

## Public finance

### Central, regional and local authorities

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#### Trends in the second quarter

In the second quarter of 1998 the results for the central and regional authorities' budgets were much more favourable than in the same period last year. The Federal and Länder Governments and the special funds (no data are available on the local authorities so far) showed a surplus of just over DM 6 billion; this contrasts with a DM 17 billion deficit in the second quarter of 1997. One reason for this improvement was the fact that tax yielded higher revenue in the second quarter than at the beginning of the year. However, a factor which had a far greater impact was that the Federal Government and the Redemption Fund for Inherited Liabilities received a profit transfer from the Bundesbank, which – owing to the revaluation of the foreign exchange reserves – was extremely large, at slightly more than DM 24 billion; last year it had come to no more than just under DM 9 billion. The far more favourable budget result in the second quarter is thus also attributable to temporary factors, which will not necessarily have a key impact on the trend for the year as a whole. However, expenditure grew by only 0.8% in the second quarter, and therefore at a slower pace than in the first few months of the year.

*General  
overview*

The trend in tax revenue has improved markedly since spring. Tax receipts<sup>1</sup> in the second quarter were almost 6% up on the corres-

*Taxes as a  
whole*

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

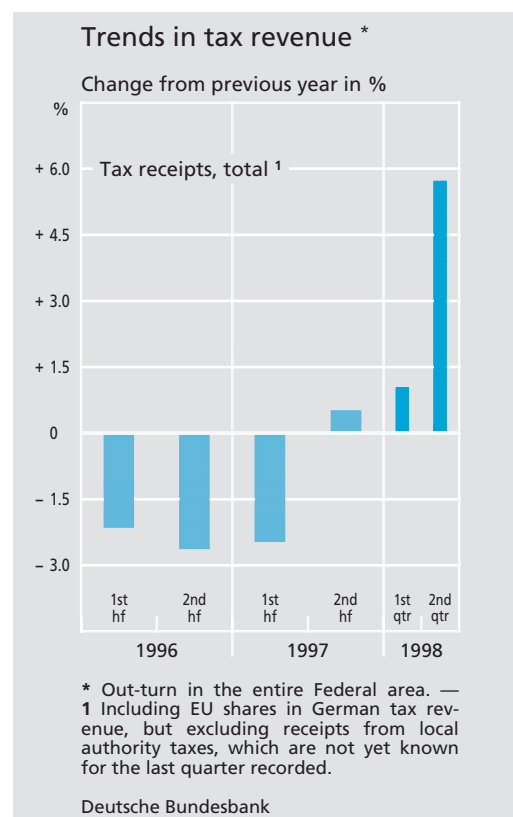
ponding level last year, compared with a rise of no more than 1% in the first three months of 1998. The significant growth in revenue was partly due to the increase in turnover tax which came into force on April 1; another factor was that the improved earnings situation of enterprises was reflected by a much more favourable figure for assessed taxes.

*Turnover tax*

Between April and June, turnover tax yielded just over 6% more than a year before; by contrast, in the first quarter revenue from this tax had fallen slightly short of the corresponding level last year. This increase was influenced by the raising of the standard rate by 1 percentage point (to 16%), the revenue from which is transferred to the pension insurance scheme as an additional Federal grant; however, turnover subject to taxation, which includes not only private consumption but also public purchases of tangible fixed assets and capital spending on housing construction, rose only slightly overall. Besides its direct impact on tax revenue – which became apparent from May onwards due to the existing payment arrangements for turnover tax –, this tax increase also had an influence on the behaviour of final consumers. For example, it gave them an incentive to make purchases before April 1; this was reflected by temporary additional receipts, although in some cases these did not appear until the second quarter. These “anticipatory effects”, however, were followed by lower turnover once the tax increase had come into force.

*Wage tax*

Among all types of income tax, wage tax recorded only a moderate growth in revenue in the second quarter; at slightly more than



3½%, however, it did exceed the level of the first three months by as much as 1 percentage point. The initial effects of this year's wage settlements, which resulted in a somewhat stronger rise in negotiated pay rates than last year, were making themselves felt here. Another significant factor was that there was scarcely any fall in the numbers in work in comparison with last year.

