

# Public finance

## Central, regional and local authorities

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### Trends since the beginning of the year

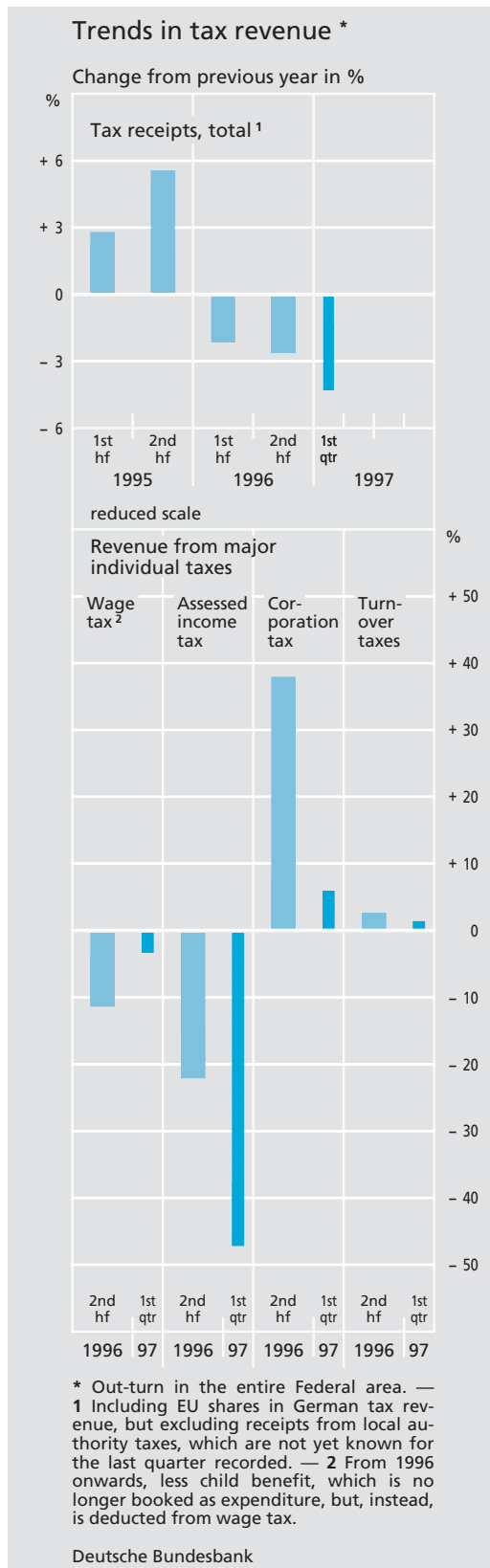
In the first few months of 1997 the financial situation of the central, regional and local authorities initially continued to deteriorate, contrary to the trend assumed in the budget plans for the entire year. The deficit of the Federal Government, the Länder Governments and the special funds, taken together, came to DM 34 ½ billion in the first quarter, and was thus DM 8 ½ billion higher than in the same period last year (no data on the local authorities are available so far). The main reason for this was the disappointing trend in tax revenue. However, it was also attributable to factors which are of a temporary nature. Expenditure in the first quarter expanded by 2 %, although the rate was different at the various levels of government.

In the first quarter tax receipts<sup>1</sup> were just over 4 % below the result achieved in the corresponding period last year. However, as mentioned above, they were also diminished by factors which will cease to be effective in the further course of the year. Firstly, a counter-effect occurred in respect of mineral oil tax and the tax on spirits and concerned the additional proceeds (totalling almost DM 3 billion) that had arisen at the end of last year, as a result of the shortening of the payment periods. Secondly, hardly any receipts flowed in from the increase in the tax on the acquisition of land and buildings, which came into

*Overall taxes*

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



force at the beginning of the year, and from the inheritance tax reform, whereas the abolition of property tax was already affecting tax prepayments.

In the first quarter wage tax yielded just over 3 % less than a year before. Revenue from this tax was also affected by the further increase in child benefit at the beginning of the year. Child benefit, which is booked to the debit of this tax, was raised (from DM 200 to DM 220 per month for the first and second child). In addition, compared with last year, the trend in revenue was understated by the fact that the reform of the childrens' benefit system, which came into force at the beginning of 1996, was partly reflected with a time lag in a decrease in wage tax revenue. However, even if calculated before deduction of child benefit payments, wage tax receipts grew by no more than just under 2 %, as a result of the slower increase in actual earnings and the unfavourable trend in employment.

*Wage tax*

Regarding assessed taxes, the decline in revenue from assessed income tax continued; in the first quarter receipts from that tax were only just over half as high as in the same period in 1996. This was partly attributable to the fact that about DM 1½ billion was paid out in respect of allowances for the construction of owner-occupied housing, which are financed from assessed income tax, whereas a year earlier this new allowance which is independent of the progressive tax scale – and which replaces the previously granted deduction as special expenses granted in accordance with section 10 e of the Income Tax Act – had hardly affected revenue. In add-

*Assessed taxes*

ition, revenue obviously continued to be substantially curbed by the claiming of special tax allowances; in this context, the special 50 % depreciation allowance for investment in eastern Germany, which was still granted without deductions until the end of 1996, was particularly significant. In contrast to assessed income tax, revenue from corporation tax increased, viz. by 6%. This owed much to the improved corporate earnings situation, which led to higher tax repayments.

