

Public finance

Central, regional and local authorities

Trends in the third quarter

In the third quarter, the deficit of the central and regional authorities (no data are available yet for the local authorities) amounted to € 16½ billion, or around DM 32 billion, which was a somewhat worse result than in the corresponding period of last year (DM 27 billion). The principal reason for this was that expenditure went up sharply, by 7%, mainly owing to higher Federal Government transfers to the statutory pension insurance scheme and substantial payments to the Post Office benefit funds (the pension funds of the successor enterprises to the Post Office)¹, which are showing deficits. The rise in civil servants' remuneration and pensions, which followed the pay increase awarded to other public sector employees and largely became effective on June 1, was another factor that caused expenditure to increase more steeply than in the preceding quarters. At 5%, the growth of receipts fell well short of this sharp rise in expenditure, owing to the retarding effect of the decline in non-tax receipts, whereas tax revenue continued to expand sharply.

Basic trends

Total tax receipts in the third quarter were 7% up on the year.² The heavier taxation of energy consumption in the context of the

Taxes as a whole

¹ The Post Office benefit funds pay the non-contributory pensions of retired civil servants who were employed by the former Post Office when it was still in the public sector; in the previous years they were funded by receipts from the Federal Government's participating interests in the successor enterprises to the Post Office and by fixed-amount transfers from those enterprises.

² Including EU shares in German tax revenue but excluding receipts from local authority taxes, which are not yet known.

first stage of the “ecological tax reform” was again a factor in the strong year-on-year rise in tax revenue; furthermore, receipts from turnover tax and assessed taxes went up sharply.

Indirect taxes

Following the raising of tax rates on fuels, heating oil and natural gas which came into force in April 1999, receipts from mineral oil tax in the third quarter were just over 7 % up on the year. Including revenue from the new electricity tax, aggregate receipts from the specific taxation of energy consumption rose by as much as 15 %. This factor, together with the marked increase in the prices of refined petroleum and other fuels owing to higher crude oil prices, may have helped to boost receipts from turnover tax, too, which went up by slightly more than 7 %. Other factors contributing to higher tax revenue were private consumption, which picked up around the middle of the year, and the fact that tax-yielding public investment and investment in the housing sector showed an upward trend. Turnover tax was additionally boosted by increased receipts stemming from the 1999/2000/2002 Tax Relief Act.³

Wage tax

Among income taxes, wage tax revenue grew by no more than ½ % under the ongoing dampening effect of the measures introduced at the beginning of this year, i.e. an increase in child benefit – which is offset against wage tax – and the raising of the basic tax allowance as well as the lowering of the entry rate of income tax. In addition, employment trends hardly had any positive effects on wage tax receipts. Finally, actual



earnings appear to have risen more slowly than negotiated pay rates.

Payments stemming from assessed income tax exceeded the corresponding refunds by around € 3 billion, or DM 6 billion. Thus this statistical “residual” item yielded over two-thirds more than during the same period last year. This was attributable to higher tax payments for past years and a stagnating level of tax refunds for earlier years, as well as increased advance tax payments. Receipts from corporation tax more than doubled. However, in the third quarter of 1998 they had been particularly low as some major enterprises

Profit-related taxes

³ These additional receipts result from the reduction or abolition from April 1, 1999 of the input tax offsetting facility for cars not used exclusively for business purposes, dining expenses and employee travel and relocation expenses.

Trends in the revenue from major taxes

Type of tax	Revenue in			Change from previous year in %
	DM billion		€ billion	
	1998	1999	1999	
	1st to 3rd quarter			
Wage tax	180.2	182.5	93.3	+ 1.2
Assessed income tax	2.6	10.3	5.2	.
Corporation tax	24.2	32.3	16.5	+ 33.6
Turnover tax	184.6	197.9	101.2	+ 7.2
	of which: 3rd quarter			
Wage tax	63.0	63.3	32.4	+ 0.5
Assessed income tax	3.5	6.0	3.1	+ 70.5
Corporation tax	4.8	10.5	5.4	.
Turnover tax	62.8	67.3	34.4	+ 7.2

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had availed themselves of the option – which expired at the end of 1998 – to reduce their tax burden by distributing profits retained in earlier years. Conversely, receipts from non-assessed taxes on earnings – which comprise mainly investment income tax on dividends – in the third quarter of this year were around one-third below the corresponding level in 1998. The combined revenue from corporation tax and non-assessed taxes on earnings, which is a far more informative indicator, exceeded the corresponding level of last year by almost 17 %, mainly reflecting the favourable trend in profits during previous years.

