

Public finance

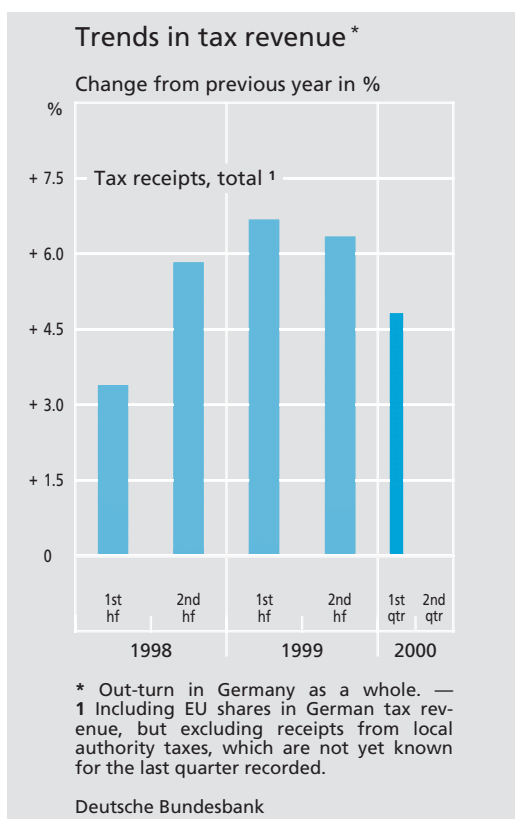
Central, regional and local authorities

Current trends

The central and regional authorities (no results are available for the local authorities yet) incurred deficits amounting to € 16 ½ billion in the first quarter, compared with € 15 billion for the same quarter last year. Given the quite pronounced fluctuations in receipts and expenditure to be expected over the year, however, the deficit trend of the first quarter cannot be extrapolated to yield deficit projections for 2000 as a whole.

Underlying trends

Moreover, from the present vantage, non-tax receipts would appear subject to additional uncertainty; this uncertainty may be attributed, in particular, to the fact that the amount of Federal receipts stemming from the upcoming auction of new mobile licences in the summer and from the sale of participating interests cannot yet be estimated with confidence. The positive trend in tax receipts of the first quarter suggests that they will lie somewhat above the initial expectations which shaped budget plans, although the costs associated with the auction of mobile licences (which will have to be borne by the enterprises concerned) constitute a risk factor. All in all, it is to be expected that receipts in 2000 – even when the sale of licences is excluded – will considerably surpass budget estimates. The savings measures adopted and more favourable trends on the labour market will create the right conditions for holding the rise in expenditure well below the figure recorded last year, which was 3 %.



Tax revenue in the first quarter of 2000 ...

The tax receipts¹ of the central, regional and local authorities continued to grow vigorously in the first quarter of this year, at a rate of almost 5%, most of which was attributable to indirect taxes. The special energy consumption taxes began to show the effects of the second stage of the "ecological tax reform", which came into force at the beginning of this year. Also, the tax increases that took effect on April 1, 1999 were still making themselves felt in this period. As a result, receipts from energy taxation (i. e. the mineral oil tax and the electricity tax, taken together) exceeded the corresponding figure for the previous year by one-third. At almost 6%, turnover tax, too, showed a marked rise; in this case the amendments to tax legislation² that went into effect in the spring of 1999 were still exerting an influence on revenue. Taxable

investments in the housing and public sectors, which increased owing to favourable weather conditions, may have had a positive effect on revenue, as well.

By contrast, income tax receipts in the first quarter rose by no more than just over 3%, with revenue from wage tax increasing by not quite 3% vis-à-vis the corresponding period in 1999. The increase in wage tax receipts was dampened by measures which took effect at the beginning of the year. These included a further increase in child benefit and tax reductions, as stipulated in the second stage of the 1999/2000/2002 Tax Relief Act. This effect was, however, temporarily obscured by the fact that some special payments were evidently assigned to the new year in order to exploit lower tax rates. As was the case during the corresponding period in 1999, the pay-outs that were posted at the expense of assessed income tax revenue again outweighed receipts. This time, however, the disbursements are to be attributed to a steep rise in the allowance for the purchase of owner-occupied dwellings; this allowance replaced the earlier special expenditure deduction facility outlined in Section 10e of the Income Tax Act and is largely paid out in March. Since last year, an additional and comprehensive category of dwellings has become eligible for this type of financial assistance; hence the allowance for the same owner-occupied dwellings, at € 5½ billion,