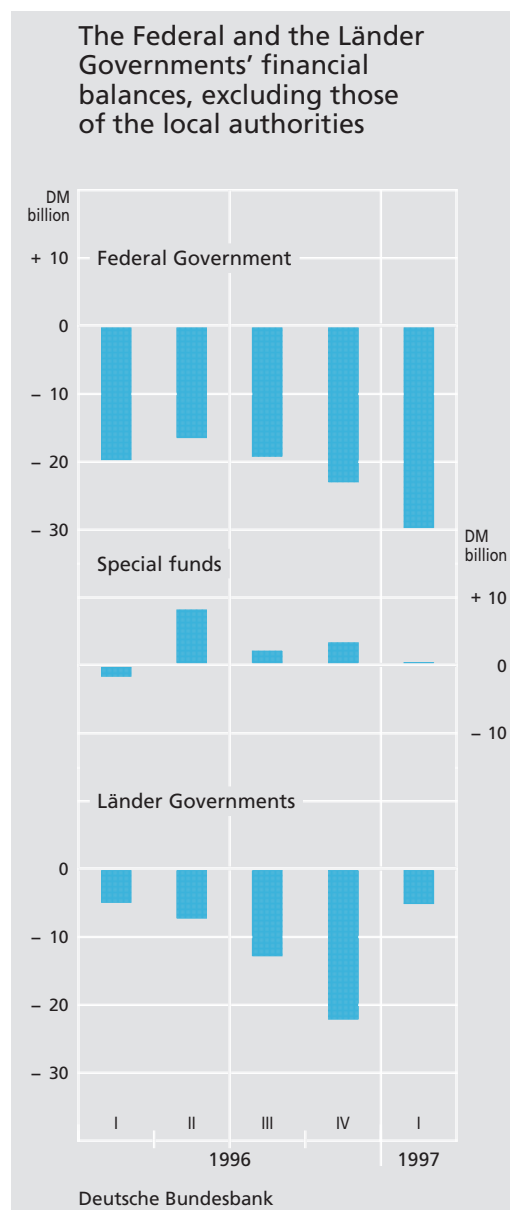
*Turnover tax*

In the first three months, revenue from turnover tax grew by no more than 1½%. In part this was because economic growth was fuelled to a considerable extent by tax-free exports. In addition, the increase in revenue was restrained by weak consumer demand.

*Federal budget*

The Federal Government incurred by far the most unfavourable budget result of all central, regional and local authorities in the first quarter. Its deficit came to just under DM 30 billion, and thus overshoot the corresponding amount reached last year by DM 10 billion. In this context, it was particularly significant that tax revenue decreased by 7½%. Since other receipts grew considerably, the decline in total receipts, at 6%, was somewhat smaller.

Expenditure in the first quarter expanded by just under 4%. This strong expenditure flow was partly attributable to the fact that the transfers to the Federal Labour Office and unemployment assistance, taken together, required 12% more funds than in the same period last year; after only a few months, it has already become apparent that this



labour-market-related expenditure will substantially overshoot the budget estimates. Another particularly significant factor was a sharp increase in expenditure on calls on guarantees. In addition, transfers to the wage and salary earners' pension insurance scheme (which are pegged both to the trend in remunerations and to the contribution rate), the transfers to the Redemption Fund for Inherited Liabilities (which had flowed out only hesi-

tantly in the same period last year) as well as other operating expenses also rose considerably. By contrast, expenditure was restrained by the fact that important benefits granted by the Federal Government (training promotion, child-rearing benefits, housing allowances, war victims' pensions and related benefits) required fewer funds than a year before. In addition, the Federal Government is being afforded considerable relief by the fact that the early retirement regulations it financed in the new Länder are gradually expiring. Finally, the transfers to the Federal Railways Fund also declined considerably. It has to be borne in mind that fluctuations in the intervals at which some of the above-mentioned expenditure items are paid out play a considerable role and this makes it difficult to forecast trends in the further course of the year.

*Special funds*

The Federal Government's special funds recorded a slight surplus in the first quarter of the year, whereas a year before they had incurred a deficit of DM 1½ billion. This improvement is mainly attributable to the decline in interest expenditure, which makes up just over one-half of the total expenditure of these subsidiary budgets; the "German Unity" Fund and the Redemption Fund for Inherited Liabilities, in particular, have to provide only interest expenditure for the most part. Since the debt level of the subsidiary budgets hardly changed at all last year, the decline in interest expenditure is principally attributable to the persistently low interest rate level, which makes more favourable refinancing possible.