Federal Government and special funds

The Federal Government deficit, which fluctuates considerably during the course of the year, amounted to slightly more than € 13 billion, or DM 26 billion, in the third quarter,

thus exceeding the corresponding 1998 level by DM 6 billion.⁴ Following only a small increase during the first six months of the year, Federal Government expenditure rose in the third quarter by a very sharp 13 %. This was due largely to an increase (by over one-quarter) in transfers to the statutory pension scheme, which is being financed primarily through the additional Federal Government receipts from the increased taxation of energy. Furthermore, higher payments were made to the Post Office benefit funds. At 9½ %, the Federal Government's receipts increased quite sharply, too, mainly owing to buoyant tax revenue. The special funds, taken together, recorded a deficit of € 1 billion or around DM 2 billion in the third quarter, compared with around DM 1 billion one year before.

The Länder Governments' deficit in the third quarter amounted to around € 2 billion or DM 4 billion, a decrease by DM 1½ billion over twelve months. Both the west German Länder Governments, which recorded a deficit of almost € 2 billion, or not quite DM 4 billion, and the east German Länder Governments, whose budgetary positions were close to balance, achieved somewhat more favourable results. The Länder Governments were able to keep the rise in expenditure below 1 %, even though expenditure on personnel, which is a major item in the Länder Governments' budgets, increased by more than 4 %,

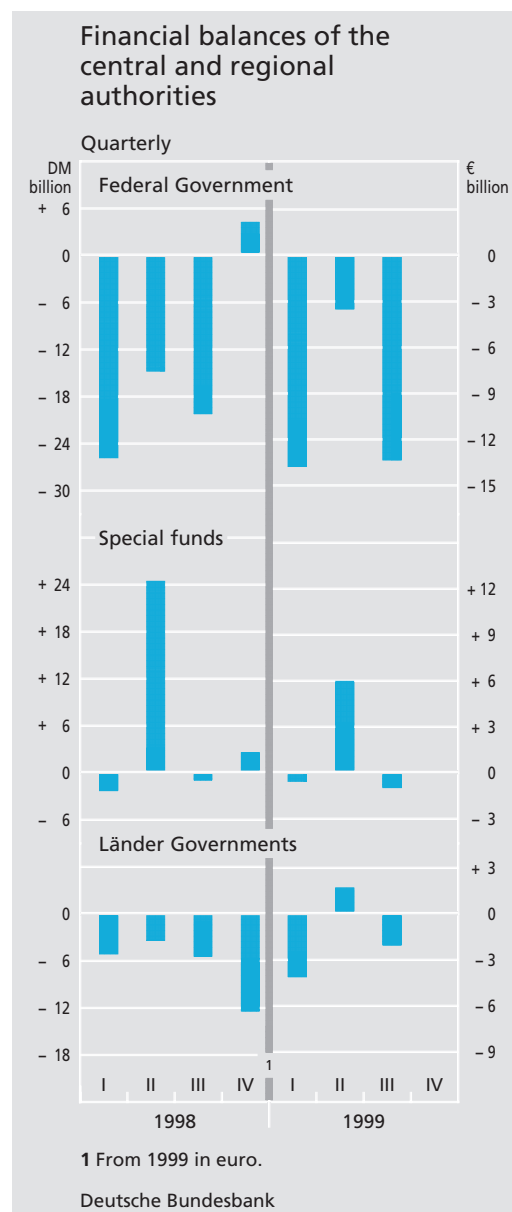
Länder Governments and local authorities

