998 | |
| 1st-3rd quarters | | | |
| Wage tax | 173.6 | 180.2 | + 3.8 |
| Assessed income tax | 0.7 | 2.6 | . |
| Corporation tax | 22.7 | 24.2 | + 6.4 |
| Turnover tax | 178.0 | 184.6 | + 3.7 |
| of which: third quarter | | | |
| Wage tax | 59.9 | 63.0 | + 5.1 |
| Assessed income tax | 0.4 | 3.5 | . |
| Corporation tax | 6.6 | 4.8 | -27.0 |
| Turnover tax | 59.4 | 62.8 | + 5.7 |

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much more instructive, was almost 22 % higher than in the corresponding period of last year.

Turnover tax

In the period from July to September, turnover tax receipts rose by 5¾ %, after having increased by just over 6 % in the second quarter. The raising of the standard rate by 1 percentage point (to 16 %) continued to affect that variable; on the other hand, eligible turnover apparently stagnated. Although private consumption increased, taxable investment in the housing and the government sector had a retarding effect on the overall turnover tax basis.

Federal budget

In the third quarter, the Federal budget incurred a deficit amounting to just under DM 20½ billion (compared with DM 16½ billion

in the corresponding period of last year). Total receipts increased by 3 %. While tax revenue rose sharply (by 6 %), non-tax receipts, which are subject to fairly large fluctuations over time, decreased by approximately one-quarter, since sizeable receipts from privatisation had accrued in the preceding year.

Expenditure went up fairly sharply, namely by just under 6 %, with transfers to special funds and to social security funds actually growing by 14 % in all. An important factor in this respect was the substantial increase in Federal transfers to the statutory pension insurance scheme, which was financed by the additional receipts from the raising of turnover tax; the sharp increase in the transfers to the Redemption Fund for Inherited Liabilities, which had been conspicuously low a year before, likewise made itself felt. In addition, there was an extremely steep rise (+ 16 %) in the Federal Government's capital spending, mainly in connection with the Government's move to Berlin. Interest expenditure, which is incurred fairly irregularly during the year, likewise skyrocketed (+ 8 %). Staff costs, by contrast, fell by 3½ %. Other operating expenditure remained at approximately the same level as in the previous year.

The Federal Government's special funds incurred a deficit of DM 1 billion from July to September, after having recorded a surplus of DM 1 billion in the corresponding period of last year. While the quarterly figures of the "German Unity" Fund and the Federal Railways Fund deteriorated, mainly on account of lower transfers from the Federal Government, the Redemption Fund for Inherited Li-

Special funds

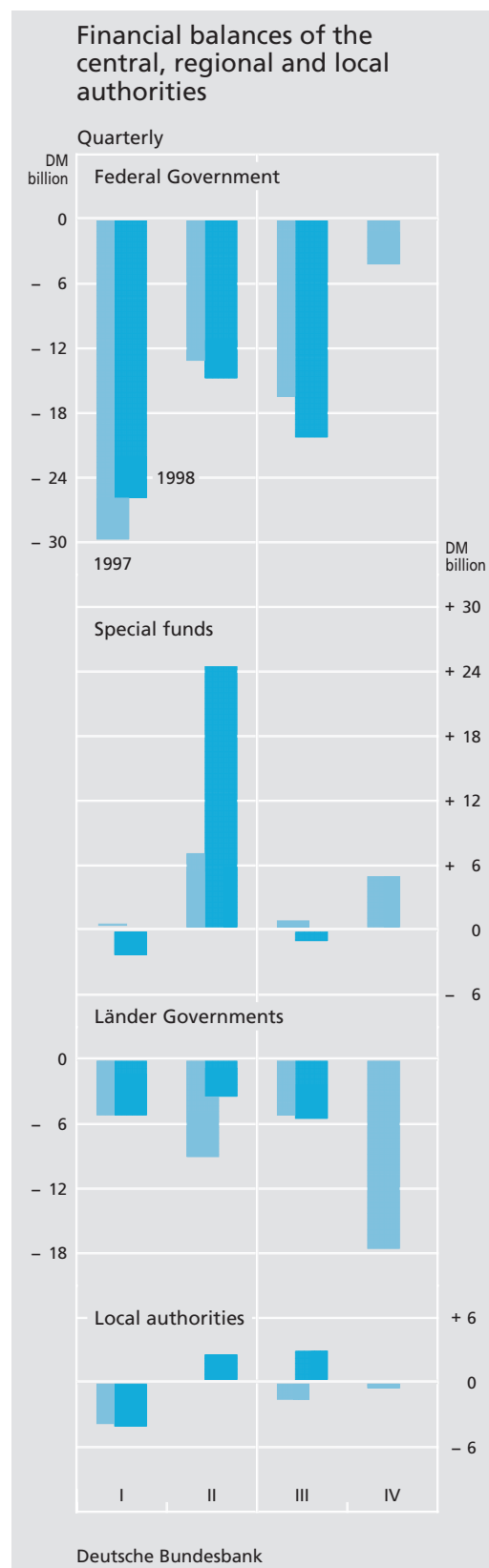
abilities showed slightly more favourable figures.