Revenue from assessed taxes has shown a particularly marked improvement. Although refunds of assessed income tax were still DM ¼ billion higher than the concurrent receipts from this tax, the negative balance was DM 1¾ billion less than in the corresponding period last year. Without the growing public expenditure on the allowance for the construction of owner-occupied dwellings, which

*Assessed taxes*

### Trend in the revenue from major taxes

Type of tax	Revenue in DM billion		Change from previous year in %
	1997	1998	
First half of the year			
Wage tax	113.6	117.2	+ 3.2
Assessed income tax	0.3	- 0.9	.
Corporation tax	16.1	19.4	+ 20.0
Turnover tax	118.6	121.8	+ 2.7
of which: second quarter			
Wage tax	56.8	58.9	+ 3.7
Assessed income tax	- 2.0	- 0.2	.
Corporation tax	8.1	10.4	+ 29.7
Turnover tax	58.6	62.2	+ 6.1

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is booked to the debit of assessed income tax, the trend would have been even more favourable. There now appears to be a reversal, at least in part, of the severe erosion of the tax base which affected assessed income tax during the past few years. This may owe something to the fact that the shortfalls in revenue resulting from tax concessions to promote the east German economy are gradually diminishing following the relevant cut-backs made at the turn of 1996-1997. The steep rise in enterprises' profits had an impact, too, which evidently resulted in a considerable increase in prepayments of tax. Enterprises' improved earnings situation had an even greater effect on corporation tax revenue than on assessed income tax (which is also payable by wage and salary earners). Corporation tax receipts in the second quar-

ter were almost 30 % up on the corresponding level last year. In this case, too, the increase in revenue was mainly attributable to the sharp rise in prepayments of tax.

In the second quarter, the Federal Government's budget deficit rose by DM 1½ billion on the year, to just under DM 15 billion. On the receipts side, tax revenue grew sharply at just over 5%. However, other receipts were down by slightly less than 12%, which was mainly due to the fact that, in contrast to the same period last year, no proceeds were received from liquidations of participating interests; as was the case last year, the Federal Government received DM 7 billion of the Bundesbank's profit transfer. Overall, the Federal Government's receipts went up by just under 3% in the period from April to June.

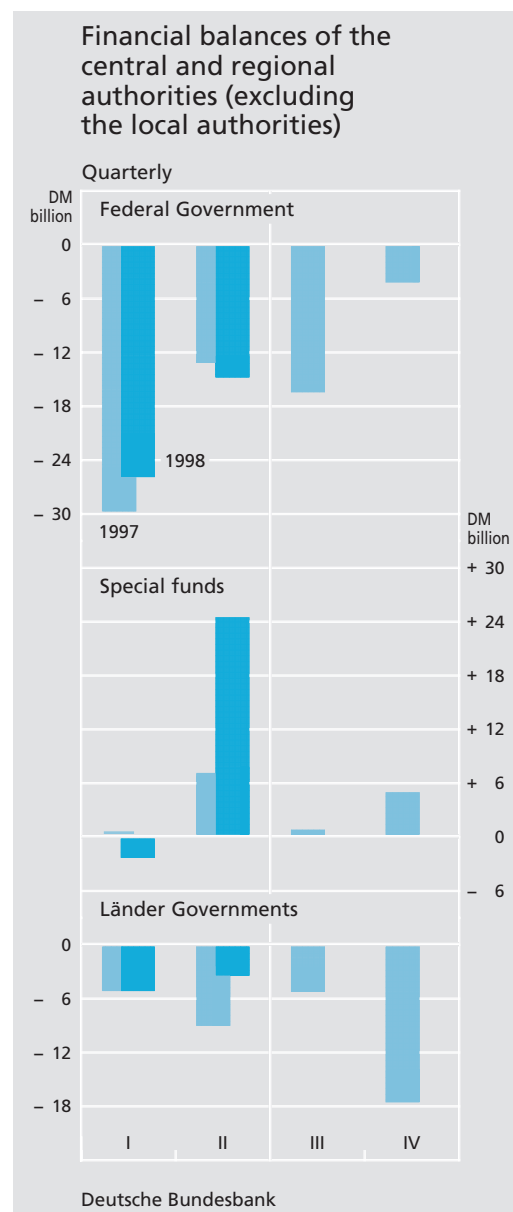
*Federal budget*

By contrast, expenditure grew more sharply, namely by 4%. This was mainly attributable to the fact that the Federal Government had to increase spending on transfers to the wage and salary earners' pension insurance scheme by one-quarter during this three-month period. Firstly, the additional Federal grant, which was financed from the increase in value added tax, was paid into the pension insurance scheme for the first time. Secondly, in calculating the "traditional" Federal grant (which is linked to the trend in remuneration and contribution rates) for 1998, a notional raising of the contribution rate to 21% was used as a basis; this would have been the rate without the payment of the additional Federal grant. Another factor which contributed to the comparatively sharp rise in expenditure was that transfers to the Redemption Fund