⁴ The interest charges on the debt of the special funds assumed in part by the Federal Government have been allocated during the current year to the quarter in which they fall due; the payment flows between the Federal Government and the special funds have been adjusted accordingly.

mainly owing to the rise in civil servants' remuneration. On the receipts side, yields from tax increased sharply (+ 6 ½ %); however, total revenue rose by only 2 ½ %, presumably because of the sharp drop in the proceeds from asset disposals. No data are available yet for the local authorities' budgetary situation in the third quarter. In the first six months of the year, the local authorities' deficit had decreased by almost DM ½ billion to less than DM 1 billion, mainly thanks to a favourable trend at the beginning of the year. However, the local authority budgetary situation is unlikely to have improved further during the third quarter.

Indebtedness

Between July and September, the central, regional and local authorities expanded their debt by nearly € 10 billion, after their net borrowing had amounted to € 15 ½ billion in the first six months of the year. The focus was on long-term borrowing through the issue of bonds (+ € 16 billion) and the sale of five-year special Federal bonds (+ € 3 ½ billion). By contrast, Treasury notes and loans against borrowers' notes were redeemed (by just under € 3 billion net and € 4 ½ billion, respectively). The money market was tapped only on a minor scale in the third quarter. The Federal Government, which obtained € 9 ½ billion net, accounted for almost the entire amount of net borrowing in the third quarter. On balance, the special funds redeemed debt, whereas the indebtedness of the Länder Governments and the local authorities is likely to have increased somewhat.



1999 as a whole

The fiscal position of the central, regional and local authorities for 1999 is expected to be more favourable than was envisaged in the budgets. Even so, the deficits – which totalled DM 57 billion in 1998 – are likely to increase further. The factor primarily responsible for this is the sharp decline in non-tax receipts

Overall trends

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 in- struments 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	+ 15.5	+ 69.6
of which:				
1st half	+ 34.5	+ 25.2	+ 9.3	+ 4.9
3rd qtr	+ 17.5	+ 9.7	+ 9.9	+ 45.1
1999				
1st half	+ 15.6	+ 17.6	- 2.0	+ 2.7
3rd qtr ^{pe}	+ 9.7	+ 15.3	- 4.4	...

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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owing, firstly, to the considerable year-on-year decrease in the Bundesbank's profit and, secondly, to the expected reduction in the volume of asset sales. Expenditure will increase faster than in 1998 – when it rose by slightly less than 2% – mainly because of higher Federal Government transfers to the statutory pension insurance scheme and the first-time transfers to the Post Office benefit funds, but also owing to the rise in the remuneration of public sector employees, which substantially exceeds last year's pay rise.

Tax estimate

The fact that the overall public finance trend is somewhat more favourable than forecast in the budget plans is mainly attributable to higher tax receipts. According to the latest official tax estimate, tax revenue will go up by 6.1% in 1999 as a whole, which is almost

DM 7 billion more than the projection of May 1999 and over DM 10 billion above the estimate of November 1998, on which the budget plans were principally based. This increase in tax revenue is even more noteworthy given that the expectations for nominal economic growth have been revised further downward (to 2½%) vis-à-vis the spring. The rise in tax receipts is mainly attributable to two factors: buoyant corporate profitability in the past few years, which is still being reflected in large retrospective tax payments, and a marked reversal of the erosion of the assessment base for income tax – which had been caused partly by the granting of special depreciation allowances on investment in eastern Germany. Thanks above all to these factors, but also to the additional receipts from the increased taxation of energy consumption, the overall tax ratio will rise in 1999 by 0.8 percentage point to 22.8%, according to the new tax estimate. However, this increase will be partly offset by reduced social security contributions.