In the first three months, taken together, the deficit of the Länder Governments came to just over DM 5 billion and was thus approximately as high as a year before. However, trends in the east and in the west developed along quite different lines. Whereas the deficit in the old Länder increased by DM 4 billion to DM 6 billion, the new Länder recorded a surplus of DM 2 billion, after recording a deficit of DM 1 billion in the first quarter of 1996. Although the deficit incurred by Berlin decreased by DM 1 billion to just over DM 1 billion, it was still comparatively high. The trend in tax revenue – whose considerable decline in the old Länder was also because net worth tax has not been levied since the beginning of 1997 – was an important cause of the differences in the financial situations of western and eastern Germany. In the further course of the year, however, it will probably be more buoyant, owing to the additional receipts arising from the increase in inheritance tax and the tax on the acquisition of land and buildings which will then make themselves felt increasingly. By contrast, in the new Länder, in which a net worth tax had not been levied before, tax revenue grew steeply in the first quarter of 1997. Overall, the Länder Governments expanded their expenditure only slightly, viz. by just over ½%, the increase in the west being sharper than that in the new Länder.

*Länder  
Governments*

In the first few months of the year, the central, regional and local authorities drew heavily on the credit markets for financing their deficits. In the first quarter new borrowing came to DM 34½ billion; in April the debt level increased once again by just over DM 14

*Borrowing*

billion. In this context, the focus was on sales of securities, which yielded DM 40 billion net between January and April. Just over DM 7 ½ billion net was raised through loans against borrower's notes, and DM 2 billion through money market loans or short-term cash advances from banks.

By far the biggest borrower was the Federal Government whose indebtedness grew by DM 38 billion in the first four months of the year.<sup>2</sup> In this context, sales of bonds, which yielded DM 26 ½ billion net, predominated. Sales of Federal Treasury notes and five-year special Federal bonds were also quite buoyant, whereas loans against borrowers' notes were redeemed, on balance. The Federal Government increased its borrowing in the money market by DM 1 billion. The special funds reduced their indebtedness by DM 5 billion between January and April, essentially by redeeming bank loans. In the four-month period, new borrowing by the Länder Governments came to almost DM 13 ½ billion; in this context, the raising of bank loans to the tune of DM 16 ½ billion and of short-term cash advances to the tune of DM 1 billion was accompanied by a reduction in the holdings of securities outstanding (particularly of bonds). At the local authority level, net borrowing came to an estimated DM 2 ½ billion.

### Budget trends in 1997 as a whole and future outlook

At present the financial situation of the central, regional and local authorities is shaped particularly by the persistent weakness in taxes, even if the trend in revenue will prob-

*Persistent weakness in taxes*

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

Period	Total	Of which		Memo item Purchases of public debt instruments by non-residents
		Securities	Loans against borrowers' notes <sup>1</sup>	
1986	+ 38.0	+ 49.7	- 11.3	+ 37.2
1987	+ 50.0	+ 46.8	+ 3.6	+ 18.8
1988	+ 54.0	+ 42.1	+ 12.2	+ 6.6
1989	+ 25.8	+ 32.9	- 6.8	+ 18.8
1990 <sup>2</sup>	+ 112.2	+ 90.9	+ 21.7	+ 15.1
1991 <sup>3</sup>	+ 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 <sup>4</sup>	+ 85.8	+ 45.6	+ 40.6	- 20.9
1995 <sup>5</sup>	+ 97.6	+ 32.6	+ 81.4	+ 58.3
1996 <sup>pe</sup>	+ 124.2	+ 65.2	+ 74.5	+ 54.1
of which				
Jan.-Apr. <sup>pe</sup>	+ 28.3	+ 11.2	+ 23.5	.
1997				
Jan.-Apr. <sup>pe</sup>	+ 48.9	+ 39.7	+ 9.4	.

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

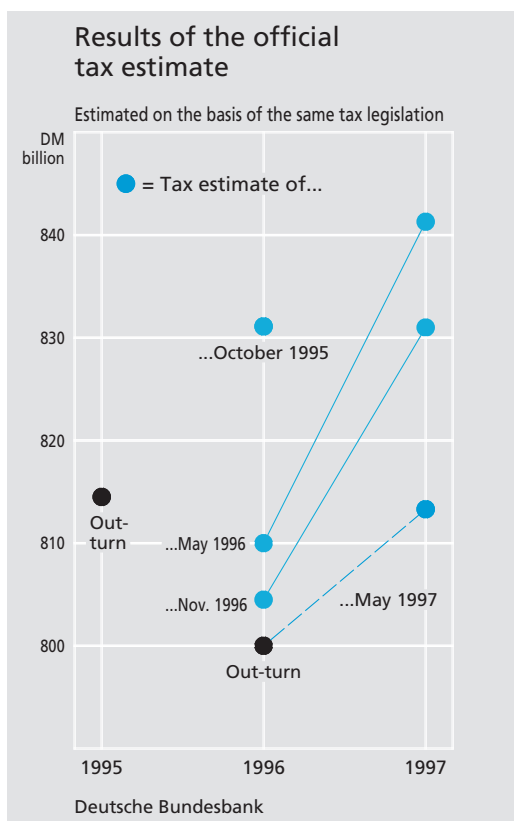
Deutsche Bundesbank

ably be slightly less unfavourable in the further course of the year than it was in the first few months of the year, which were influenced by special factors. In the official tax estimate of May, the increase in tax revenue for 1997 was put at 1.6%. Compared with the similar estimate of November 1996, which largely formed the basis of the budget plans, expectations were thus reduced by DM 18 billion.