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

2 These included the reduction or abolition of the input tax offsetting facility for cars not exclusively used for business purposes, additional dining expenses and employee travel and relocation expenses.

required significantly greater funding than one year before (€ 3¾ billion). Adjusted for this factor, assessed income tax receipts again increased substantially. Corporation tax rose dramatically, as well (+ 11%). The main reason for this was, however, that dividend payments – which are subject to a lower taxation rate – decreased in comparison with the corresponding period in 1999.

... and in 2000
as a whole

The favourable data for the first quarter suggest that tax revenue for the year as a whole will greatly exceed expectations held in the autumn of 1999, on which budget plans had largely been based. In its latest forecast, the Working Group on Tax Estimates placed the increase in revenue at 2.9%. Expected revenue has thus risen by approximately € 2½ billion, compared with the corresponding estimate of autumn 1999. In 1999, too, the actual data had exceeded the originally forecast figures by € 1¼ billion. The aforementioned revenue projection does not take into account loss of revenue resulting from the auction of mobile licences.

The projection for nominal economic growth – almost 3½% – on which the new tax estimate has been based only just fulfils the expectations held in autumn 1999.³ This notwithstanding, assessed income tax, in particular, seems to offer rosier revenue prospects than had been expected at that time. Thus retrospective payments for earlier years will probably continue to be high; at the same time, tax prepayments show an unmistakable upward trend, partly owing to the fact that previous tax advantages have been rescinded. In addition, receipts from turnover

Trends in the revenue from major taxes

€ billion			
Type of tax	Revenue in the 1st quarter		Change from previous year in %
	2000	1999	
Wage tax	30.7	29.8	+ 2.8
Assessed income tax	- 0.2	- 0.2	.
Corporation tax	6.2	5.6	+ 11.0
Turnover tax	35.5	33.5	+ 5.9

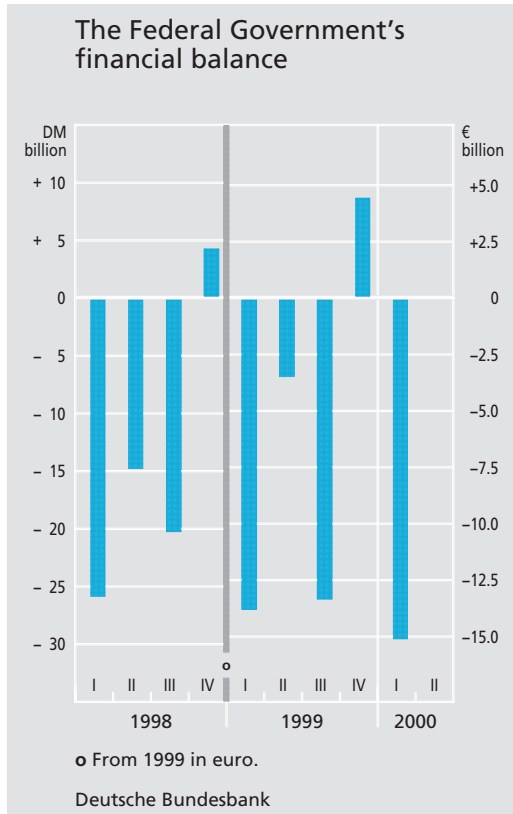
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tax are likely to be larger than the preceding forecast would suggest. By contrast, the autumn projections, especially for corporation tax, will in all likelihood not be fully met. On the whole, the new official tax estimate suggests that the rise in tax receipts will be slightly more subdued than that in nominal GDP; thus, at 22.8% (as defined in the budgetary statistics), the tax ratio will have declined by 0.1 percentage point.

