

Public finance

Central, regional and local authorities

Trend in the second quarter

According to the figures available so far, the financial situation of the central, regional and local authorities did not continue to deteriorate in the second quarter. The deficit (excluding the local authorities for which no data are yet available) came to DM 15 billion in that period, and was thus just as high as a year before. In the first quarter, by contrast, the deficit of all central, regional and local authorities, at DM 32 billion, had overshoot the amount reached in the same period last year by DM 8 billion. On the one hand, tax receipts were not so far below their previous year's level as at the beginning of the year, even though the trend in revenue continued to be disappointing. On the other hand, the rate of expenditure, which initially had been quite considerable, slowed down; the expenditure of the central, regional and local authorities will probably even be lower than in the second quarter of 1996.

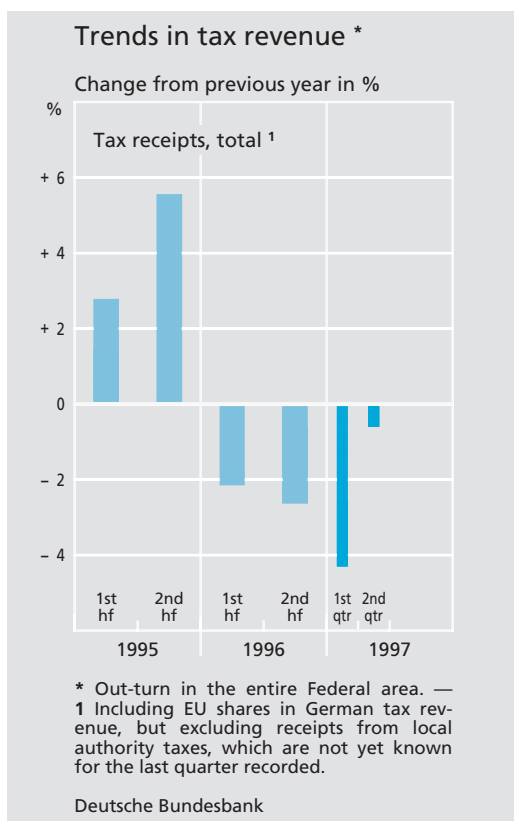
*General
overview*

The trend in tax receipts continued to be in stark contrast to the movement in the cyclical expansionary forces. In the second quarter, revenue¹ was just over ½% lower than a year before, whereas in the first three months of the year, as a result of some special factors², it had actually diminished by more than 4%. In addition to the persistent weakness of

Overall taxes

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

2 In addition to the severe winter weather, it was also the shortening of the payment periods for mineral oil tax and spirits tax at the end of 1996 which affected revenue at the beginning of this year.



certain major taxes, the fact that wealth tax has not been levied since the beginning of 1997 and the associated shortfalls have hardly been offset so far by the increase in the tax on the acquisition of land and buildings and the reform of inheritance tax continued to have a negative impact.

Wage tax

In the second quarter receipts from wage tax overshot their previous year's level only slightly (+ ¾ %). The increase in child benefit, which came into force at the beginning of 1997 and which now impinges on the receipts from wage tax, continued to affect revenue. Even if calculated before deduction of child benefit payments, the increase in receipts from wage tax, at about 2 ½ %, was moderate since actual earnings had grown only slightly and the number of employed

persons had continued to decrease compared with last year.

Assessed income tax, in particular, was once again disappointing. In the case of this tax, refunds perceptibly overshot simultaneous tax payments, viz. by DM 2 billion, for the first time in a single quarter; by contrast, the amount which accrued in the same period last year was no less than DM 1¼ billion. In the entire first half of the year, the net revenue from this tax was extremely low. On the one hand, the level of refunds, particularly to employees, continued to increase; on the other hand, tax prepayments have also declined perceptibly since the end of last year. This is probably due not least to the fact that considerable use was still being made of the special depreciations on investment in eastern Germany shortly before these were reduced on January 1, 1997 and that some of these allowances were already claimed during the tax prepayment procedure. For the rest, revenue also continued to be affected by the allowance for the construction of owner-occupied houses (booked to the debit of that tax); this allowance replaced the former special expenditure allowance under section 10 e of the Income Tax Act which in most cases had already been taken into account during the wage tax deduction procedure.