This was attributable not only to the baseline effect of lower revenue last year but also to the fact that the increase in nominal gross domestic product in the current year was put at 3 ½ %, and thus about ½ percentage point

*Result of the most recent tax estimate*

<sup>2</sup> In this context, it should be noted that the increase in the effective total debt described here may deviate from net borrowing booked in the budget.



lower (whereas the estimate of real growth remained unchanged, at + 2 ½ %). Particularly regarding the proceeds from wage tax (which yields a large amount of revenue), it is apparent that actual earnings have been increasing less and employment has been developing more unfavourably than assumed at the time. In addition, there have been considerable shortfalls in revenue in respect of assessed income tax, which are obviously largely attributable to the claiming of various tax concessions and possibilities to make deductions, the actual extent of which had not been expected. This concerns not least the special depreciation allowances in eastern Germany, which have been cut back since the beginning of 1997. In addition, particularly in respect of value added tax, an increasing “loosening” of the ties between revenue and the

underlying tax base has occurred; that the possibilities for tax evasion have been utilised more intensively probably also played a part here.

Unemployment which continues to persist at a high level and which will probably considerably exceed the magnitude assumed in the budget plans (about 3.9 million persons on an annual average in 1997) leads to high additional requirements on the expenditure side, apart from entailing shortfalls in taxes and social security contributions. Since expenditure on “active labour market policy” was already reduced by the retrenchment measures included in the “Programme for more growth and employment”, it will hardly be possible to offset the – necessarily substantial – additional expenditure on unemployment relief by providing for cuts in other areas of the budget of the Federal Labour Office.

*Burden of high unemployment*

However, these deficit-increasing factors are offset by the fact that the central, regional and local authorities endeavour to limit the flow of expenditure as sharply as possible at all levels concerned and to keep the volume even below the amount provided for in the budget plans. In its budget the Federal Government provided for a decline by about 3 ½ %, compared with the 1996 out-turn. The increase is ½ %, when calculated without the estimates for labour-market-induced payments, which, from the present perspective, were too low and which are considerably below the real level of expenditure effected last year.

*On the other hand: pronounced retrenchment course*

The Länder Governments’ budget plans provide for an increase in expenditure of less

than 1%. This strict limitation was made easier not least by the moderate pay settlements for the public service, which led to rises of 1.3% in income from January; the remuneration of civil servants – with the exception of the highest pay groups – was increased from March by the same percentage rate. The fact that the Länder Governments reduced their transfers to the local authorities in many cases also had an expenditure-restraining effect. In view of the shortfalls which appear likely in tax revenue, the Länder Governments are endeavouring, in addition, to realise further cuts in the implementation of the budget – also by adopting supplementary budgets and by imposing budget freezes.

At the local authority level – according to the results of surveys carried out by Deutscher Städtetag (German City Diet) – expenditure will probably tend to be below the level recorded last year.<sup>3</sup> In this context, relief was afforded by cuts in social assistance measures, which resulted from the fact that the payments under the nursing insurance scheme have been extended since mid-1996 to include in-patient nursing care. However, local authorities' expenditure on tangible fixed assets will probably also be reduced – for the fifth year in succession.

*Decline in the  
government  
ratio*

In spite of the labour-market-induced additional burdens, a perceptible decrease in the government ratio (i.e. the share of general government expenditure in gross domestic product as defined in the national accounts) is to be expected for the current year, for the

first time since 1994, viz. below the ceiling of 50%.

Generally speaking, it should be borne in mind as far as the budget plans of the central, regional and local authorities are concerned that, although the high degree of monetary stability achieved initially influences the trend in tax revenue, it also makes it easier to limit the rise in expenditure. This applies not only to the government demand for goods and services but also to the social transfers, which are pegged in many cases to the trend in nominal income. Not least, a low level of interest rates (which is made possible by price stability) curbs the increase in interest expenditure – an effect which is of considerable importance in view of the current financial trends in the central, regional and local authorities. Particularly, the debt which is now becoming due for repayment can be refinanced, as a rule, at perceptibly lower interest rates, and this – in view of the rescheduling volumes reached, which far overshoot the amount of new borrowing – is very important. In spite of the previous high level of new borrowing, the increase in interest expenditure could therefore be limited last year to less than 1%, and, on the whole no substantially sharper increase is to be expected in the current year either.