*Länder
Governments*

The Länder Governments, taken together, ran a deficit of DM 5 ½ billion in the third quarter; that was approximately the same figure as in the corresponding period of last year. In the old Länder (including Berlin), the deficits rose by DM 1 ½ billion to DM 4 ½ billion. In that part of Germany, an increase of 1 ½ % in expenditure (with staff costs going up by just over 1 %) was accompanied by a stagnation of revenue. While tax receipts rose by just over 7 ½ %, other receipts fell by almost 20 %; in particular, sales of participating interests were well below their 1997 level. The deficits of the new Länder, by contrast, dropped from more than DM 2 billion in the third quarter of 1997 to DM 1 billion this year. Receipts increased by just under 6 %; this was mainly attributable to an increase of nearly 6 ½ % in tax revenue. By contrast, expenditure was stepped up by little more than ½ %. The rise in staff costs was likewise limited to that rate.

*Local
authorities*

In the third quarter – just as in the second – the local authorities' budget position improved sharply. After having incurred a deficit of DM 1 ½ billion in the corresponding period of last year, the local authorities recorded a surplus of DM 3 billion this year. That was mainly due to the plentiful tax receipts, which – given the favourable trend in trade tax – rose by more than 12 %. Despite decreasing income from fees, overall receipts went up by no less than 5 ½ %. By contrast, expenditure fell by slightly more than 1 %, with the local authorities' efforts to econo-



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

DM billion

| Period | Total | of which | | Memo item Purchases of public debt instru- ments by non-resi- dents |
|-------------------------|---------|------------|---|--|
| | | Securities | Loans against bor- rowers' notes ¹ | |
| 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 | + 62.1 |
| 1996 | + 124.3 | + 65.2 | + 74.4 | + 57.3 |
| 1997 | + 95.8 | + 65.9 | + 40.1 | + 80.7 |
| of which | | | | |
| 1st hf | + 51.9 | + 57.1 | + 3.4 | + 36.6 |
| July-Oct. | + 30.6 | - 6.1 | + 38.1 | . |
| 1998 | | | | |
| 1st hf | + 34.5 | + 25.2 | + 9.3 | + 3.5 |
| July-Oct. ^{pe} | + 41.3 | + 26.0 | + 17.5 | . |

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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mise continuing to be reflected, above all, in spending on tangible fixed assets, which decreased by more than 3%. Considered as a whole, it must be borne in mind that the trends in both revenue and expenditure are being moderated by the continued separate presentation of fee budgets.

In the third quarter, net borrowing by the central, regional and local authorities amounted to just over DM 19 billion, thus being much larger in volume than in the second quarter, when, particularly owing to the large profit distribution by the Bundesbank, it had come to only DM 3 billion. In October, borrowing in the credit markets actually amounted to DM 22 billion. From July to October, bonds featured prominently among the types of debt, and the outstanding

amount thereof increased by DM 30 ½ billion; recourse to the money market totalled DM 6 ½ billion. In the first ten months of 1998 taken together, the central, regional and local authorities increased their indebtedness by DM 76 billion, against DM 82 ½ billion in the same period of last year.