Assessed
income tax

It is true that in the second quarter corporation tax yielded about 5 % more than a year before, but that means that the increase was smaller than at the same time last year. Apart from the weaker growth in final payments for previous years, the upward trend in prepayments obviously slowed down in spite of the

Corporation tax

favourable trend in profits. The massive use of special depreciation allowances – in addition to other tax-related options – probably made itself felt in this context, too.

Turnover tax

By contrast, the increase of just over 3 ½ % in turnover tax was quite a favourable result. The fact that there were considerable catch-up effects following the severe winter weather probably played a major role here. This was particularly true in respect of construction services, some of which are subject to tax. However, private consumption – the most important component of the VAT determination basis – was still sluggish.

Federal budget

Of the individual levels of government, the Federal Government achieved an improvement in its finances in the second quarter; compared with the same period last year, the deficit decreased by DM 3 billion to DM 13 billion, whereas in the first three months it had increased by DM 10 billion to just under DM 30 billion. Total receipts grew by just over 2 ½ %, a low increase in tax revenue (1 ½ %) being accompanied by a steep increase in other receipts (just under 10 %).

In the second quarter, the Federal Government's expenditure was slightly lower than in the previous year, whereas between January and March it had expanded by 4 %. It was particularly transfers to the Redemption Fund for Inherited Liabilities which decreased considerably, after they had grown especially sharply in the first quarter; the transfer by the Federal Government to the Federal Railways Fund was also perceptibly smaller than the amount transferred a year before. The finan-

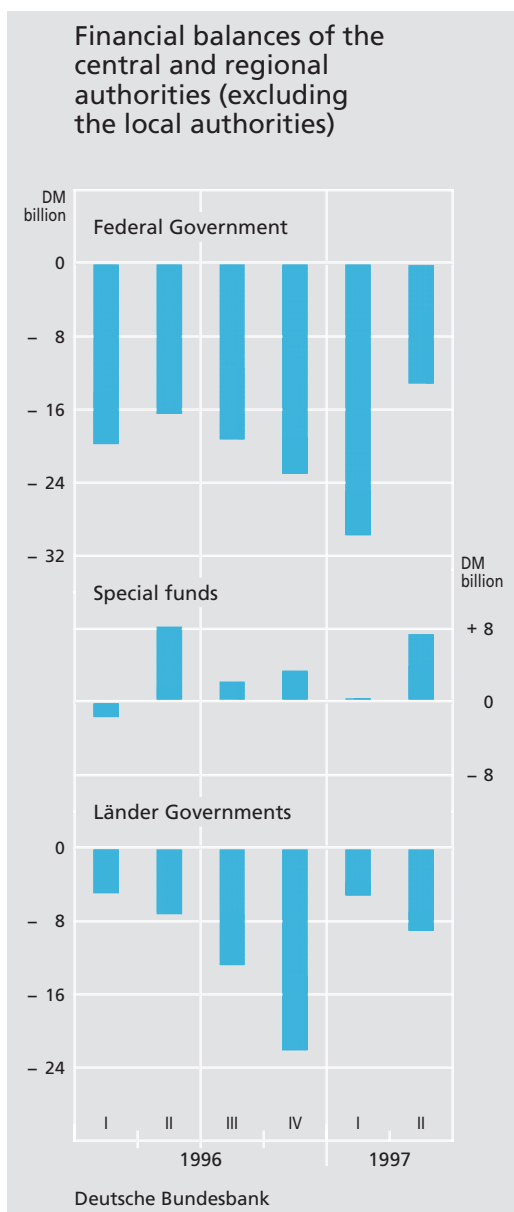
Trend in the revenue from major taxes

Type of tax	Revenue in DM billion		Change from previous year in %
	1996	1997	
First half of the year			
Wage tax	115.1	113.6	- 1.3
Assessed income tax	5.6	0.3	- 94.9
Corporation tax	15.3	16.1	+ 5.4
Turnover tax	115.7	118.6	+ 2.5
of which: second quarter			
Wage tax	56.3	56.8	+ 0.8
Assessed income tax	1.3	- 2.0	.
Corporation tax	7.7	8.1	+ 4.8
Turnover tax	56.6	58.6	+ 3.7

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cial position was also eased by the fact that expenditure on staff had declined and that, of the social security benefits granted by the Federal Government, war victims' pensions and related benefits had decreased by almost one-quarter, compared with the same period last year.