for Inherited Liabilities were one-third higher than last year's level; after these payments had been down on the year in the first quarter, this gap was now closed. Expenditure on personnel, too, grew quite sharply, at slightly more than 5%, owing to the increase in wages and salaries, which had been agreed to become effective from the beginning of the year, being paid out retroactively. On the other hand, the burden was eased by the fact that labour-market related spending was almost one-tenth below the amount paid in the same period last year. Admittedly, the Federal Government had to spend considerably more on unemployment assistance than a year before, since many unemployed persons still switch to this type of assistance once the maximum period of entitlement to unemployment benefits has expired. However, the transfers to the Federal Labour Office and the transitional benefits for early retirement in eastern Germany (the latter are being phased out) dropped sharply. Interest payments, too, required fewer funds than twelve months earlier, this type of expenditure having risen substantially at the beginning of this year.

*Special funds*

The Federal Government's special funds showed an extremely high surplus in the second quarter, which – as mentioned at the beginning of this article – was attributable to the Bundesbank's profit transfer to the Redemption Fund for Inherited Liabilities (amounting to just over DM 17 billion compared with slightly less than DM 2 billion a year before). In addition, the increased transfers by the Federal Government were a significant factor. On the expenditure side, the



burden was eased by the interest payments being considerably lower than they had been last year, which was due, not least, to the persistently low interest rate level. For that reason, the Redemption Fund for Inherited Liabilities ran a surplus of just under DM 24 billion, compared with slightly more than DM 4 billion in the same period last year. The surplus of the other special funds, taken together, went back from DM 3 billion to

*Länder Govern-  
ments*

DM 1 billion in the second quarter, which was mainly attributable to increased lending activity by the ERP Special Fund.

Altogether, the fiscal position of the Länder Governments improved considerably. In the second quarter, their deficit amounted to DM 3½ billion and thus was DM 5½ billion lower than the figure twelve months earlier. However, this decline was concentrated on western Germany (including Berlin), where the Länder Governments recorded a financial gap of just over DM 1½ billion, compared with DM 7½ billion in the second quarter of 1997. The very sharp growth in tax receipts (by slightly more than 8%) had a positive effect on this. The increase was attributable not only to the favourable trend in assessed taxes but also to the reform of inheritance tax and the rise in the tax on the acquisition of land and buildings, which came into effect at the beginning of 1997 to compensate for the abolition of wealth tax. Expenditure remained more or less at the same level as one year earlier, although personnel costs went up by slightly more than 2½%, mainly owing to deferred payments in connection with the public sector pay settlement. In eastern Germany, the deficit, at slightly more than DM 1½ billion in the second quarter, was more or less the same as it had been twelve months previously. Tax receipts increased by no more than 2½%; this was a small rise in comparison with western Germany and applied to all major types of tax. By contrast, other receipts, which carry a relatively large weight owing to the high level of transfers from the Federal Government and the payments received through the vertical tax redis-

tribution scheme between the central government and the Länder Governments, were just over 6% higher than their level in the corresponding period of last year. Expenditure rose by 5%, which, however, was mainly due to deferred bookings occurred in one of the Länder.

At the local authority level, only data for the first quarter are available so far. During that period, the deficit totalled DM 4 billion, thus remaining more or less at the same level as a year before. Whereas the shortfall in western Germany decreased marginally to just under DM 3½ billion, it increased slightly in eastern Germany to just over DM ½ billion. In western and in eastern Germany alike, receipts and expenditure were both down on the previous year's level. Once again, spending on tangible fixed assets declined, albeit at a slower pace than before.