The deficit of the Federal Government amounted to € 15 billion in the first quarter, compared with € 14 billion one year before. The data for the first three months are, how-

Federal
Government

³ Although, at 2¾%, the estimate for real economic growth in 2000 is ¼ percentage point higher than in the autumn of 1999, the rise in the general price level (measured in terms of the GDP deflator) is smaller than previously expected.



ever, not representative of the annual trend since various receipts and expenditure items were subject to considerable, transient fluctuations during that time.

Increase in revenue for the entire year

For the current fiscal year, the Federal budget plan envisages a slight decrease in the deficit from last year's € 26 billion to € 25 billion. As things now stand, even excluding proceeds from the auction of mobile licences, the Federal budget is likely to end up in a stronger position than planned. Tax revenue, for example, should be larger than had been assumed at the time the plan was framed. The Working Group on Tax Estimates now expects Federal tax receipts to increase by slightly less than € 1½ billion (including a reduction in transfers to the EU of almost € 1 billion) vis-à-vis the budget plan. Moreover, unless

privatisation projects are postponed until next year, receipts from privatisation proceeds, especially those deriving from the sale of further shares in successor enterprises to the Post Office, may exceed the € 5 billion envisaged in the budget.

An increase in the financial burden, however, will be reflected in various expenditure items. For example, expenditure relating to compensation payments for former forced labour may affect the budget as early as this year. Moreover, the Federal Government's planned withdrawal of funding for the lump-sum housing allowance, included in the austerity package and estimated at just over € 1 billion in the Federal budget, did not materialise. By contrast, labour market-related expenditure might be lower than envisaged owing to an expected decline in the number of unemployed, provided the active labour market policy of the Federal Labour Office is not extended again. Some expenditure relief may also come from interest payments insofar as the Federal Government continues to profit from the fact that old debt reaching maturity is refinanced at a relatively low interest rate.

Increased expenditure ...

... and financial relief

At € 1½ billion, the Federal special funds deficit in the first quarter of 2000 increased slightly over the year. The fiscal position of the special funds for the entire year will be greatly inferior to that of 1999, when it showed a surplus of € 5 billion. The main reason for this is the Bundesbank profit, that part of it in excess of DM 7 billion (approximately € 3½ billion) going directly to redeem debt incurred by the Redemption Fund for Inherited Liabilities. Total revenue from this

Special funds

source has halved to € 4 billion so that in April a mere € ½ billion was made available to the Redemption Fund for Inherited Liabilities.

*Länder
Governments*

The Länder Governments' budgets showed an aggregate deficit of € 3½ billion for the first quarter. Thus the deficit fell short of the corresponding figure for the previous year by just over € ½ billion, owing primarily to a marked increase in receipts of the east German Länder Governments' budgets. At 2½%, the rise in total revenue was somewhat larger than that in expenditure, which sustained a year-on-year increase of 1½%. The high pay settlements of last year continued to have an adverse effect here, with expenditure on personnel accounting for over one-third of regional budgets. Pay settlements in the public sector and – particularly important for the Länder Governments' budgets – adjustments to civil servants' life-long salaries to be determined by the legislature will have a significant influence on the trend for the remainder of the year. The positive underlying trend in tax receipts may be expected to contribute to a further stabilisation of the Länder Governments' financial position. The budgets for the entire year envisage a cumulative deficit of € 15 billion, which is roughly equivalent to the corresponding figure of last year. The actual outcome for 1999 was, however, at € 10 billion, considerably better. It may be possible to observe a similarly favourable divergence from original estimates this year, as well.

*Local
authorities*

As in the preceding year, local budgets in 1999 recorded a surplus of almost € 2½ billion (al-

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

To end-1998: DM billion / from 1999: € billion

Period	Total	of which		Memo item Acquisition of public debt instruments by non-residents
		Securities	Loans against borrowers' notes ¹	
1991 ²	+ 106.0	+ 71.3	+ 34.9	+ 50.9
1992	+ 102.6	+ 95.0	+ 8.1	+ 59.4
1993	+ 159.1	+ 120.3	+ 39.3	+ 109.1
1994 ³	+ 86.0	+ 45.6	+ 40.8	- 20.9
1995 ⁴	+ 97.7	+ 32.6	+ 81.4	+ 62.1
1996	+ 123.8	+ 65.2	+ 74.1	+ 57.3
1997	+ 95.5	+ 65.9	+ 39.9	+ 80.7
1998	+ 66.9	+ 53.6	+ 15.6	+ 71.0
1999 <i>pe</i>	+ 34.1	+ 44.9	- 10.6	+ 17.1
of which				
1st qtr	+ 12.7	+ 14.1	- 2.0	+ 1.7
2000				
1st qtr <i>pe</i>	+ 11.7	+ 7.5	+ 4.2	...