In the period from July to October, the Federal Government, at DM 29 billion, accounted for the greater part of the central, regional and local authorities' net borrowing, with Federal bonds in the amount of DM 20 ½ billion constituting the primary source of finance. In view of the substantial redemptions, the Federal Government's gross borrowing in the capital market totalled DM 85 ½ billion. The Länder Governments' debts went up by DM 11 ½ billion in that four-month period. The local authorities increased their indebtedness by an estimated DM 2 ½ billion. The special funds, by contrast, reduced their liabilities by DM 1 ½ billion net. That was mainly because the Redemption Fund for Inherited Liabilities redeemed DM 3 ½ billion net; the repayment of Treuhand special five-year bonds to the value of DM 7 billion played a special role in that context. As part of their joint securities issues along with the Federal Government, the special funds, taken together, raised funds totalling DM 12 ½ billion.

Outlook for 1998 as a whole

The central, regional and local authorities are likely to reduce their budget deficits substantially this year, viz. to under DM 70 billion (compared with DM 94 billion last year). The

... and by level
of government

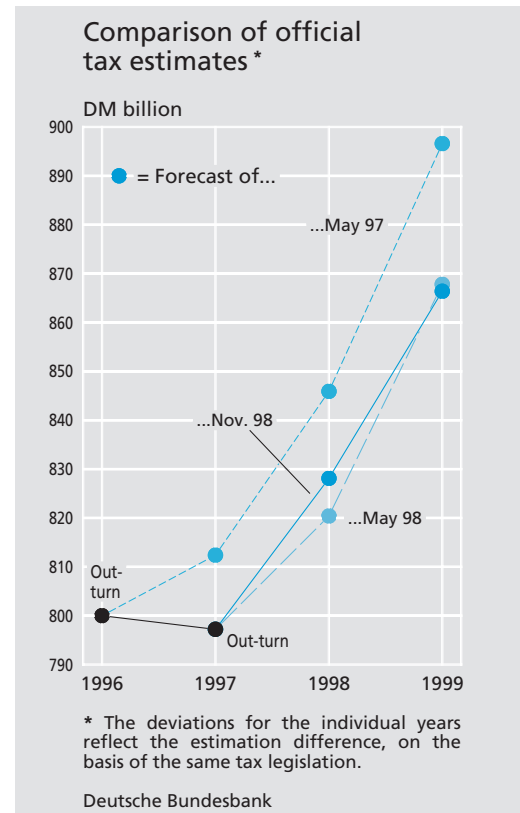
Borrowing
as a whole ...

Public
authorities,
total

key factor contributing to this decline is exceptionally large non-tax receipts. The Bundesbank profit, for example, amounted to DM 24 billion (particularly owing to the revaluation of the foreign exchange reserves), thus exceeding the 1997 level by more than DM 15 billion. Sales of participating interests also contributed materially to the reduction in the deficits; the Federal Government's corresponding receipts are expected to be DM 20 billion larger than a year before. In the definitions of the national accounts, the financial situation will improve less strongly. In those definitions, the large non-tax receipts mentioned are mostly recorded as financial transactions and, to that extent, have no impact on the deficit. Even so, the deficit ratio in the "Maastricht definition" (which largely corresponds to that of the national accounts) is likely to be markedly lower than it was last year (2.7%) if the social security funds are also taken into account.

Tax receipts largely in line with the budget

In contrast to the preceding financial years, which were marked by sizeable tax shortfalls, in 1998 there are no signs of major deviations from the budgets, which were mainly based on the tax estimate of autumn 1997. After the expectations for the Federal and Länder Governments' tax receipts had been revised slightly downwards in the light of the May 1998 tax estimate, the most recent (November) tax estimate yielded a brighter picture, so that receipts can now be expected to somewhat exceed the envisaged level. For the local authorities, the situation is actually more favourable still: an increase in tax revenue of approximately DM 5 billion over the May estimate appears likely. The main reason for this



is that trade tax revenue, which largely accrues to the local authorities, is rising sharply, owing in part to the favourable outcome of the assessment for earlier years. All in all, tax revenue is expected to grow by 3.9%. The overall tax ratio (as defined in the financial statistics) would then remain unchanged, at 22%.