On the other hand, the Federal Government had to spend 10 % more on transfers to the pension insurance institutions, particularly since the Federal grant to the wage and salary earners' pension insurance scheme is also pegged to the trend in the contribution rate, which had to be raised sharply at the beginning of the year. Labour-market-induced expenditure increased by a total of just over 4 %. An increase in the transfers to the Federal Labour Office and in spending on un-



employment assistance was accompanied by the gradual expiry of the early retirement regulations agreed for eastern Germany and therefore by the considerable decrease in the payments required for this purpose. Finally, a heavy burden was imposed on the Federal Government by the sharp increase in interest expenditure (+ 13%), although this fluctuates sharply from one quarter to another.

In the second quarter the Federal special funds, taken together, ran a surplus of DM 7 billion, which was thus DM 1 billion lower than a year before. The main reason for this was the (aforementioned) lower transfers of the Federal Government to the Federal Railways Fund and the Redemption Fund for Inherited Liabilities. The latter fund also received a lower transfer from the Bundesbank profit. On the expenditure side, the position of the special funds is being eased particularly by the fact that, as a result of the persistently low interest rate level, they can refinance expiring debt on more favourable terms. Thus, the special funds' interest expenditure decreased by 6½% in the second quarter.

Special funds

In the second quarter the deficit of the Länder Governments increased by DM 2 billion to DM 9 billion. The expansion concentrated on the old Länder (including Berlin), which incurred a deficit of DM 7½ billion. The less favourable result is essentially attributable to the weakness in tax revenue, which both in the east and the west was lower than the corresponding results achieved last year. In this context, the fact that in the west – as already mentioned – wealth tax was no longer levied and that the resulting shortfalls in receipts have hardly been offset so far in cash terms by the increase in the tax on the acquisition of land and building and the reform of inheritance tax also played a part. On the other hand, total expenditure expanded by no more than 1%; whereas it increased by just over 1½% in the west, it actually declined by just under 1½% in the east. Restraint in spending was made possible

Länder Governments

above all by the fact that expenditure on staff could be limited; in the west expenditure here was actually below last year's level, which probably also owed something to the reduction in staff levels.

*Local
authorities*

Although no recent figures are available for the local authorities, it seems likely that expenditure will decline perceptibly here. In the first quarter, local authority spending had been reduced by 3% in the west and by as much as 9% in the east. In addition to expenditure cuts in respect of investment, it was particularly a decrease in expenditure on social assistance which made itself felt; this decrease is attributable to the fact that benefits paid by the statutory nursing insurance scheme now cover in-patient nursing care, too. In spite of the weak inflow of receipts, the local authorities had thus succeeded in reducing their deficits somewhat in the first quarter, compared with the corresponding amount last year.

Total borrowing

In the past few months, the central, regional and local authorities resorted to the credit markets to a large extent in view of the favourable conditions still prevailing in the capital market. In the second quarter new borrowing came to DM 23 billion, and in July as much as just under DM 17 billion (net) was obtained. In the first seven months, taken together, indebtedness grew by DM 73½ billion, compared with almost DM 50 billion in the same period last year. Between April and July, net borrowing, at DM 29 billion, concentrated on securities; moreover, loans against borrowers' notes were taken up to the tune of DM 12½ billion net. In addition, money

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 ¹	
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 ²	+ 112.2	+ 90.9	+ 21.7	+ 15.1
1991 ³	+ 106.8	+ 71.3	+ 35.8	+ 50.9
1992	+ 102.4	+ 95.0	+ 7.9	+ 59.4
1993	+ 159.1	+ 120.3	+ 39.3	+ 109.1
1994 ⁴	+ 85.8	+ 45.6	+ 40.6	- 20.9
1995 ⁵	+ 97.6	+ 32.6	+ 81.4	+ 58.3
1996 p	+ 123.3	+ 65.2	+ 73.7	+ 54.1
of which				
1st qtr	+ 17.0	+ 6.6	+ 13.0	- 2.8
Apr.-July	+ 31.7	+ 34.7	+ 5.5	.
1997				
1st qtr p	+ 33.8	+ 25.5	+ 8.5	+ 17.2
Apr.-July p ^e	+ 39.7	+ 28.7	+ 13.2	.