¹ Including cash advances and money market borrowing. — ² From 1991 including the east German Länder Governments and local authorities. Excluding Federal Railways debt assumed by the Federal Government. — ³ From 1994 including Federal Railways Fund. — ⁴ From 1995 including Redemption Fund for Inherited Liabilities.

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ways allowing for large discrepancies between individual municipalities). Among the different revenue sources, trade tax receipts, in particular, rose markedly, although a slight decline had been expected after the large rise of the last few years, which was based in part on extensive retrospective payments. In addition, expenditure growth was limited to just over 1½%; this may, however, be attributed, in part, to the exclusion of municipal amenities from the core budgets. In 2000, the local authorities' fiscal position may be expected to deteriorate, on the whole, owing to a slackening in revenue momentum and a larger rise in expenditure. The financial positions of east and west German local authorities continue to differ considerably. While the local authorities in western Germany may again enjoy surpluses, albeit diminishing ones, the budgets of the

east German local authorities are unlikely to rise above the deficit level.

Indebtedness

The central, regional and local authorities stepped up their debt by € 11½ in the first quarter. Money market borrowing, which increased by € 8½ billion, was predominant, while funds amounting to € 3 billion, on balance, were procured in the capital market. As regards the different levels of government, the Federal Government expanded its indebtedness by € 13 billion, resorting primarily to money market loans and to bond issues. By contrast, the Länder Governments reduced their debt in the first quarter by € 2 billion. The level of local authorities' indebtedness is not likely to have risen very much in the first three months of the year.

Outlook for the central, regional and local authorities

Large, unexpected licence revenue ...

The budgetary outcome for the central, regional and local authorities will depend primarily on the size of the proceeds that the Federal Government derives from the upcoming auction of mobile licences in the summer; as of yet, the Federal budget does not include receipts from this source. Ever since the auction of similar licences in the United Kingdom raised approximately € 38 billion in revenue, observers have been unwilling to rule out the prospect of substantially higher proceeds for Germany. In keeping with this scenario, the surplus posted by the Federal Government could prove so large that it would more than compensate for the deficits of the regional and local authorities. This may well result in

substantial relief for the financial markets in the second half of the year, as the Federal Government redeems debt; this development would be offset, however, by an increase in the borrowing needs of licence purchasers.

At the same time, it is necessary to emphasise the fact that this unforeseen increase in receipts represents a one-off easing of Federal fiscal positions, which cannot be expected to occur again and so provide relief for future budgets. Proposals to devote at least part of these special receipts to cover specific expenditure items, which could be heard increasingly often lately, are inconsistent with the Federal Government's policy of pursuing sustained fiscal consolidation. The same may be said of the demand that this revenue be used to fund further tax cuts. As desirable as such reforms are, they must be backed over the long term by structural reductions in expenditure or by an extension of the tax assessment basis. Although effective tax reforms may stimulate economic growth, which, in turn, would provide the basis for a future increase in tax receipts, it is one of the core principles of a forward-looking and sound fiscal policy that revenue gains of this kind not be allocated in advance but only be taken into account once they have actually been raised.

... does not constitute a long-term source of financing

It would be more in keeping with the one-off nature of these receipts if they were to be applied, in full, to the repayment of debt, which, incidentally, is in line with the Federal Government's intentions. In the period extending from the end of 1990 to the end of 1999, the Federal Government's level of indebtedness rose from approximately DM 540

Use of licence revenue to redeem debt ...

billion to almost DM 1,400 billion (approximately € 715 billion), largely fuelled by German reunification; this accumulation of debt considerably constrained budgetary room for manoeuvre by increasing the size of interest payments. Moreover, the level of general government debt in Germany continues to violate the upper limit of 60 % of GDP set by the Maastricht Treaty. Also, in view of the demographic trend and the implicit debt associated with the current system of old-age provision, no effort should be spared to reduce the level of indebtedness and thus the size of the burden to be carried by future generations.