The trend in the Federal budget seems likely to be more favourable than envisaged. The deficit budgeted for, at DM 56.5 billion, can therefore be maintained, although it is planned to shift some of the privatisation receipts to the coming year. A reduced demand has already resulted from the reduction in the transfers to the "German Unity" Fund which was approved after the adoption of the Federal budget. In the course of the financial

Federal Government

year, it transpired that the amount required for transfers to the Federal Labour Office would be substantially smaller than envisaged in the budget (just over DM 14 billion). In addition, expenditure on interest, staff costs and other operating expenditure might remain below the budget appropriations. Elsewhere, however, extra spending will be required. For example, it is to be assumed that expenditure on unemployment assistance will be larger than expected.

*Regional and
local authorities*

The Länder Governments, too, will record more favourable figures than last year, when they incurred a deficit of DM 37 billion. Their deficits are likely to decline to around DM 30 billion, particularly owing to the favourable trend in tax revenue, the moderate increases in staff costs and the continued curbing of transfers to local authorities; that implies that the budgets will largely be complied with. The local authorities' financial situation will improve substantially – with great differences between individual authorities – despite the limitation of transfers from the Länder. The improvement will owe a great deal to the receipts from trade tax. Finally, the surplus of the special funds, which amounted to DM 13 billion in 1997, is likely to increase to more than DM 20 billion despite the reductions in transfers from the Federal and Länder Governments, since that part of the sharply increased Bundesbank profit which exceeded DM 7 billion was transferred to the Redemption Fund for Inherited Liabilities.

Budget outlook for 1999

The Federal Government's fiscal plans for the coming year focus on projects designed to reduce unemployment. For instance, a multi-stage reform of income taxation is to be implemented, concentrating on granting tax relief to low-income groups and families with children. On the one hand, these measures serve distributional purposes; on the other, stimulatory effects on the economy are hoped for by fostering the demand for consumer goods. Besides an increase in the basic tax allowance and in child benefit, the plans provide for a limited reduction in the overall tax scale, particularly for low-income groups, and thus a slight intensification of the progressive effect. A further feature of the approach is the gradual reduction in the next few years of the rates of taxation of business earnings, with a view to strengthening enterprises' propensity to invest.

*New fiscal
projects*

The tax shortfalls associated with the relief are to be financed for the most part by broadening the tax basis. This broadening is to focus on the business sector, and to come into effect as soon as possible; employees' tax deduction options will mostly remain in place (see the box on page 41). According to the bill, in its present form, the business sector as a whole will be additionally burdened – with some differentiation between individual enterprises. This might hamper the investment terms even if private consumption demand is favourably affected in the short run. All in all, the measures taken as part of the reform are intended to have little impact on revenue in the first three years; not until 2002

Main features of the new Federal Government's tax package

On the basis of a **Tax Relief Act dated 1999-2000-2002**, income taxation is to be reformed in three stages. The purpose of this Act is to improve the conditions for growth and employment, significantly to ease the tax burden on employees and families, to provide greater tax equity and to simplify tax law. To that end, statutory income and corporation tax rates are to be lowered, the basic allowance and child benefit are to be raised, and the tax basis is to be broadened by cutting back tax concessions. It is planned to **ease the tax burden by an amount of some DM 15 billion net**. However, this tax relief is not meant to come into effect until the start of the third stage in 2002; the first two reform stages, by contrast, will have no great impact on revenue.

The reform encompasses **gross tax relief amounting to DM 57 billion in all** (relative to the accounting year 2002), arising primarily from the following measures:

- progressive raising of child benefit for the first and second child, to DM 260 per child per month;
- gradual reform of the income tax scale by 2002: raising of the basic tax allowance to around DM 14,000; lowering of the entry rate to 19.9%; thereafter, two-stage linear-progressive movement of marginal tax rates up to the start of the upper proportional zone, with a new general top rate of 48.5% as from an income of approximately DM 107,500;
- progressive lowering of the special top rate of income tax for business earnings to 43% in the year 2000;
- reduction of the corporation tax rate for retained profits to 40% as from 1999.

What is not yet included in this package of measures is the fundamental reform of business taxation, which is likewise envisaged by the Government coalition; under this reform, from the year 2000 onwards, if possible, all business earnings are to be taxed at a rate not exceeding 35%; the reform is to be prepared by a commission composed of representatives of the Federal and Länder Governments.