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

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market loans and short-term cash advances from banks were taken up to the tune of DM ½ billion. On the other hand, equalisation claims were redeemed.

At DM 25 billion, just over one-half of new borrowing was attributable to the Federal Government in the four-month period under review. At DM 18 billion net, sales of bonds predominated; sales of five-year special Federal bonds and Federal Treasury notes, at a total of DM 14 billion, were quite buoyant, too. By contrast, liabilities arising from loans against borrowers' notes were reduced. As the borrowing of funds in the capital market overshot the deficit which had to be financed simultaneously, the Federal Government could improve its net position in the money market by DM 8 billion; nevertheless, its net

Federal Government and special funds

liabilities still came to about DM 6½ billion at the end of July. Between April and July the subsidiary budgets reduced their debt level by DM 4 billion, and it was particularly the Redemption Fund for Inherited Liabilities and the "German Unity" Fund which repaid funds to the markets, on balance.

*Länder Govern-
ments and local
authorities*

Like the Federal Government, the Länder Governments resorted to the credit markets to a large extent. Between April and July their new borrowing came to DM 18 billion, DM 15 billion of which was attributable to the old Länder and DM 3 billion to the new Länder. As usual, the raising of loans against borrowers' notes predominated here. By contrast, the local authorities did not have any net borrowing requirements.

1997 as a whole

*Financial trend
less favourable
than planned*

In the current year the finances of the central, regional and local authorities have been overshadowed by the persistent weakness in taxes. Particularly for the Federal Government, an additional burden arises from the fact that the situation in the labour market continues to deteriorate, in contrast to original expectations. Particularly after the last official tax estimate of May, in which tax shortfalls totalling DM 18 billion were forecast for 1997, compared with the previous estimate of November 1996, it became clear that the deficit envisaged in the 1997 Federal budget would be overshot. It thus became necessary for the Federal Government to submit a supplementary budget, since the – still unutilised – borrowing authorisations from previous years were not sufficient to cover

the foreseeable additional credit requirements in budgetary terms.

The Federal Cabinet adopted a supplementary budget for 1997 and the draft budget for 1998 on July 11. The supplementary budget provides for an increase in net borrowing of DM 18 billion to DM 71 billion; however, that means it will be about DM 7 billion lower than in 1996. The additional financial requirements, compared with the original plan, actually amounted to DM 30 billion. This sum was to cover the DM 9 billion shortfall in tax forecast in the tax estimate of May, an increase of DM 11 billion in the transfer to the Federal Labour Office, and an additional expenditure of DM 10 billion on unemployment assistance. On the other hand, this was accompanied by relief to the tune of DM 12 billion, which, apart from economies (particularly in the form of overall cuts in expenditure) and higher receipts from fees and charges, was particularly attributable to sales of assets; in this context, sales of Deutsche Telekom shares to the Reconstruction Loan Corporation were of primary importance. In the draft supplementary budget, the sum total of investment provided for in the budget (DM 59 billion), which is the upper ceiling for new borrowing in accordance with Article 115 of the Basic Law, is overshot by net borrowing. For that purpose, the Government makes use of the exception clause (also laid down in Article 115 of the Basic Law), according to which overshooting is permissible in the event of a disturbance of the macroeconomic equilibrium; in this context, the Government has referred in particular to the fact that unemployment has grown

*Supplementary
Federal budget
for 1997*

Budget plans of the Federal Government

DM billion

Item	Financial year 1997				Financial year 1998	
	Medium-term financial planning for 1995-1999	Draft budget	Budget	Draft supplementary budget	Medium-term financial planning for 1996-2000	Draft budget
Receipts	408	384	387	387	391	403
of which						
Taxes	379	350	346	337	357	348
Privatisation ¹	1	4	8	17	3	21
Expenditure	458	440	440	459	447	461
of which						
Labour-market-induced expenditure ²	.	18	22	43	17	40
Investment	64	61	60	59	61	58
Deficit	49	57	53	71	56	58

¹ Including reduction of capital. — ² Grant to the Federal Labour Office and unemployment assistance.