*... would result
in lasting
savings on
interest
payments*

In addition, debt redemption would result in an immediate and lasting structural improvement in Federal Government finances insofar as it would simultaneously entail a reduction in the size of the interest burden. At the current interest-rate level, a decrease in indebtedness of € 10 billion would translate into a long-term easing of Federal budget pressures equivalent to roughly € ½ billion per year. The fiscal policy latitude gained should be used to come closer to the fiscal objectives of the European Stability and Growth Pact and – insofar as room to manoeuvre still exists – to finance new and sustainable budget policy initiatives, among which further tax cuts would be one of the options worth considering.

*Loss of tax
revenue
associated with
licence
proceeds*

These positive consequences for budgetary positions will, however, be coupled with new financial burdens. Thus it should be borne in mind that enterprises which are successfully involved in the sale of licences incur high additional costs primarily through write-offs on

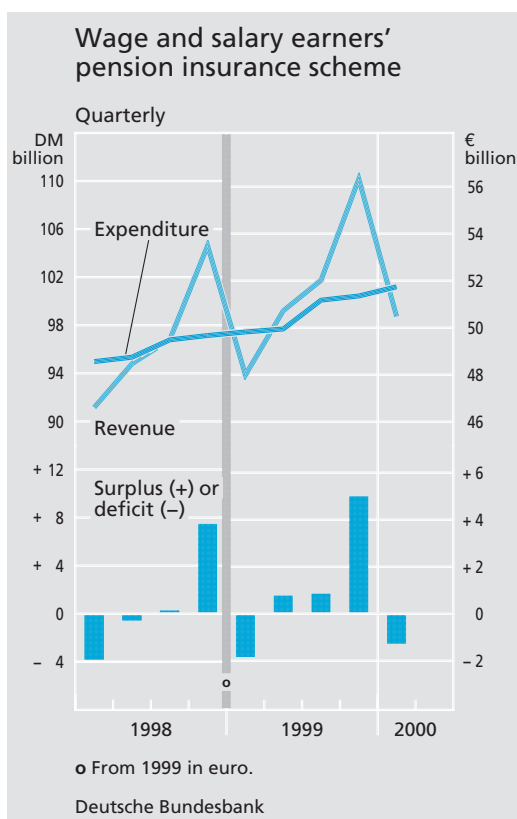
acquisition costs. These may be claimed as tax-reducing expenditure and would thus curtail corporation and trade tax revenue. Both the extent and the timing of this loss in tax revenue are, however, completely uncertain at this stage.

It is also important to note in connection with the Federal Government that the capital which the Government receives from restructuring and privatising the successor enterprises to the Post Office is intended to fill gaps in the funding of “postal pensions”. Post Office pension funds pay the pensions for civil servants who were employed either by the Post Office itself or by a successor enterprise to the Post Office. Contribution payments from the successor enterprises are made to the Post Office pension funds on behalf of civil servants who are still employed. Since the number of active civil servants continues to decline, however, the size of transfers has also decreased, while pension obligations will subsist over decades. As a result, the Federal Government’s need for supplementary funding may be expected to increase sharply in future. Already this year, the Federal Government’s expenditure in this area, estimated at just over € 3 ½ billion, will represent a considerable financial burden.

*Increase in
financial
burden by Post
Office pension
funds*

As has already been pointed out, the Federal Government will suffer considerable loss of revenue owing to the planned reform of business taxation and the accelerated implementation of the third stage of the 1999/2000/2002 Tax Relief Act. Neither the effects of the austerity package adopted last year nor the persistently low interest rate level will be able

*Loss of revenue
as a result of
tax reform in
the next fiscal
year*



to compensate for this shortfall in revenue. Thus the Federal deficit of just under € 24 billion envisaged in the medium-term financial plan for 2001 may be achieved only if extensive asset sales are again conducted. Despite recent positive developments, the Federal Government will be able to achieve its avowed objective of balancing the budget by 2006 at the latest only if it adheres to a strict consolidation policy. The loss of revenue associated with the tax reform in 2001 will also place a considerable financial strain on Länder Governments and local authorities and will result in their financial positions being less favourable than they will have been in 2000; this, in turn, will require redoubled efforts at economising at these government levels, too.