The **broadening of the tax basis**, which (relative to the accounting year 2002) is to yield additional

receipts totalling **almost DM 42 billion**, comprises the following main features:

- a substantial tightening-up of the accounting rules for determining taxable profits (particularly by reducing the options for provisioning, abolishing write-downs to going-concern value and introducing a requirement to reinstate original values), along with restrictions on loss compensation and reduced transferability of undisclosed reserves to new assets;
- the abolition of the reduced tax rate on extraordinary income (instead, such income is to be spread – in accounting terms – over five years), reduction of special depreciation allowances and of tax-free investment reserves for small and medium-sized enterprises (other than persons starting up in business);
- the halving of savers' tax-free allowance and lengthening of the fiscal "speculative periods" for private profits from sales of securities and of non-owner-occupied real property, extension of the taxation of "speculative gains" to include margin trading (e.g. in financial derivatives) and investment funds.

The broadening of the tax basis will mainly affect the business sector, which, on balance, will be additionally burdened by the tax package.

Moreover, an **"ecological tax reform"** is planned that is intended both to reduce environmental pollution and to enhance employment by progressively increasing the cost of energy consumption, while simultaneously lowering non-wage labour costs. To this end, the existing mineral-oil tax is to be increased (by 6 pfennigs per litre for petrol and diesel fuel, 4 pfennigs per litre for heating oil and 0.32 pfennigs per kilowatt-hour for natural gas), and a new electricity tax (to be charged at the rate of 2 pfennigs per kilowatt-hour) is to be introduced as an initial statutory step on April 1, 1999. However, the rate of tax increase will be reduced for the producing sector, and industries whose production is energy-intensive will be exempted altogether. The additional revenue expected from these measures, amounting to just over DM 8 billion in 1999, is to be used to finance a lowering – by 0.8 percentage point – of the contribution rate to the statutory pension insurance scheme, which reduction will likewise come into force on April 1, 1999.

will net tax relief amounting to DM 15 billion be aimed at.

Another Government project aims at a direct reduction of non-wage labour costs. In a process which likewise comprises several stages, the social security contribution rates are to be lowered by 2½ percentage points, to below 40%, by the end of the legislative period. As a first step, the contribution rate to the pension insurance scheme is to be reduced from currently 20.3% to 19.5% as from April 1999. In order to offset the resultant shortfall in contributions, amounting to around DM 8 billion in the coming year, the mineral-oil tax rates are to be raised and a new electricity tax (from which the producing sector, and particularly the energy-intensive industries, are to be largely or wholly exempted – see the box on page 41) is to be introduced at the same time. Hence a reduction in the heavy total burden of taxes and social security contributions in Germany is not associated with the lowering of the contributions to the pension insurance scheme. If the tax burden were to be reduced without increasing the deficit, that would presuppose a limitation of government expenditure, and particularly of social security spending.

*Underlying
budgetary
trends*

The aforementioned government projects which have little impact on revenue will, in the aggregate, be reflected only marginally in the central, regional and local authorities' budget balances in the coming year. Those balances are likely to be determined by three other trends: a sharp rise in tax receipts – together with the curbing of the rise in expenditure aimed at by the central, regional

and local authorities – will no doubt tend to improve the budgetary situation; but one factor militating against any such improvement is that a marked decrease in other receipts (e.g. those from sales of participating interests) is to be expected in 1999.

The Working Party on Tax Estimates expects an increase of 4.6% in tax revenue in 1999 on the basis of the existing legislation, with the nominal gross domestic product being forecast to rise by around 3½%. Taking account of the planned amendments of tax law, tax receipts might increase by just over 5% in the year to come. This would mean that, for the first time since 1992, the tax ratio would go up (by 0.4 percentage point to 22.4%, as defined in the financial statistics). There are two factors which are tending to boost receipts: the erosion of the tax base – which is due not least to the tax concessions for the sake of investment in the new Länder – is declining, and the pattern of overall economic growth is shifting in favour of tax-yielding domestic demand. In addition, the raising of value-added tax is now making itself felt over a full year, and the shortfalls of corporation tax engendered by tax-induced special distributions have ceased.