*Positive impact  
of monetary  
stability on  
expenditure*

Generally speaking, the possibility of the deficits of the central, regional and local authorities overshooting the budget estimates cannot be ruled out, given the considerable

*Prospective  
financial  
position of  
the central,  
regional and  
local authorities*

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<sup>3</sup> However, it should also be borne in mind that the volume of the budget is reduced by the extraction of fees budgets, in particular.

amount of uncertainty, not least with respect to further budget policy decisions. However, they will presumably be lower than the level actually reached last year (about DM 120 billion), even though the decline will probably be lower than originally expected. The Federal Government is the level of government whose expenditure is most likely to exceed the budget, since its budgetary position is affected even more by the additional requirements of the Federal Labour Office and additional funds necessary for unemployment assistance than it is affected by the tax shortfalls of DM 9 billion which it has to bear according to the official estimate. The Federal Government is endeavouring, particularly through greater sales of participating interests than previously planned as well as through very strict budgeting, to limit the overshooting of the budget estimate (DM 53 ½ billion) wherever possible.

The budget plans of the Länder Governments provide for a deficit of about DM 32 billion, in all, and thus a considerable decline, compared with the provisional out-turn of DM 47 billion in 1996. As a result of the expected shortfalls in taxes of about DM 7 billion, it is possible that the Länder Governments may be unable to keep to the budget estimates, even though they are endeavouring to effect further expenditure cuts. It appears likely that the local authorities will incur a deficit which is approximately as high as last year's (DM 7 billion). The financial position of the special funds will probably show little change from last year when they achieved a surplus of DM 12 billion.

No sufficiently accurate data on the budget plans of the central, regional and local authorities for the coming year are available so far. Financial policy makers are faced with the task of adjusting these plans to the medium-term strategy, which is geared towards reducing the deficits from their currently high level, and at the same time of curbing the burden of taxes and social security contributions. Important decisions have already been made in order to achieve the latter. These include the decrease in the solidarity surcharge by 2 percentage points envisaged for 1998 and, in particular, the fundamental reform of income taxation initiated by the Government. The main part of this reform will come into force in 1999 and is aimed at reducing the burden on tax payers by up to DM 30 billion net. In addition to the envisaged net relief, the tax reform provides for a far-reaching restructuring of income taxation by decreasing tax rates – in some cases dramatically – and at the same time by broadening the tax base (for details of the planned regulations, see the adjacent overview). However, the final parliamentary decision on the tax reform has not yet been made.

The tax weakness, which has emerged since 1995 and whose causes are only partly of a cyclical nature, the additional labour-market-induced requirements as well as the existing uncertainties regarding the outcome of the tax reform debate make it more difficult for financial policy makers to achieve the targets over the short term. In view of the additional burdens, the envisaged tax cuts can be realised without jeopardising the consolidation objective only if the policy of strictly curbing

*Medium-term requirements*

*Draft of an income tax reform*

*Additional expenditure cuts required*



## Main elements of the Government's concept for the 1998-9 tax reform

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The fundamental reform of income taxation envisaged for 1998-9 is intended to improve permanently the underlying conditions for economic growth and employment prospects in Germany as well as to make the tax system more transparent and equitable than hitherto. For that purpose, a perceptible decrease in the rates of income and corporation taxes has been planned, together with a simultaneous reduction in tax concessions and special regulations; ultimately, i.e. after inclusion of additional increases in indirect taxes not yet specified in the draft legislation, the burden on tax payers is to be **reduced by up to DM 30 billion net** as a result of these measures. (In addition, relief totalling DM 7½ billion is to be provided through the envisaged reduction of the solidarity surcharge by 2 percentage points to 5½ % from the beginning of 1998.)

The reform concept comprises **gross relief totalling DM 84 billion** (in the first year in which the measures will be fully effective). This relief arises from the following measures in particular:

- New income tax scale with a starting rate of 15 % in the lower proportional zone up to DM 18,000 a year, linear-progressive marginal tax rates from 22½ % to 39 % in the progressive zone up to DM 90,000 and a special maximum rate of 35 % for business earnings (or 40 % in the first stage in 1998);
- Lowering of corporation tax rates for retained earnings to 35 % (or 40 % in 1998) and for distributed profits to 25 % (or 28 % in 1998);
- Lowering of capital yield tax for dividends to 15 %;
- Lowering of withholding tax on interest income to 25 % (or 30 % in the case of over-the-counter transactions).