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unexpectedly sharply (for the basic planning data, see the table above).

Budgets of the Länder Governments and the local authorities in the current year

In the current year the budgetary developments of the subordinate levels of government, too, are affected by additional burdens, although these are essentially limited to the expected shortfalls in taxes. For the Länder Governments, which are providing for a deficit of DM 32 billion (compared with an out-turn of DM 47 billion in 1996), shortfalls will amount to approximately DM 7 billion, according to the official tax estimate. These shortfalls in revenue, however, are to be offset by additional expenditure cuts (which, among other means, are to be achieved through the imposition of budget freezes) as well as by increased sales of assets. At the local authority level, it seems likely that the

retrenchment course adopted as early as last year will be continued, with the result that here no major overshooting of last year's deficit (of about DM 7 billion) is to be expected, even if receipts tend to be weak. The special funds which continue to profit from the low interest rate level will probably record figures that are more or less as favourable as last year's, when, together, they had run a surplus of DM 12 billion.

Generally speaking, the trend in the finances of the central, regional and local authorities will be more unfavourable in the current year than provided for in the original budget plans. This applies all the more since – judging by the trend in the first half of the year – the structural tax weakness will persist. On the other hand, the central, regional and

General outlook for 1997

local authorities are all pursuing a pronounced retrenchment course in the budget implementation. From the present perspective, it is unlikely that expenditure in 1997 will be much higher than its previous year's level. It is therefore possible that in the current year the deficit incurred by the central, regional and local authorities will be below the amount recorded in 1996 (about DM 120 billion), albeit not to the extent initially targeted. The social security funds – which last year again incurred a deficit of DM 13 billion – will probably record a surplus in 1997, and this will be of great importance for the overall trend in public sector finances. However, this “positive swing” is largely due to the sharp rise in the contribution rate in the statutory pension insurance scheme which had become necessary.

In spite of the deterioration compared with the plans, the overall deficit will in all probability be substantially lower in 1997 than last year when it reached 3.8 % of gross domestic product as defined in the financial statistics. According to the accounting method used for the national accounts (which is the one that counts for entry into European monetary union), a reduction in the government deficit is also to be expected compared with 1996. Owing to methodological differences, however, the improvement will probably be lower here than in the financial statistics – particularly since the extensive proceeds from privatisation do not affect the general government financial balance as defined in the national accounts. As part of the revision of the national accounts submitted recently by the Federal Statistical Office, the general govern-

ment deficit ratio for 1996 was revised downwards from 3.8 % (in the spring) to 3.5 %. If one includes another statistical revision – which was in line with the Maastricht Treaty regulations³ – it comes to 3.4 %.

Further outlook

Fiscal policy makers at all levels of government are faced with the task of having to continue pursuing a strict limitation of expenditure in order to create financial leeway both for the still outstanding radical reduction in public sector deficits and for a comprehensive tax reform with a perceptibly lower burden of taxes and social security contributions. Success in tackling this dual task is necessary not only in view of the need to start European monetary union on a sound anti-inflationary footing but also to make an important contribution to overcoming the structural economic weakness, which will ultimately have a favourable impact on public finance, too.

In this context, it should be borne in mind that the sustained reduction of the government ratio (i.e. government expenditure in relation to gross domestic product) to the value reached before unification – which is the aim of fiscal policy makers – cannot be achieved by short-term measures – such as budget freezes, global expenditure cuts or the postponement of expenditure – geared towards meeting the budget estimates for a single year at a time. Instead, a radical review of all public expenditure in terms of its

*Strict spending
restraint
required*

³ The main difference is that hospitals which keep commercial accounts were transferred from the general government to the corporate sector.

urgency and appropriateness is necessary; in this context, the measures would have to range from increased efficiency in public administration and the reduction of subsidies, particularly those that merely prop up outdated structures, to a review of social security benefits, not least with a view to concentrating more heavily on those really in need of assistance.