Tax estimate

At the latest meeting of the Financial Planning Council on December 2, the central, regional and local authorities reaffirmed their intention of limiting the growth of their expenditure to 2% a year. That implies that the central, regional and local authorities will continue to lower the government spending ratio, which will provide financial scope for cutting the deficits and reducing the burden

*Trends in
expenditure*

of taxes and social security contributions. Besides the persistently low interest rate level, successful anti-inflation policy will make it easier to achieve this objective and also exercise a restraining effect on the expenditure side of the budget. Continued moderate pay settlements for public-sector employees would likewise make a substantial contribution to containing expenditure.

*Federal budget
for 1999*

The budgets of the individual levels of government are still incomplete. The adoption of the Federal budget has been delayed since the draft budget will have to be reconsidered and resubmitted to Parliament in accordance with the financial policy objectives of the new Government. Additional funds are required under various headings compared with the appropriations of the first draft budget. For instance, payments to the Länder Governments are to be increased, and the appropriations (particularly for unemployment assistance, warranties and the Federal grant to the pension insurance scheme) will probably be augmented, too. On the other hand, some additional revenue is expected owing to the shifting of privatisation receipts to the coming year.

*Other levels of
government*

At Länder Government level, the marked decline in the deficits is unlikely to continue in 1999. Although the rise in expenditure is to be limited to about 1%, according to the data available so far, the Länder Governments cannot expect their tax receipts to grow by more than about 2½%, according to the latest official estimate. This is because the receipts from motor vehicle tax are declining owing to the exemption of low-pollutant

motor vehicles from tax, and because back payments of wealth tax, which was levied until the end of 1996, are gradually tailing off. Of the other receipts, the proceeds of sales of assets are likely to slacken considerably. The local authorities' budget positions will probably deteriorate again in 1999. In this connection, it is to be expected that a slower rise in tax revenue will be accompanied by a faster increase in expenditure; in particular, the marked decline in capital spending which has persisted for several years is unlikely to continue. The special funds are a significant factor in the budget trends of the central, regional and local authorities as a whole; their surplus is going to decline sharply, mainly because of the smaller revenue of the Redemption Fund for Inherited Liabilities from the Bundesbank profit.

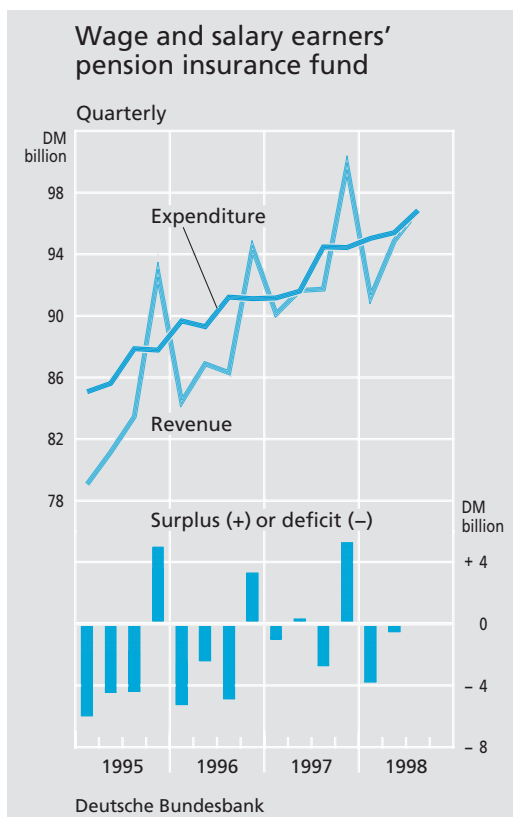
All in all, the central, regional and local authorities' budget deficits seem likely to increase in 1999, because the revenue from sales of assets and from the Bundesbank profit will be considerably lower than it was in 1998. Since, in the definition of the national accounts, such receipts will have virtually no impact on the deficit, the decline in the deficit ratio is likely to continue if the social security funds are taken into account.

Overall trends

Social security funds

The financial situation of the wage and salary earners' pension insurance scheme developed favourably in the third quarter of 1998. Revenue and expenditure ran at approximately the same level, whereas a deficit

*Statutory
pension
insurance
scheme*



of DM 2¾ billion had been incurred a year before. Thanks to the reversal in the employment trend from the middle of the year, and owing to the higher pay settlements, the receipts from compulsory contributions – which are by far the biggest source of revenue, accounting for about 75% of the total – increased by 2.8%, after having diminished in the first half of the year. Payments by the Federal Government actually rose by just over one-fifth because the additional Federal grant, which is being financed by the increase in the VAT standard rate, has been transferred to the pension insurance scheme since April. Overall, the receipts of the pension insurance funds rose by 5.6%.