The draft of the tax reform bill provides for the **broadening of the tax base**, which is expected to yield additional revenue totalling **DM 45 billion**; the following are its main elements:

- Tightening of the tax-related profit calculation regulations (particularly the requirement to reinstate original values, reduction of reserve possibilities, decrease of degressive depreciation for investment in machinery and equipment by 5 percentage points – 3 percentage points of which in 1998 – and of the linear depreciation for commercial buildings by 1 percentage point);
- Limitation of the allowance for work-related expenses for employees (introduction of a standard travel allowance of 40 pfennigs per kilometre for that part of the distance between an employee's home and his/her place of work which exceeds 16 km, decrease in the standard allowance for employees to DM 1,300) and full taxation of shift increments;
- Introduction of a final 10 % tax rate on interest from capital-sum life insurances and halving savers' tax allowances for other capital income to DM 3,000;
- Abolition of the degressive depreciation for privately owned rented buildings;
- Cancellation of reduced tax rates for extraordinary income; instead, tax on this income is to be distributed over five years;
- Extension of the "speculation period" for profits from sales of private real property to ten years, and of private portfolio investment to one year;
- Extended taxation of retirement income (50 % taxation of social security pensions, reduction by one-half of the old age relief amount and the pension exemption limit).

expenditure is tightened even more over the medium term while investment expenditure – which has been declining anyway for some time – is exempted as far as possible.

*Positive impact  
of tax reform*

Despite short-term shortfalls in demand associated with even stricter retrenchment, growth stimuli, which would be triggered over the medium and longer term if the envisaged tax reform were adopted in the near future, will probably predominate. The perceptible decrease in tax rates, particularly for enterprises, would improve production and employment conditions in Germany. In addition, performance disincentives would be reduced for employees, too. In connection with the cancellation of exceptional circumstances, the tax scale reform would have favourable effects on allocation and counteract a further erosion of the tax base. Thus, higher tax revenue, which would facilitate the necessary consolidation of public sector budgets, could be expected over the medium and longer term. However, such “self-financing effects” are uncertain, both in terms of their size and in terms of their profile over time, with the result that they should not be included from the outset in a “cost calculation” of the tax reform.

### Social security institutions

*Overall trend  
in 1997*

Whereas the central, regional and local authorities are likely to achieve little progress in reducing the deficits in 1997, the social security institutions will have a considerably more favourable position than last year. Whereas in 1996 the social security sector incurred a def-

icit of DM 13 billion, a surplus is to be expected for the current year. However, a major part of this positive swing is accompanied by a sharp increase in the contribution rate to the statutory pension insurance scheme, which is necessary in order to replenish the fluctuation reserve which at the end of 1996 was below the statutorily prescribed minimum volume of one month's expenditure.

In the first quarter of 1997 the deficit of the Federal Labour Office came to just over DM 5 billion, and was thus DM 1½ billion larger than in the first quarter of the previous year. In this context, the financial situation deteriorated both in eastern and in western Germany. While expenditure had increased by just over 5½%, revenue was practically unchanged. Although in January larger non-recurring contribution inflows were recorded, owing to the shortening of the surrender periods for social insurance contributions to ten days,<sup>4</sup> the unfavourable situation in the labour market had negative effects.<sup>5</sup>

*Federal Labour  
Office in the  
first quarter of  
1997*

On the expenditure side, the continuing growth in unemployment was reflected in a 12½% increase in unemployment benefit payments; the increase in eastern Germany was considerably sharper. A minor part of this

<sup>4</sup> This regulation included in the 1996 Growth and Employment Promotion Act led to the fact that employers who pay wages and salaries in the middle of the month have to surrender the contributions to the social insurance institutions in the same month. For that reason, employers' contributions both for December 1996 and for January 1997 were received in January.

<sup>5</sup> Revenue from contributions was also decreased in March by the fact that, owing to the new regulation of the surrender periods, part of the employers' contribution payments were not booked until April, as a result of the Easter holidays.

## Legislative amendments in the field of social security

### **Important new regulations resulting from the Work Promotion Reform Act**

The Work Promotion Reform Act came into force on April 1, 1997. It essentially comprises a series of amendments to the existing Work Promotion Act dating from 1969 and includes the complete redrafting of the latter and its integration into Social Security Code III; this new version will come into force on January 1, 1998.

#### **Amendments to the Work Promotion Act**

- Lengthening of the interval for paying out wage substitutes retroactively from two weeks to one month.
- Reduction of the compulsory insurance threshold from 18 to 15 working hours per week.
- Raising of the age limit from which an extended claim to unemployment benefit is granted from 42 to 45 years.
- Tightening of the rules governing jobs which the unemployed can be reasonably expected to accept (discontinuance of "occupational protection").
- Taking account of lump-sum severance payments when calculating unemployment benefit and assistance.
- Introduction of a grant (for up to 12 months) to newly established enterprises for recruiting up to two unemployed persons.
- Introduction of a special type of contract for the integration of unemployed persons, which may be terminated within six months without giving reasons. The local labour exchange takes over the payment of wages and salaries in the event of illness.

#### **Integration of the Work Promotion Act into Social Security Code III**

- Strengthening the labour exchanges' own responsibility and control by introducing so-called integration balance sheets.
- Introduction of unemployment benefit granted to partially unemployed persons and limited to a period of six months.