Looking at the individual levels of government, the Federal Government's fiscal position is developing more favourably on balance than was projected in the 1999 budget plan, which envisages a deficit of DM 53½ billion following last year's actual deficit of DM 56½ billion. Besides the expected additional receipts, the expenditure burden is likely to be eased not least by lower-than-forecast labour market-related spending. The final out-turn of the Federal Government's fiscal position will hinge on the extent to which the substantial asset disposals budget-

Federal Government and ...

ed for are actually realised.⁵ The postponement of individual projects until future financial years could doubtless be accommodated without exceeding the planned level of net borrowing. Unlike the Federal Government, the special funds, taken together, will record distinctly less favourable results in 1999 than last year, when they ran a surplus of DM 24 billion. The chief reason for this is that the share of the Bundesbank profit transferred to the Redemption Fund for Inherited Liabilities was around DM 8 billion lower this year than in 1998.

... special funds

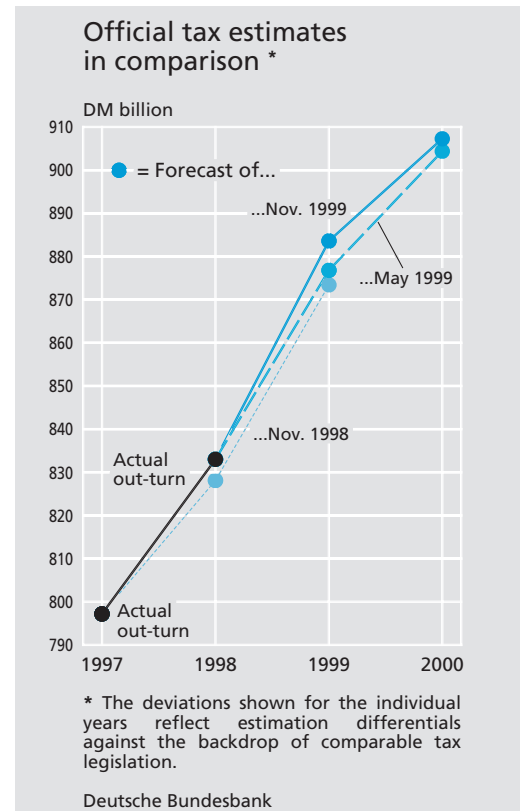
Länder Govern-
ments ...

As things now stand, the Länder Governments' deficits will be significantly smaller than last year, whereas the budget plans had foreseen a slight expansion of their deficits. As in 1998, the revenue side is being bolstered by sizeable privatisation proceeds. In addition, extra tax receipts are expected to accrue to the Länder Governments on an even greater scale than in the Federal Government's case. A negative factor, however, is the more sharply rising trend in personnel expenditure following the relatively large pay settlement of spring 1999. Nevertheless, the overall rise in expenditure is likely to remain moderate and to keep within the upper limit of 2% set by the Financial Planning Council. The local authorities will probably be unable to match last year's high surplus as tax receipts will grow far more slowly and privatisation proceeds, which were exceptionally large in 1998, will be smaller.

... and local
authorities

Outlook

The combined deficits of the central, regional and local authorities are not likely to decrease



in 2000 but will probably increase further. Seen from the present perspective, the public authorities should be able to contain the rise in expenditure to well below the 2% limit aimed at by the Financial Planning Council, provided that the Federal Government's consolidation package is implemented. In that case, expenditure on personnel, in particular, but social welfare payments, too, should rise more slowly than this year. However, the growth of receipts could be even smaller than that of expenditure. This is due, firstly, to a substantial fall in non-tax receipts. These will be depressed by declining privatisation proceeds and asset sales plus a smaller Bundes-

*No reduction in
deficits to be
expected*

⁵ This also concerns the planned sale of railway workers' dwellings by the Federal Railways Fund. If this sale fails to materialise in 1999, the required amount of transfers to this special fund will increase accordingly.

bank profit, which will no longer be boosted by special factors. Secondly, the expansion of tax receipts is likely to decelerate sharply.