The expenditure side likewise contributed to the improvement in the pension funds' fi-

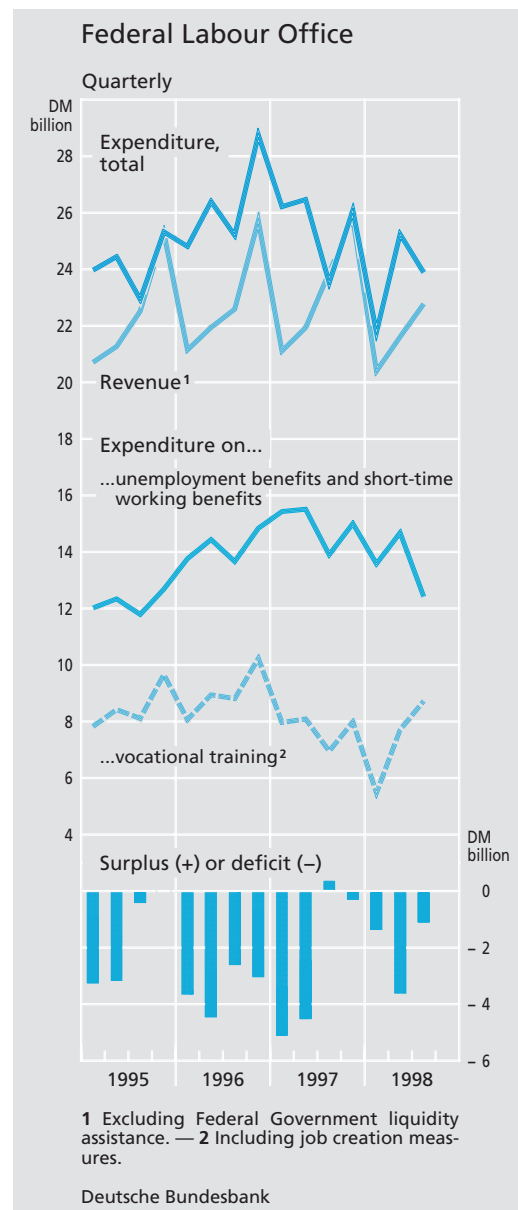
nances. Thus, expenditure on pensions rose by only 2.6% in the third quarter, compared with the previous year, after having increased by more than 4% in the first half of 1998. The main reason for this was that the mid-year pension adjustment, which follows the trend in net wages and salaries with a time-lag of one year, at 0.44% in the old Länder and 0.89% in the new ones, was substantially lower than a year before. The further increase in the number of pensions paid tended to enhance expenditure. On the other hand, the "replenishing amounts" granted for a transitional period are gradually dwindling and therefore exercising a moderating effect in the new Länder. The total spending of the pension insurance scheme in the third quarter exceeded its 1997 level by 2.5%.

In the fourth quarter, the favourable trends are likely to continue, so that, as things look today, the pension insurance scheme may be expected to run a surplus of about DM 3 billion over the whole year (against one of just under DM 2 billion last year). Admittedly, this amount will not suffice to enlarge the fluctuation reserve to the statutory minimum level of one month's expenditure by the end of the year; instead, the reserve will probably amount to the expenditure of 0.7 month and undershoot the statutory minimum level by approximately DM 8 billion. The fluctuation reserve will therefore have to be replenished next year, and this will call for a surplus which is much larger than this year's. If the law had remained unchanged, this would have necessitated keeping the contribution rate at its existing level.