Social security funds

The statutory pension insurance scheme showed a deficit of € 1¼ billion for the first quarter of 2000; this amounts to a year-on-year decrease of € ½ billion. Total expenditure increased by almost 4%. Pension payments rose by just over 3½%; the change in this figure may be attributed not only to the after-effects of the pension increase in mid-1999 (by 1.34% in western Germany and 2.79% in eastern Germany), which had still been indexed to changes in net wages, but also to a consistently high rise in the number of pensions paid.

Wage and salary earners' pension insurance scheme

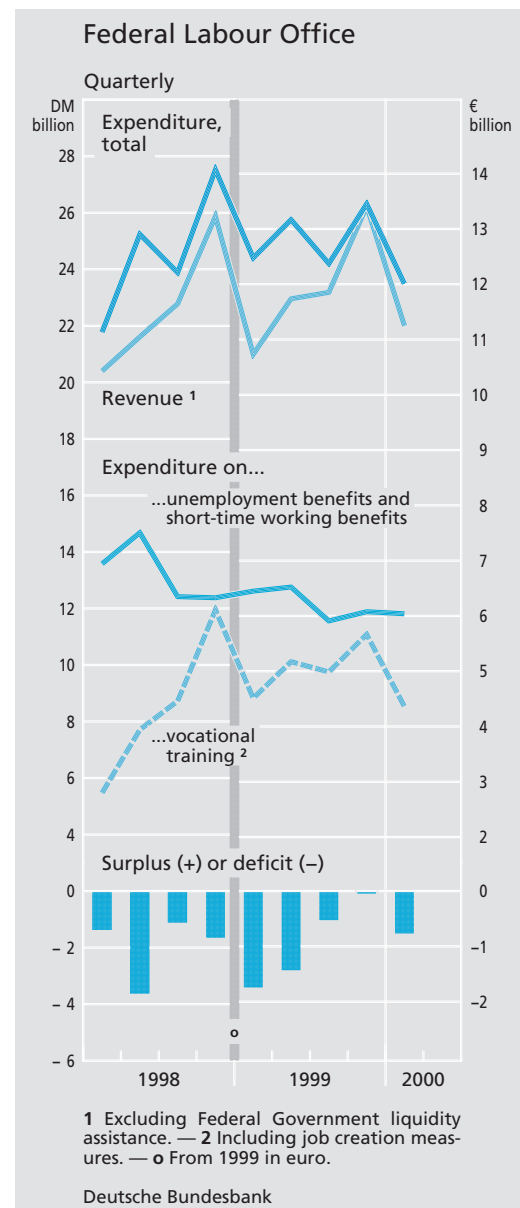
Pension insurance institutions' receipts were just over 5% higher than one year previously. The main factor contributing to this steep rise were additional Federal Government payments relating to child-rearing, which were initiated in June of 1999 and are financed through the increase in energy taxation. By contrast, compulsory contributions rose by a mere ½%, the reason being that the contribution rate was lowered from 20.3% to 19.5% as of April 1, 1999 and again to 19.3% at the beginning of 2000. Adjusted for these changes in the contribution rate, compulsory contributions would have increased by just over 5%, as revenue here benefited from additional contributions stemming from the introduction of compulsory social insurance contributions for part-time workers below a certain earnings level as of April 1, 1999 and from the large wage increases in the spring of 1999, which continued to affect year-on-year comparisons. By contrast, contributions receipts relating to the

recipients of wage substitute benefits have sharply declined owing to the more favourable labour market trend and a narrowing of the assessment basis for these contributions.⁴

The pension insurance scheme will presumably show only a small surplus for the entire year, while in 1999 receipts exceeded expenditure by € 4½ billion. The main reason for this is that the pension insurance scheme is no longer required to generate a substantial surplus since the required fluctuation reserves were replenished in 1999. In consequence, the contribution rate could, as already stated, be lowered. Savings arising from a restriction of pension increases to the inflation rate of the previous year (+ 0.6 %), effective July 1, 2000, and higher Federal payments were also taken into account when fixing the contribution rate. At the same time, the fact that the lowering of pension contributions in respect of unemployment assistance recipients will have a stultifying effect on revenue growth also played a role.