*Local  
authorities*

The central, regional and local authorities incurred relatively little debt during the past few months; however, in the first quarter of this year they had already obtained substantial borrowed funds, at DM 31 billion net. In the second quarter, indebtedness was expanded by DM 2½ billion, although money market loans and short-term bank advances were redeemed to the amount of DM 7 billion on balance. It was only in July that the central, regional and local authorities again took recourse to the markets to a greater extent. Including that month, new borrowing amounted to DM 20 billion, involving almost exclusively securitised debt (DM 24½ billion), while loans against borrowers' notes were redeemed on balance (DM 3½ billion). Further-

*Borrowing*

### 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 r	+ 124.3	+ 65.2	+ 74.4	+ 57.3
1997 p	+ 95.8	+ 65.9	+ 40.1	+ 80.7
of which				
1st qtr	+ 33.8	+ 25.5	+ 8.5	+ 18.3
Apr.-July	+ 34.4	+ 28.5	+ 16.3	.
1998				
1st qtr p	+ 31.3	+ 12.5	+ 18.8	+ 6.2
Apr.-July pe	+ 19.9	+ 24.3	- 2.4	.

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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more, just over DM 1 billion was obtained by taking up money market loans (including short-term bank advances); equalisation claims were redeemed to the tune of DM 2 billion.

The trend in the period from April to July was largely characterised by two "players", i.e. the Federal Government and the Redemption Fund for Inherited Liabilities. During those months, the Federal Government borrowed DM 24 billion net, which was done exclusively through the sale of securities, with two-year Federal Treasury notes and five-year special Federal bonds being to the fore. On the other hand, the Redemption Fund for Inherited Liabilities paid back to the markets borrowed funds amounting to DM 16 billion net; medium-term bonds previously taken up by

the Treuhand privatisation agency accounted for the bulk of this. The Special Fund's substantial net redemptions must be seen against the backdrop of the above-mentioned profit transfer by the Bundesbank, which had boosted the Fund's liquidity considerably. The other special funds of the Federal Government took up virtually no funds at all on balance. New borrowing by the Länder Governments between April and July amounted to just under DM 11 ½ billion, with the sales of loans against borrowers' notes predominating, as usual. Overall, the local authorities' level of debt remained virtually unaltered in that period.

#### 1998 as a whole

In contrast to previous years, in which the emergence of large unplanned deficits was a feature, there are no indications for this year of any major deviation from the planned budgets of the central, regional and local authorities. As far as tax receipts are concerned, the official tax estimate of May showed that some further shortfalls in receipts are expected to occur this year compared with the autumn 1997 estimate, on which budget plans had largely been based. However, at no more than DM 3 billion, the forecast shortfalls were far smaller than in previous years and therefore did not give rise to major revisions of the budgets.

Moreover, as things stand at present, the trend this year so far tends to suggest that the May tax estimate marks the lower limit of the expected result for the year. At 3.8 %, the increase in tax revenue (excluding local au-

*No perceptible risks...*

*... in tax receipts...*

thority taxes) between January and July corresponded roughly to the 3.7 % rise that was forecast for 1998 as a whole. It should be borne in mind here that the increase in value added tax has had an effect only for a relatively short period of time; furthermore, given somewhat more steeply rising incomes during the course of this year and the more favourable prospects for employment, an acceleration of wage tax may be expected. However, total tax receipts (including local authority taxes, which are likely to stagnate in 1998 owing to the abolition of trade capital tax) will probably grow even more slowly than nominal GDP. This is due to the fact that the bulk of overall economic growth continues to be driven by components that are exempt from turnover tax, i.e. exports and, increasingly, business investment; although the erosion of the tax base is diminishing, it is still showing its effects. The scope for additional expenditure will therefore continue to be strictly limited in 1998 in terms of tax receipts.