*Trends in tax
revenue*

Based on current tax legislation (i. e. disregarding the bills not yet passed by Parliament), the Working Group on Tax Estimates expects overall tax revenue to rise by a mere 2¾% and additional receipts to amount to no more than DM 3 billion in the year 2000, compared with the May 1999 forecast. The Working Group's estimate is based on the assumption that GDP will grow in 2000 by 3½% in nominal terms and by 2½% in real terms. Although economic growth would be roughly the same under this assumption as envisaged in the spring, the rise in tax revenue will be curtailed by the fact that retrospective payments of assessed taxes for past years will be lower than in 1999 in the context of this year's less favourable trend in corporate earnings. The tax-raising and tax relief measures envisaged for 2000 will approximately cancel one another out. The second stage of the "ecological tax reform" will result in a further increase in revenue from energy taxes. However, the additional relief measures for families and the second stage of the 1999/2000/2002 Tax Relief Act, which will cut tax rates further and raise the basic income tax allowance once more, will have a dampening effect on tax revenue.

*Trends by level
of government*

The individual levels of government will experience different fiscal trends in 2000. The Federal Government may be expected to record lower deficits, mainly owing to the measures contained in its consolidation package and a more favourable development on

the labour market. By contrast, the special funds will probably once more record lower surpluses, primarily on account of the expected smaller Bundesbank profit. At the Länder Government level, too, trends are likely to be less favourable than in 1999. Although the pegging of civil servants' pay and pensions to the inflation rate, as foreseen in the consolidation package, would limit the rise in expenditure, it is likely that the Länder Governments' tax receipts will increase only moderately and that the grants from the Federal Government will decrease. The local authorities will probably record no surpluses next year, owing to a muted rise in receipts but also a stronger increase in expenditure.

Social security funds

In the third quarter of 1999, the wage and salary earners' pension insurance scheme ran a surplus of almost € 1 billion, or DM 1¾ billion, whereas it had ended up close to balance in the corresponding quarter in 1998. This more favourable financial position was attributable to higher transfers from the Federal Government, especially the new payments financed through the increased taxation of energy which have been transferred to the pension insurance institutions since June in equal monthly instalments. This more than offset the merely marginal increase in compulsory contributions, which were only 0.3% above their corresponding level of 1998 owing to the lowering of the contribution rate from 20.3% to 19.5% from April 1, 1999. Adjusted for this lower contribution rate, however, receipts from compulsory contributions rose sharply (by 4.4%), which is attribut-

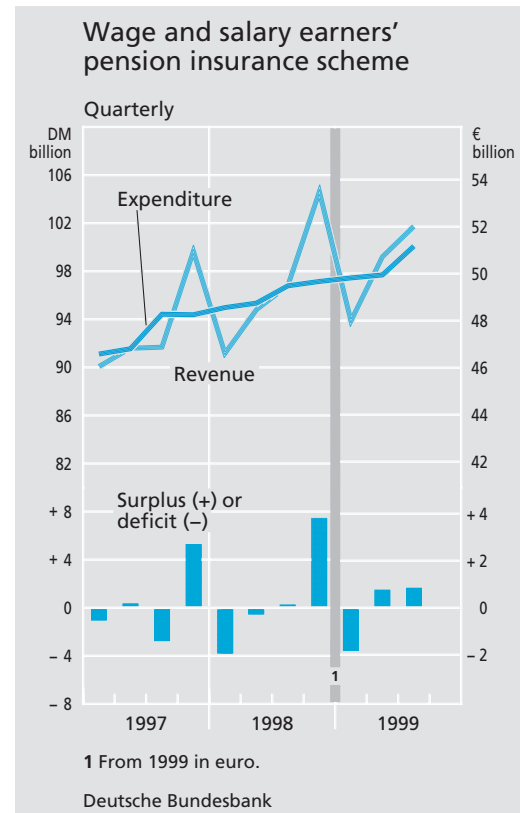
*Statutory
pension
insurance
scheme*

able not only to the increase in negotiated pay rates in the spring but also to additional receipts stemming from the introduction of an insurance obligation for part-time workers below a certain earnings level. Total receipts increased by 5.1%. At 3.4%, expenditure, too, rose rather sharply, reflecting the pension increase from July 1, 1999 of 1.34% in western Germany and 2.79% in eastern Germany and, more importantly, the fact that the number of pension recipients continued to rise.