### **Important new regulations resulting from the first and second Acts on the New Regulation of Autonomy and Responsibility in the Statutory Health Insurance System (first and second New Regulation Acts)**

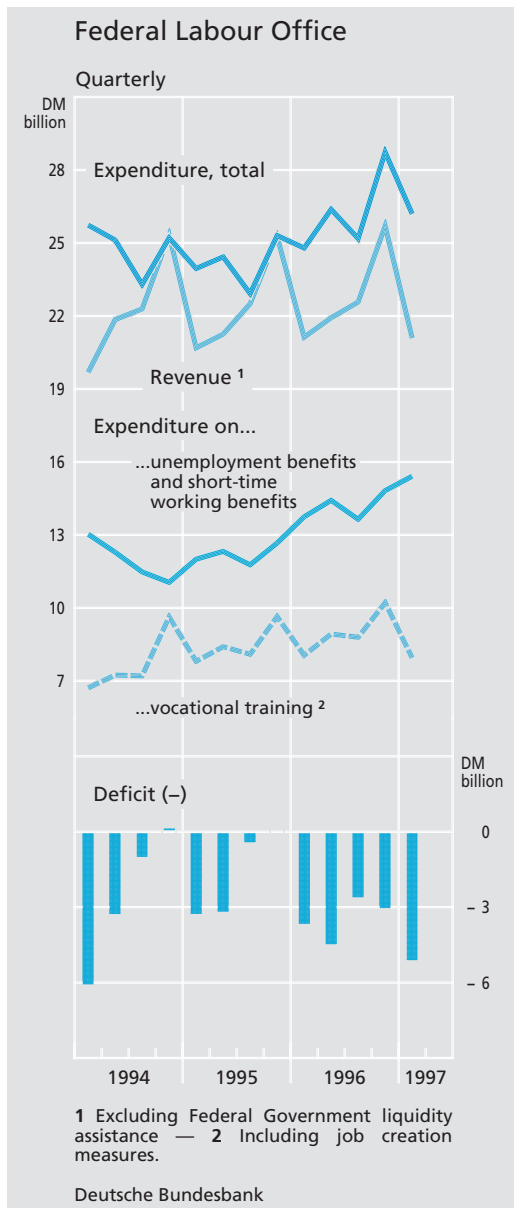
The first and second New Regulation Acts jointly make up the third stage of the reform of the health sector. The Acts come into force in mid-1997.

#### **First New Regulation Act:**

- Higher personal contributions to the cost of health services and extraordinary right of termination of a health insurance contract if the health insurance institution increases its contribution rate after March 11, 1997. Each increase of 0.1 percentage point in the contribution rate causes an increase in the insured persons' own contributions by DM 1 in monetary terms and by 1 percentage point if expressed as a proportion of the total contribution.
- More generous regulation for cases of hardship by lowering the income-dependent burden limits for the chronically ill from 2 % to 1 % of their gross income.

#### **Second New Regulation Act:**

- General increase in personal contributions to costs of DM 5 in the case of fixed amounts and of 5 percentage points in the case of percentage contributions. Personal contributions expressed in fixed DM amounts are to be adjusted regularly to trends in the insured persons' wages and salaries.
- A personal contribution of 20 % is levied for certain pre-defined medical aids.
- The general budgets for medicines and medical aids are being replaced by guidelines geared to individual categories of medical practices, which have to be negotiated between the health insurance institutions and the doctors' associations.
- A standard service volume is being introduced for medical services, based on a point system which has to be agreed in advance. If the standard service volumes are overshoot, volume-related remuneration deductions have been provided for. So far, the points for the individual services have been determined only retroactively, with the result that the budget could not be exceeded overall.
- The rate of increase of the overall remuneration and of the service-related remuneration of hospitals has to be agreed between the health insurance associations and the *Deutsche Krankenhausgesellschaft* (German Hospital Association) from 1998 onwards.
- The health insurance institutions have to take over maintenance investment of the hospitals for 1997 to 1999. As a compensation, an additional contribution of DM 20 per year and per member is being levied for this period.



sharp increase is also attributable to the fact that, owing to the retrenchment efforts of the Federal Labour Office, the numbers participating in vocational training measures decreased, compared with the previous year. Accordingly, expenditure on vocational training decreased by 1%, and expenditure on job creation measures by almost 2%; the decrease was concentrated on the old Länder, whereas an increase in expenditure on “ac-

tive labour market policy” was recorded in the east.

In the further course of the year, the existing trends towards an expansion of the deficit will probably disappear, a development which will also be attributable to initial cuts arising from the amendment to the Work Promotion Act which came into force on April 1, 1997. However, most of the relief which these new regulations will bring will not be apparent until the coming year (for details, see the overview on page 49). The lengthening of the interval for paying out wage substitutes from two weeks to one month will have an impact in the current year. Nevertheless, the deficit which has to be covered by the Federal Government will be considerably in excess of the grant of DM 4.1 billion provided for in the Federal budget.