*...and labour-market related expenditure*

On the expenditure side, unlike in previous years, no significant additional risks have been discernible so far in respect of labour-market related expenditure, given that the number of unemployed has been showing a year-on-year fall for some months. Although an increasing amount of funds will be needed for the extended use of active labour market measures which so far this year has led to a steep rise in the number of persons participating in them, the amount of slightly more than DM 14 billion appropriated in the Federal budget for transfers to the Federal Labour Office would appear to be sufficient in

the light of the trend so far. Last year this grant amounted to just under DM 10 billion. However, expenditure on unemployment assistance, which reflects mainly payments to the long-term unemployed, is likely to rise sharply again this year and even to exceed the amount appropriated in the budget. The shift from unemployment benefits to unemployment assistance, which is funded directly out of the Federal budget, has little impact on the Federal budget insofar as the Federal Government has to pay a grant towards covering the Federal Labour Office's deficit. However, in principle, the greater weight carried by long-term unemployment will result in the costs of unemployment increasingly being shifted from the social security funds to the Federal Government – or, in the case of social assistance, to the local authorities.

On the whole, it appears unlikely that the deficit of DM 56½ billion envisaged in the Federal budget will be overshot. Taking due account of seasonal fluctuations, in the first seven months of this year both expenditure and receipts were roughly in line with the targets set for 1998 as a whole. At the level of the Länder Governments, which are planning to reduce their deficits by DM 7 billion to about DM 30 billion in 1998, no substantial deviations from budget plans are identifiable, either. In the first half of the year, their deficits already showed a decline of DM 5½ billion, which was mainly attributable to limiting the rise in expenditure to less than 1%. The fiscal position of local authorities is likely to improve over last year, when they recorded a deficit of DM 6½ billion.

*Anticipated results at the individual levels of government*

*Total result*

Including the special funds, the central, regional and local authorities, taken together, will be able to reduce their budget deficits considerably in comparison with last year (around DM 95 billion). However, this result is also due to substantial liquidations of public assets and the Bundesbank's large profit transfer. In the definition of the national accounts, which is of relevance to the Maastricht criteria and under which these flows do not have any impact on the total balances, the reduction of the deficits is smaller. As things stand at present, and including the social security funds, which will likewise show an improvement in their fiscal position this year, the general government deficit as a ratio of GDP might decrease to just under 2½%, compared with a ratio of 2.6% in 1997.

### Outlook

*1999 draft  
Federal budget*

In respect of budget plans for next year, a full set of data is so far available only for the Federal Government level. The draft budget for 1999 adopted by the Federal Government in July provides for an increase in expenditure of no more than 0.4% vis-à-vis the (updated) target for 1998.<sup>2</sup> This restrictive planning of expenditure has been made easier by the improving trend in the labour market, by the fact that virtual price stability has been achieved, and by the persistently low interest rate level, which is restraining the rise in interest payments despite the fact that new borrowing is still running at a high level. Another factor playing a role here is that there is to be a further cut-back in the transfers to the Redemption Fund for Inherited Liabilities. Re-

ceipts, too, scarcely exceed the 1998 target, although a 7½% increase in tax revenue is envisaged on the basis of the May tax estimate. However, other receipts will decline by around one-third, which is mainly due to the fact that only DM 12 billion is envisaged for liquidations of participating interests and other capital assets, compared with DM 32 billion in the 1998 budget. The draft budget closes with a deficit of slightly more than DM 56 billion, thus slightly overshooting the (updated) 1998 target (DM 55½ billion).

According to the medium-term financial plan presented simultaneously with the draft budget, the Federal Government will continue to pursue its restrictive spending policy (the annual average increase in expenditure will be 1.4% in the period from 2000 to 2002). In line with the tax estimate, tax receipts are expected to increase by 4% per year, which is roughly the same rate as assumed nominal economic growth. On the other hand, since other receipts are diminishing (although they will still be fairly high in 1999 as a result of various one-off factors) the rise in total receipts will amount to no more than 2.4% on an annual average. This is the main reason for the slow reduction in the deficit. It is expected to be still slightly more than DM 45 billion in 2002.

Sufficient data are not yet available on the Länder Governments' and local authorities' budget plans. However, it may be expected

*Federal  
Government's  
medium-term  
financial  
planning*

*General  
outlook for  
1999*

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<sup>2</sup> The 1998 target was supplemented by the transfer to the pension insurance scheme, which followed the increase in value added tax, and by the reduced grant to the "German Unity" Fund.



that a continued restrictive spending policy will be pursued at these levels of Government, too, making a reduction in deficits likely, given increasing tax revenue. In the definition of the national accounts, the ratio of general government deficit to GDP might fall below the 2 % mark.