Federal Labour
Office

In the first quarter of 2000, the Federal Labour Office recorded a deficit of € ¾ billion, more than halving the corresponding figure for the previous year. Revenue grew by slightly more than 5 %, mainly as a result of last year's increases in negotiated pay rates, which continued to make their influence felt. By contrast, expenditure declined by almost 4 %; expenditure on unemployment benefits even fell by close to 6½ %. Active labour market policy expenditure decreased by a total of almost 3½ %, which may primarily be attributed to the fact that fewer job creation measures were adopted. By contrast,



scarcely less was spent in 2000 than in 1999 on professional training, which also covers continued implementation of the programme designed to achieve an immediate reduction in youth unemployment.

⁴ Since January 1, 2000, pension insurance contributions in respect of unemployment assistance recipients have no longer been calculated as 80 % of previous gross earnings but according to the actual contributions made. Claims to unemployment assistance – assuming need can be proven – amount to either 53 % of previous net earnings or – if at least one child is being cared for – 57 %.

As a result of more favourable trends on the labour market, the Federal Labour Office will have to spend less on unemployment benefits during the remainder of the year, too. Since the number of persons – especially in eastern Germany – benefiting from active labour market policy measures is lower than last year, when it reached an exceptionally high level, this expenditure item will probably also call for fewer funds. By contrast, an increase in expenditure may result from a ruling of the Federal Constitutional Court expected later this year, which would allow one-off wage-related payments to be taken into account when determining wage substitutes. Still, the need for Federal Government transfers, amounting to almost € 4 billion, provided for in the Federal Labour Office's budget plan and to be financed through the Federal budget, is likely to prove more than ample.

Outlook for the general government sector as a whole

Current year

As defined in the national accounts and excluding additional revenue stemming from the sale of mobile licences, the general government budget for 2000 is likely to show an almost unchanged deficit ratio, compared with 1999 (the Federal Statistical Office recorded a deficit amounting to 1.1% of GDP for 1999); both the expenditure and the revenue ratios will decrease significantly. Taxes on the receipts side are likely to rise at a somewhat slower pace than nominal GDP, while growth in non-tax receipts will probably lag considerably behind GDP growth, partly owing to the lowering of the contribution

rate for the statutory pension insurance scheme. Furthermore, the Bundesbank profit was appreciably smaller than one year earlier. As for expenditure, the growth rate will be particularly slowed down by the austerity package. If, however, receipts from the sale of mobile licences are taken into account, this year's general government fiscal positions might show a temporary surplus. This will depend not only on the size of the proceeds but also on how they will be recorded in the national accounts statistics, a matter that has still to be clarified.

A marked deterioration in the general government budget balance may be expected next year, although the underlying overall economic conditions would appear beneficial to public finances. The main reason for this is the loss in revenue associated with the tax reforms, which is likely to amount to just over 1% of GDP. In its stability programme for 2001, which was updated in January, the Federal Government envisages a deficit ratio equivalent to 1½%, which is to be reduced to ½% by 2003. The proceeds from privatisation, which are intended partially to cushion the loss in tax revenue in the Federal budget of 2001, will not be able to halt this temporary return to a rising deficit ratio, since, in the definition of the national accounts, receipts of this kind do not have a deficit-lowering effect. This provides all the more reason for the Federal Government to continue adhering to a strict consolidation course after 2001, especially if it is to attain over the medium term budgetary positions close to balance or in surplus, as stipulated by the Stability and Growth Pact. This also applies to the other levels of

Outlook

government, which also bear responsibility for implementing the objectives of the Stabil-

ity and Growth Pact consistently on the national level.