1998 draft
Federal budget

The draft budget for 1998 adopted by the Federal Government is shaped by efforts towards ensuring a restrictive expenditure policy. The expenditure volume comes to DM 461 billion and is only 0.5% above the amount budgeted for 1997 (including the supplementary budget). Of the major types of expenditure, only interest expenditure is planned to increase considerably. This increase is necessary – despite the sustained low interest rate level – because of the substantial new borrowing in the current year. Investment expenditure is to decline by just under DM 1 billion to just over DM 58 billion. Although the total amount of budgeted expenditure overshoots the volume envisaged in the most recent medium-term financial plan by DM 14 billion, it should be borne in mind that an additional DM 23 billion has to be included for the transfers to the Federal Labour Office and for unemployment assistance alone. Apart from this labour-market-induced expenditure, all other planned expenditure, taken together, could therefore be reduced by DM 9 billion.

On the receipts side, the draft provides for an increase of 4%. While in respect of tax revenue an increase of 3% is expected ac-

ording to the tax estimate of May, the other receipts will probably rise by 9½%. The main reason for this is that proceeds from privatisation (including receipts from capital reductions) are to be expanded by another one-quarter to just over DM 21 billion; the sale of another tranche of Deutsche Telekom shares worth DM 15 billion is the most important measure planned in this context.

On balance, the draft provides for a deficit which, at DM 58 billion, is DM 13 billion below the amount envisaged in the supplementary budget for 1997. In spite of the (envisaged) tax shortfalls and additional labour-market-induced burdens (totalling DM 32 billion), the deficit now envisaged is only DM 2 billion higher than in last year's medium-term financial plan; this is particularly due to the inclusion of additional proceeds from privatisation as well as the above-mentioned decline in expenditure in other fields. The draft budget may still be subject to considerable changes before it is finally adopted, however. For example, it takes into consideration the 1998 Tax Reform Bill, which has been conceived as the first part of the tax reform and has been approved by the Bundestag but which, in spite of an initial round of the mediation procedure, has not yet been adopted.⁴ In addition, it remains to be seen whether or not the new tax estimate, due in November, will require a correction to be made of the estimates in view of the persistent tax weakness.

⁴ In addition to initial tax scale reductions, the bill provides, *inter alia*, for a reduction of the solidarity surcharge by 2 percentage points; in this context, the shortfalls are to be offset mainly by restricting the tax-related leeway granted to enterprises.

*Federal
Government's
medium-term
financial
planning*

The medium-term financial plan, submitted together with the draft budget, continues the policy of limiting increases in expenditure. From 1999 to 2001 spending is to be expanded by no more than 1¼% on an annual average – assuming a growth rate of nominal gross domestic product of about 4½%. Nevertheless, the decline in the deficit (to DM 47 billion by 2001) seems relatively moderate, particularly since there will be no repeat in subsequent years of the large proceeds from privatisation estimated for 1998. In spite of the retrenchment efforts, therefore, the budget situation of the Federal Government will remain tight over the medium term.

*Perspectives for
the Länder
Governments
and the local
authorities ...*

The data available so far on the 1998 budget plans of the Länder Governments and the local authorities are incomplete. However, it can be assumed that the policy of limiting expenditure will be continued, which, particularly in the case of the Länder Governments, presupposes a continuation of the moderate income trend in the public service. In addition, since tax revenue will probably develop more favourably than hitherto, in view of the continuing economic recovery, a decline in the deficits is to be expected at these levels of government, too. Provided that the financial position of the social security funds remains largely unchanged, the general government deficit will probably continue to decline in the coming year. However, Germany still has some way to go to achieve the objective of the balanced financial position which is to be aimed at over the medium term and which has also been enshrined in the stability and growth pact.