*Medium-term prospects*

At the last meeting of the Financial Planning Council in June, the Federal and Länder Governments and the local authorities reaffirmed their aim of restricting the annual rise in expenditure to a maximum of 2 %. On that condition and on the basis of the macroeconomic assumptions for the medium-term tax estimate of May<sup>3</sup> – and according to the calculations submitted by the Federal Government in the Financial Planning Council – the deficit ratio as defined in the Maastricht Treaty can gradually be reduced to ½ % by 2002. Given these conditions, the ratio of government spending to GDP would fall from slightly less than 49 % in 1997 to 44 % in 2002. However, it should be borne in mind that these projections do not take into account any tax concessions.

*Medium-term requirements*

The public authorities in Germany are committed to the medium-term objective, set forth in the Stability and Growth Pact, of achieving budgetary positions which are close to balance or in surplus. In order to meet this target, it is necessary to continue a strict containment of the rise in expenditure. This restrictive policy must not be abandoned – as was often the case in the past – even if there are more sharply rising tax receipts again which might exceed budget expectations. Instead, any “growth dividend” must be used –

as was also stressed by the European Commission – for reducing the deficits. This is all the more pressing bearing in mind the fact that, in Germany, it is necessary not only to consolidate budgets but also to create scope for a second major fiscal task, i.e. the reduction of the excessive burden of taxes and social security contributions. It is only when these two objectives have been attained that fiscal policy makers will be able to meet their economic responsibilities in monetary union to the full, namely, those of fostering the conditions for sustained economic growth and of cushioning any adverse impact arising from national “shocks”. The role played in this respect by fiscal policy makers will be more important than hitherto, since monetary policy will be geared to the overall trend in monetary union and will no longer be able to take into account the interests of individual countries.

A projection contained in a policy paper entitled “Symmetrical fiscal policy 2010”, which was presented by the Federal Ministry of Finance and published in August, indicates how important it would be to keep the rise in general government expenditure below economic growth even beyond the medium-term planning horizon. Assuming nominal economic growth of slightly more than 4 % per year, the government spending ratio would fall to 40 % by 2010, provided that the increase in general government expenditure were to be restricted to 3 %. Given an

*“Symmetrical  
fiscal policy  
2010”*

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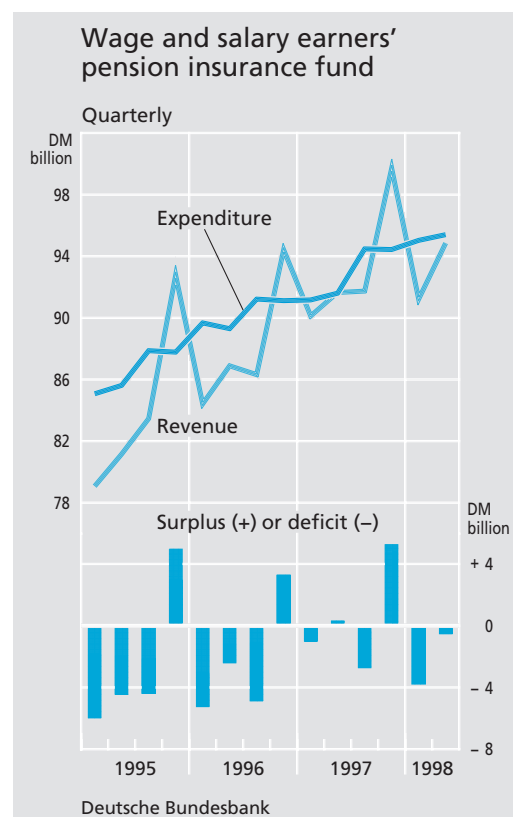
<sup>3</sup> A growth in GDP of 4 ½ % in nominal terms and 3 % in real terms was assumed for 1999 and a growth in GDP of around 4 ¼ % and 2 ¼ %, respectively, on an average of the years 2000 to 2002.

unchanged deficit ratio of ½ %, the additional leeway of 4 % of GDP in comparison with 2002 could be used to reduce the taxes and social security ratio to 36 ½ %; both the government spending ratio and the taxes and social security ratio would thus have fallen roughly to the same level as in the early seventies. A fiscal policy strategy of this kind would bring about a crucial improvement in the general economic climate. It would, however, make great demands on budgetary policy at all levels, since a continual lowering of the general government spending ratio over a longer period requires reviewing existing categories of spending in order to identify less pressing items of expenditure.