Although the pension insurance scheme recorded a deficit of almost DM ½ billion in the first nine months of the year, taken together (compared with not quite DM 4 ½ billion one year before), it appears likely to run a relatively large surplus in the fourth quarter, mainly owing to extra contribution receipts stemming from the traditional Christmas bonus payments. For the first time since 1994 the pension insurance scheme might manage to top up its fluctuation reserves to the statutory minimum level of one month's average expenditure. For that reason alone it will be possible to lower the contribution rate in 2000 as the fluctuation reserves will no longer need to be replenished. An additional factor conducive to lowering the contribution rate is the limitation of the rise in pensions to the rate of inflation, as envisaged in the Budget Consolidation Bill.

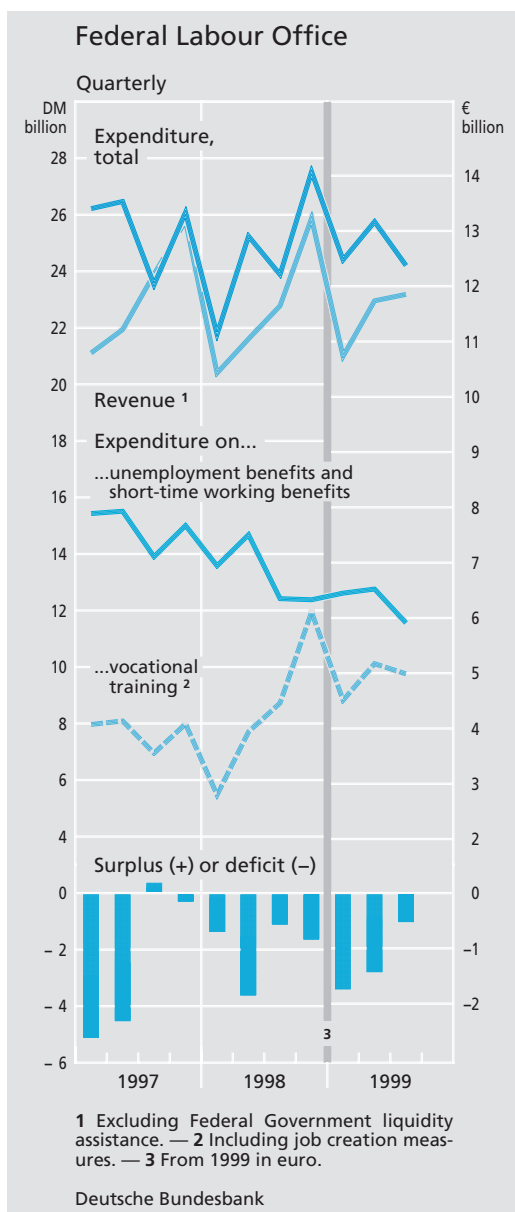
Federal Labour
Office

The Federal Labour Office ran up a deficit of € ½ billion, or DM 1 billion, in the third quarter of 1999, which roughly equals the corresponding figure in 1998. Aggregate receipts increased by 1.8%, with contribution receipts rising at the somewhat faster rate of 2.3%. Expenditure grew by a very moderate 1.3%.



Above all, this was because the cost of unemployment benefits was 7.0% below the corresponding level in 1998, after having declined by a massive 10.1% in the first six months of this year. This deceleration in the rate of decrease reflects the fact that the year-on-year drop in unemployment has grown smaller and smaller since the beginning of 1999. By contrast, spending on active labour market policy measures, which had been expanded dramatically in the course of 1998, rose by a further 11.7% in the third quarter of 1999. It must be said, however, that this rate of increase had been much more pronounced in the first and second quarters, at 60% and 31%, respectively.

Aggregating the first three quarters, the Federal Labour Office recorded a deficit of slight-



ly more than € 3½ billion, or just over DM 7 billion, compared with DM 6.1 billion one year before. This deterioration is attributable to a special factor, however. In January 1998, expenditure had been exceptionally low owing to a change in the rhythm of wage substitute payments, whereas in January 1999 it returned to its normal level. The deficit for 1999 as a whole might be lower than in 1998 (DM 7.8 billion), in particular because

spending on active labour market policy in the fourth quarter is likely to fall well short of the extraordinarily high level in the corresponding period of 1998. As a result, the required transfer from the Federal Government is likely to be considerably less than the figure of DM 11 billion earmarked in the Federal budget for this year.