*Prospects for the whole of the year*

The wage and salary earners’ pension insurance scheme had a deficit of DM 1 billion in the first quarter of 1997, but this was just over DM 4 billion below the corresponding amount recorded last year. The key factor for this considerable improvement was that receipts, at just under 7%, increased sharply, whereas expenditure increased by no more than just over 1½%.

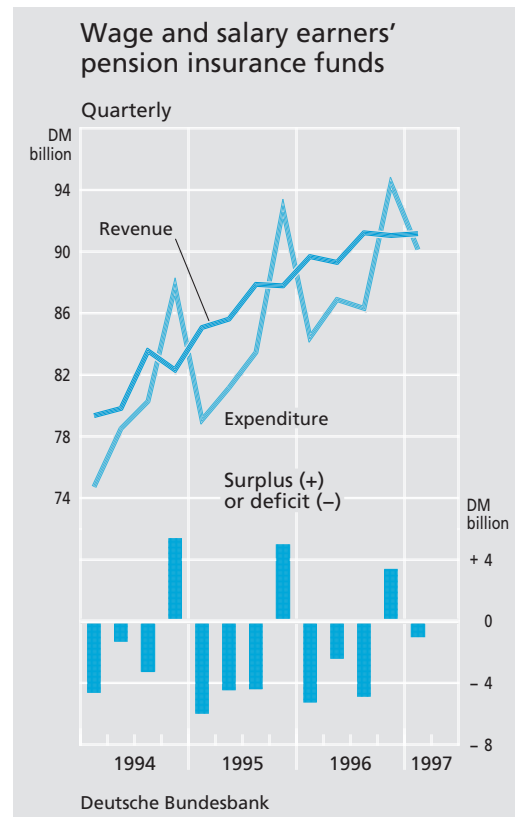
*Statutory pension insurance in the first quarter of 1997*

The sharp increase of just over 6% in contribution receipts in the first quarter was due, on the one hand, to the raising of the contribution rate from 19.2% to 20.3% at the beginning of 1997, although this did not fully influence cash figures in the first quarter. On the other hand, the shortening of the payment intervals already mentioned ensured a

one-off increase in contribution receipts in January.<sup>6</sup> Overall, expenditure on pensions grew by 2%. The increase in the west, at 2½%, perceptibly overshoot the 0.95% pension adjustment in mid-1996, which was mainly attributable to the further increase in the number of pensions. Expenditure on pensions in the new Länder grew by no more than ½% even though the number of pensions had increased there, too, and the pension adjustment in mid-1996 had been as much as 1.21%. This was mainly attributable to the further reduction in the replenishing amounts introduced as a result of the pension transference to eastern Germany. The contribution payments for pensioners' health insurance and nursing care insurance increased sharply, primarily as a result of the fact that contribution rates in respect of this branch of the social security system had increased, compared with the same quarter last year. By contrast, expenditure on treatment at health resorts was reduced by more than one-quarter. This owed much to the restrictions introduced with the 1996 Growth and Employment Promotion Act (higher contributions by insured persons towards costs in this area of benefits and shorter stays at the health resorts).

*Prospects for  
the whole of  
1997*

On July 1, 1997 pensions will be raised by 1.65% in the old Länder and by 5.55% in the new Länder in accordance with the trend in net remunerations last year. The basic net east German pension will thus reach 85.2% of the western level. In order to replenish the fluctuation reserve at the end of the year to achieve its statutorily prescribed volume of one month's expenditure, it would be neces-



sary to have a surplus of about DM 12 billion. However, existing financial trends indicate that this amount will possibly not be achieved. In view of the statutory regulations in force, it will probably be necessary to increase the contribution rate again in the coming year.

In the first three months of the year, the deficit of the statutory health insurance institutions came to DM 2½ billion; it was thus DM 1 billion lower than in the first quarter of 1996. Compared with last year, expenditure on benefits hardly increased at all, which was also attributable to the first effects of the 1996 Contribution Relief Act.

*Statutory  
health  
insurance  
institutions*

<sup>6</sup> However, one-off shortfalls resulted in March in respect of the pension insurance scheme, too (see footnote 5).

*Trend in  
contributions*

However, contribution receipts also grew only moderately. The unfavourable employment situation was reflected in a slower increase in eligible income. In addition, statutorily prescribed reductions in contribution rates came into force at the beginning of the year, but these were partly offset by subsequent increases. Compared with the same period last year, the average contribution rate was slightly lower in the west, whereas in the east it was perceptibly higher. In April and May the contribution rates continued to be raised substantially and recently came to 13.6 % in the old Länder and 13.9 % in the new Länder.

The two Acts on the New Regulation of Autonomy and Responsibility in the Statutory Health Insurance System come into force in mid-1997. They provide particularly for increased personal contributions to the cost to be effected by the insured persons. This will probably help to check expenditure in the further course of the year, too. For that reason, a perceptibly more favourable financial result is to be expected for the entire year, compared with last year, when the deficit had come to almost DM 6 ½ billion.

*Prospects  
for 1997*