### Social security funds

*Statutory  
pension  
insurance  
scheme*

The wage and salary earners' pension insurance scheme recorded a deficit of DM ½ billion in the second quarter, whereas it had ended up close to balance a year before. The fact that contribution receipts continued to yield little revenue had an adverse impact on finances. Receipts from compulsory contributions declined by just under 1%, which was mainly attributable to the moderate trends in wage and salary rises as well as the fact that the number of persons in work still was below last year's level despite the recent trend towards a recovery. By contrast, receipts from the general Federal grant increased by around one-quarter, mainly because, since April, the pension insurance scheme has been receiving the additional Federal grant, funded by the raising of the standard rate of value added tax by 1 percentage point. Hence total



receipts increased rather sharply, namely by 3 ½ %.

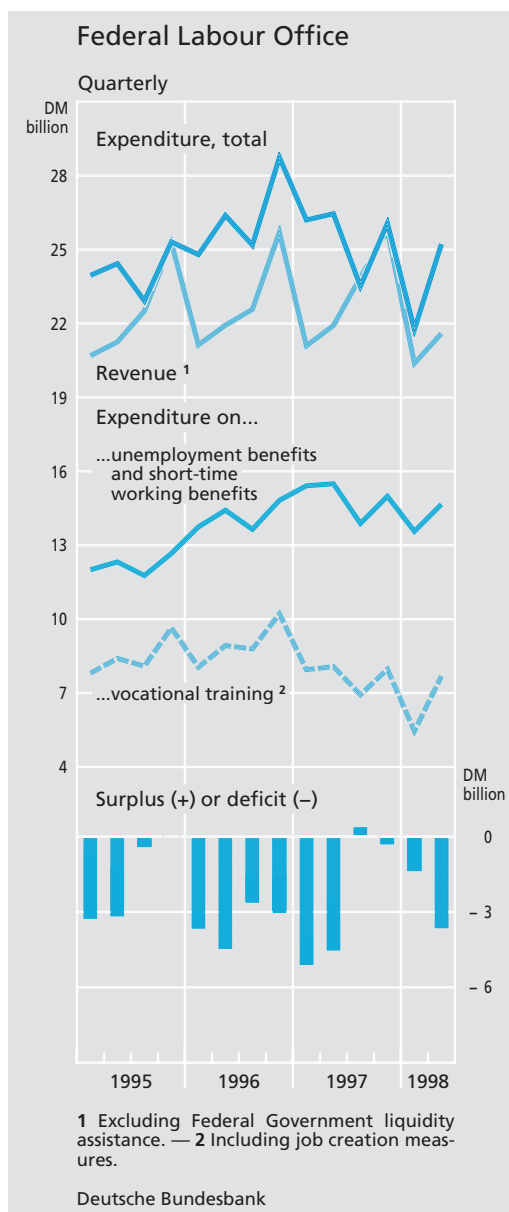
However, the rise in expenditure in the second quarter was even more pronounced than before, totalling slightly more than 4 %. Spending on pensions in western Germany increased by 4 %, which was attributable not only to the 1.65 % pension adjustment in mid-1997 but, above all, to the continuing rise in the number of pension recipients. In eastern Germany, expenditure on pensions exceeded the figure for the corresponding period last year by slightly more than 5 %, which primarily reflects last year's pension adjustment of 5.55 %. A further cost-curbing factor was that the "replenishing amounts", which had been granted temporarily, are slowly being phased out.

Outlook

In the middle of 1998, pensions were raised by 0.44% in western Germany and by 0.89% in eastern Germany; especially in eastern Germany, the adjustment was thus considerably smaller than twelve months earlier, which was in line with last year's trends in net wages. However, an additional strain is being placed on the pension insurance scheme by the improvements in child-rearing benefits which came into force on July 1; these are estimated to amount to DM 1 billion for 1998 alone. Over the year as a whole, the pension insurance scheme will achieve a substantial surplus, primarily as a result of the additional Federal grant; however, once again this is unlikely to be enough to replenish the fluctuation reserve to one month's expenditure by the end of the year. If so, this statutory minimum level – contrary to the original plans – might not be achieved until 1999 when the additional Federal grant will be paid for a whole year. In its recently submitted Pension Insurance Report, the Federal Government expects that the contribution rate can be lowered marginally – from 20.3% to 20.2% of wages and salaries that are subject to compulsory insurance – at the beginning of 1999. According to the medium-term forecasts contained in the Pension Insurance Report, the contribution rate could be kept at this level up to 2002, a situation which is mainly attributable to the consolidation measures agreed in connection with the 1999 Pension Reform Act.