The data currently available for the statutory health insurance funds only cover financial trends up to mid-1999. These data suggest that the unfavourable first-quarter result was superseded by a slight easing of the financial situation. At any rate, the growth of receipts in the second quarter, at 2.8 %, again outpaced that of expenditure (+ 2.2 %), partly owing to additional new contribution receipts from low-paid part-time workers. The deficit for the period April to June amounted to € ½ billion, or around DM 1 billion; this was somewhat smaller than the corresponding level in 1998. However, the deficit of just over € 1½ billion (almost DM 3½ billion) run up in the first six months of 1999, taken together, was well above the corresponding 1998 level of just under DM 2 billion.

*Statutory
health
insurance funds*

Outlook for the general government sector as a whole

On the basis of the calculation method currently used in the context of the excessive deficit procedure⁶, the government deficit

*Deficit ratio
likely to fall in
1999*

⁶ Up to the regular notification of September 1999, the data to be submitted were based on the European System of Accounts (ESA) 1979. From 2000 onwards, data will be based on ESA 1995.

ratio (i.e. the combined deficit ratio of the central, regional and local authorities and the social security funds) for 1998 amounted to 2%. According to the provisional calculations of the Federal Statistical Office, which are based on the statistical method to be used from next year onwards, this figure was somewhat lower (1.7%). The government deficit ratio for 1999 (in contrast to the result as defined in the financial statistics) is likely to decrease further, albeit only moderately. This is due in part to the favourable trends in tax revenue, which will more than offset the accelerated year-on-year rise in expenditure. A second contributory factor is that, as explained above, the statutory pension insurance scheme will record relatively large surpluses in 1999, thus enabling it to replenish its fluctuation reserves. The general government spending ratio, which amounted to 48.8% in 1998 (based on ESA 1995), will increase further owing to the low level of nominal economic growth. The taxes and social security ratio (42.9% in 1998) can be expected to increase, too. The debt-to-GDP ratio, which amounted to 61.1% in 1998 on the basis of the Maastricht definition, is likewise expected to rise somewhat in 1999.

*No major
improvement
expected in
2000*

Despite a likely improvement in the economic situation and the envisaged adoption of the consolidation package, no major reduction is to be expected in the government deficit ratio in 2000. As described above, tax receipts are likely to increase by a far more moderate margin than in 1999. Non-tax receipts will probably even decline vis-à-vis this year.⁷ In addition, the surplus achieved by the pension insurance scheme will shrink marked-

ly, since in 2000 it will probably not be necessary to replenish the fluctuation reserves.

Even if the Federal Government's consolidation package is implemented in full, the public authorities will nevertheless have to continue to pursue a fiscal consolidation policy. The European Stability and Growth Pact requires that governments achieve budgetary positions close to balance or in surplus in the medium term. Achieving this budgetary objective would lower the debt ratio and thus help to lessen the burden of redistribution to the detriment of young people and future generations resulting from the present tax and social security legislation and likely demographic developments.

The goal of reducing the general government deficits must also be considered in the context of the current debate on structural reforms in the field of fiscal policy. The high level of general tax rates and social security contributions is a handicap for economic growth in Germany. In making the necessary changes to the system of taxes and social security contributions, policy makers should not focus on the seemingly "easy" option of increasing general government deficits but instead should curb public spending and broaden the tax assessment base in order to create the financial leeway for a reduction in tax rates.

*Continued
consolidation
efforts
needed ...*

*... not least to
create leeway
to reduce tax
and social
contributions*

⁷ Although in the national accounts, unlike the definition used in the financial statistics, financial transactions (e. g. privatisation proceeds) have no effect on the deficit, the fiscal balance is affected by items such as sales of tangible fixed assets.