*... and public
sector budgets
as a whole*

Social security funds

The statutory pension insurance institutions ended up in balance in the second quarter of 1997, whereas a year before they had still incurred a deficit of DM 2½ billion. The most significant factor for this improvement was the raising of the contribution rate from 19.2% to 20.3% at the beginning of this year, which led to a sharp increase of 7½% in receipts from compulsory contributions. Total receipts, at 5½%, grew at a somewhat slower pace, particularly since voluntary contributions were diminishing.⁵

*Statutory pen-
sion insurance
scheme*

In the second quarter expenditure on pensions was just under 3% higher than in the same period last year. In the west it increased by almost 3½%; the main cause of this was the growing number of pension recipients, in addition to the pension adjustment of just under 1% carried out in mid-1996. In the east, by contrast, the increase in expenditure on pensions was lower, at 1½%, despite the slight increase in the pension adjustment realised in mid-1996 (+ 1.2%). An expenditure-reducing factor was that the replenishing amounts introduced in the new Länder following the pension insurance transference are being gradually reduced. As a result of the statutory limitations in the field of rehabilitation, expenditure for these purposes was more than one-sixth below the previous year's amount. Overall, the expenditure of the pension insurance scheme increased by just over 2½% in the second quarter.

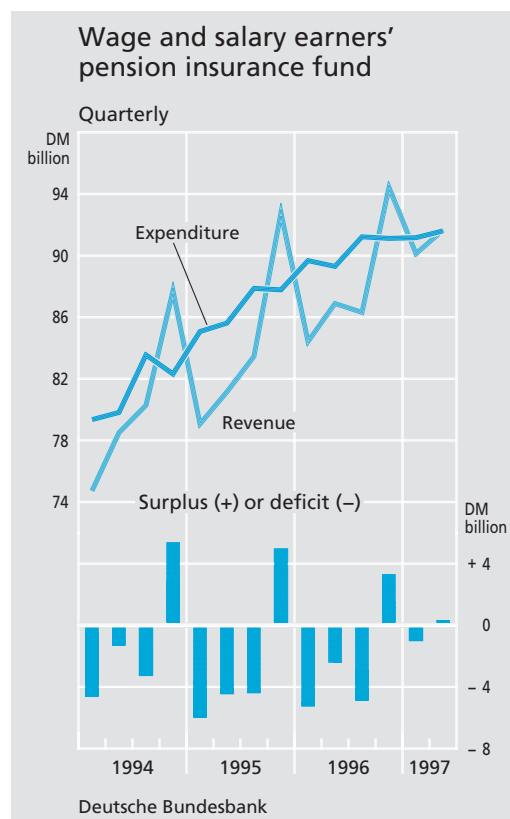
⁵ The expiry in mid-1996 of the possibility of repaying pension-insurance-related "marriage refunds", which was in force for a limited period only, played a role here.

Prospects

Although the pension insurance institutions will achieve a surplus over the year as a whole, it will be lower than had been expected when the contribution rate for 1997 was fixed, particularly as a result of the unfavourable trend in employment. The fluctuation reserve will therefore presumably fail to reach the statutorily prescribed minimum volume of one month's expenditure by the end of the year. This will also influence the trend in finances in the coming year. According to the forecast contained in the Federal Government's Pension Insurance Report, the contribution rate will have to be raised again at the beginning of 1998 – viz. to 20.6 % – in order to replenish the fluctuation reserve to the minimum volume by the end of that year.⁶