Federal Labour Office

The Federal Labour Office ran a deficit of just over DM 3½ billion in the second quarter, which was not quite DM 1 billion less than the corresponding amount last year. The de-



cisive factor in this improvement was that expenditure fell by slightly more than 4½%. However, revenue, too, decreased by 1½%, which was mainly due to the persistently sluggish trend in contribution receipts.

Trends in expenditure were influenced by the upturn in the labour market; for the first time in some while, the number of unemployed in one quarter virtually no longer exceeded the

corresponding level twelve months earlier. The number of recipients of unemployment benefits, which are disbursed for a limited period only, even dropped relatively sharply. As a consequence, the Federal Labour Office's expenditure on unemployment benefits decreased by 4½%; in western Germany it declined by as much as 8%, whereas in eastern Germany it even exceeded last year's level. Spending on active labour market policy was affected by the expansion of the promotional labour-market policy measures, which was initiated this year and has so far resulted in an increasing number of participants in vocational training schemes and job-creation measures. Although expenditure on these schemes was still below last year's level, the difference was far less pronounced than it had been in the first quarter. For example, there had been a 28% fall in spending on training in the first quarter, whereas the decline amounted to no more than ½% in the period from April to June. During that time, the decline in expenditure on job-creation measures narrowed from 39% to 16%.

#### *Outlook*

In the first half of the year, taken as a whole, the deficit of the Federal Labour Office amounted to DM 5 billion, which was thus only just over half as high as last year. However, it should be borne in mind here that this improvement is partly attributable to the fact that the payment period for all wage substitutes was changed at the beginning of the year from two-week to monthly intervals, which resulted in one-off savings at that time. In addition, the expenditure required for labour-market policy measures is likely to increase sharply during the course of this

year, owing to the expansion of those schemes. However, this contrasts with a continuing decline in expenditure on unemployment benefits, especially in western Germany. As a consequence, the improvement in financial trends observed so far is unlikely to continue in the second half of the year. Nevertheless, the Federal Labour Office can be expected to record far better results in 1998 as a whole than was envisaged in the budget. The latter shows a deficit of slightly more than DM 14 billion, expenditure having overshoot receipts by just under DM 10 billion in 1997.

In the second quarter of 1998, the deficit of the statutory health insurance scheme amounted to just under DM 1½ billion, which was almost as much as in the corresponding period last year. At DM ½ billion, the deficit in the first quarter had been DM 2 billion below the amount recorded a year before. Admittedly, expenditure on pharmaceuticals, in particular, was much lower when comparing this year with last year, owing to the New Regulation Acts which came into force in the middle of 1997. However, spending on hospital treatment, which alone accounts for around one-third of total expenditure in the statutory health insurance scheme, increased sharply, especially in western Germany.

*Statutory  
health  
insurance  
scheme*

All in all, expenditure in the second quarter exceeded last year's level by slightly more than 2%, while receipts went up by just under 2½%. However, part of the increase in contribution receipts is attributable to the year-on-year rise in average contribution

rates, which peaked in both western and eastern Germany – at the levels of 13.6% and 14.0%, respectively – only in mid-1997 (after they had had to be lowered by 0.4 percentage point at the beginning of 1997 because of the Contribution Relief Act). Since then, it has been possible to keep contribution rates stable; in July, they averaged 13.5% in western Germany and 13.9% in eastern Germany.

In the second half of the year, however, some factors that had been easing the financial

burden in 1997 will no longer apply. On the receipts side, the contribution rates are unlikely to continue to exceed last year's level; on the expenditure side, the higher contribution payments, especially for prescription medicines, were already in place in the second half of 1997. On the whole, the result of the second half of this year is likely to be less favourable than in the corresponding period of 1997, when a surplus of DM 5 billion was achieved. Nevertheless, a deficit appears unlikely in 1998 as a whole.