Outlook

New statutory provisions

However, the new Federal Government has set itself the target of lowering the contribution rate by 0.8 percentage points, to 19.5 % of wages and salaries subject to compulsory contributions, from April 1, 1999. This is supposed to be achieved by means of additional Federal transfers, which will be financed by higher taxation of energy consumption. The funds obtained in this way are to be recorded mainly as payments made by the Federal Government in order to take account of periods of child-rearing. This means that, in the statutory old-age pension scheme, the new Government is continuing the change-over from financing through contribution receipts to financing through tax revenue which the old Government had started with the raising of value-added tax in April 1998. Moreover, the pension insurance scheme is to obtain extra income by including persons doing "insignificant jobs" and the ostensibly self-employed in the ranks of those subject to compulsory social security contributions. This extra income, which is accompanied by wage tax shortfalls incurred by the central, regional and local authorities, will be meant to serve as financial compensation for the fact that the reductions in benefits which were approved by the former coalition government as part of the erstwhile "1999 pension reform" (particularly the introduction of a demographic factor in the pension adjustment) have been suspended. These provisions are to be superseded by a comprehensive pension reform planned for the year 2001, in which the demographically-induced financing problems are likewise to be taken into account. A reassessment of the longer-term prospects of the statutory pension insurance



scheme will not be possible until concrete proposals have been made with regard to that reform.

The Federal Labour Office recorded a deficit of DM 1.1 billion in the third quarter of 1998. The figures were therefore less favourable than in the same period of last year, when the Federal Labour Office had run a surplus of DM 0.3 billion. However, this was entirely due

Federal Labour Office

to the fact that large extraordinary receipts from sales of assets had accrued at that time. Total receipts went down by 4.6 %, while contribution receipts – as in the case of the pension insurance scheme – developed distinctly more favourably, increasing by 2.2 % (after having decreased by 1.2 % in the first half of the year). On the expenditure side, the positive trends in the labour market led to a decline of one-tenth in expenditure on unemployment assistance. On the other hand, the number of participants in measures taken in the context of active labour-market policy increased sharply again during the year, and that now began to be felt. The amount spent on this in the third quarter was 25 % higher than in the previous year, after having declined by approximately 20 % in the first half of this year. The total expenditure of the Federal Labour Office therefore rose by 1½ % from July to September, after having decreased in the first half of 1998.

Outlook

For this year, considered as a whole, the deficit of the Federal Labour Office to be financed by the Federal Government seems likely to be much smaller than was budgeted for (just over DM 14 billion). The main reason for this is that the average annual unemployment figure will probably not reach the level on which the budget was based (4.4 million). Moreover, the appropriations for active labour-market policy will no doubt not be fully utilised either, because trends in expenditure are lagging behind the promotional measures taken. For the year to come, the recently adopted budget of the Federal Labour Office provides for a deficit of DM 11 billion, which is probably more than the actual figure

for 1998. Since it is also expected that the unemployment rate will continue to go down slightly, this estimate reflects the new Federal Government's objective of continuing to foster a high level of employment as part of its active labour-market policy. These measures will be supplemented by a new programme designed to give vocational training and jobs to unemployed young people.

In the third quarter, the statutory health insurance system ran a surplus of DM 1 billion and thus recorded slightly more favourable figures than in the same quarter of last year (+ DM ¾ billion). On the receipts side, it was particularly the larger influx of contributions in the west, which increased by almost 2 %, that had a positive impact. Here – just as in the other branches of social security – this owed something to the more favourable employment trend, whereas the average contribution rate level was actually slightly lower than a year before. Overall, receipts rose by just over 1 %. Total expenditure increased by little more than ½ %. A marked decline in expenditure on dental prostheses contrasted with increased expenditure on pharmaceuticals and health aids, which, however, was partly due to the extremely low level of this expenditure category in the previous year, after the contribution payments had been distinctly increased as from July 1, 1997.

*Statutory
health
insurance*

In the first three quarters of 1998, taken together, the statutory health insurance system incurred a deficit of just under DM 1 billion, compared with one of almost DM 3¼ billion in the same period of last year. Over the whole of 1998, however, the seasonally

favourable trend in the fourth quarter will probably generate a surplus, which might be slightly higher than in the previous year (just over DM 1 billion). In the year to come, some provisions of the 1997 New Regulation Acts will be amended by the Solidarity Enhancement Act relating to the statutory health insurance system. For instance, particularly the contribution payments for pharmaceuticals will be lowered and the "hospital emergency

levy" will no longer be collected (just as in 1998). This financial burden for the health insurance system is accompanied by some relief, particularly in the form of lower expenditure on pharmaceuticals and higher contribution receipts owing to the introduction of separate compulsory insurance for persons performing "insignificant jobs". The Government therefore expects that the contribution rates will not have to be increased in 1999.