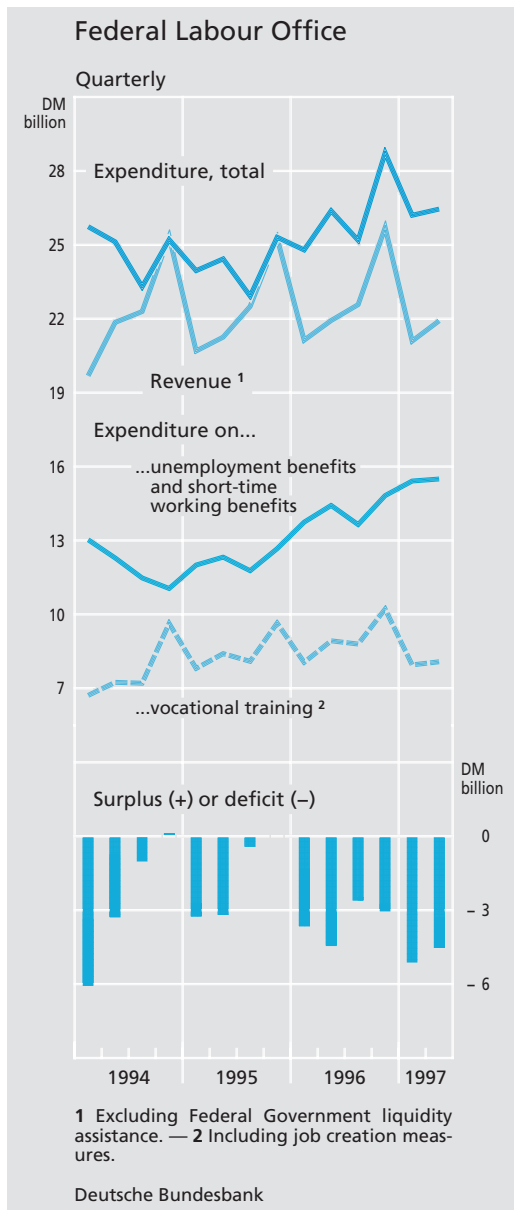
1999 Pension
Reform Bill

However, this would be associated with a further increase in the additional wage components, whose development has contributed substantially to structural unemployment in Germany. In order to reduce the heavy contribution burden and limit the increase which, in view of demographic problems, seems likely to recur over the longer term, the Federal Government has presented a draft for a new Pension Reform Bill, which was originally supposed to come into force at the beginning of 1999 (for details, see the overview on page 45). However, consideration is now being given to bringing the reform forward to 1998, in order to avoid the increase in the contribution rate which seems likely in the coming year, given the legal status quo. The main way of avoiding this increase would be to carry out the planned increase in the Federal grant, which, in turn, is to be fi-



nanced by an increase in value added tax by 1 percentage point. The most important point to remember when considering the reform is that a "refinancing" – even if it seems reasonable to a certain extent in terms of the pension system and of the overall economy – does not imply a reduction in the total burden of levies but only a restructuring of it. It is therefore impossible to circumvent the – ultimately necessary – adjustments by means of such measures. For that reason, the Pension Reform Bill provides for a moderate reduction in benefits, which would also have to come

⁶ In this context, it was assumed that in 1998 the average income of insured persons would increase by 2.1 % in the west and by 2.4 % in the east and that the number of insured persons would increase by just under 0.5 % in the west and decrease by just under 0.2 % in the east.



into force earlier if the “refinancing” were brought forward.⁷

Federal Labour
Office

In the second quarter, the Federal Labour Office incurred a deficit of DM 4½ billion, which was just as high as in the corresponding quarter last year. In the first three months of the year, by contrast, the deficit had increased by DM 1½ billion to just over DM 5 billion. However, in the second quarter trends

developed along different lines in the east and in the west. Whereas the surplus usually achieved in the west increased by DM ½ billion to DM 4½ billion, the deficit in the east grew to DM 9 billion. Contribution receipts grew by almost 2%, an increase of just over 2% in the west being accompanied by a decline of 4½% in the east – as a result of the more unfavourable trend in employment. Owing to a decrease in other receipts, the Federal Labour Office did not receive more funds overall than a year before.

Expenditure hardly rose above its previous year’s level either. On the one hand, unemployment payments, at 9%, increased sharply once again (they grew considerably more sharply in the east, at more than 20%, than in the west, at 4%). On the other hand, there was a decline in vocational assistance measures; thus, at the end of the second quarter, the number of persons participating in such measures was just under 200,000 lower than in the previous year. Hence, the increase in registered unemployment is accompanied partly by a decrease in hidden unemployment.

The Federal grant to the Federal Labour Office was increased for the current year in the Federal Government’s draft supplementary budget from DM 4.1 billion to DM 15.1 billion, and for 1998 the draft budget provides for DM 14.1 billion. These funds will

⁷ This was also recommended by the majority of the members of the Social Advisory Board in the latter’s report on the medium-term and long-term forecasts included in the 1997 Pension Insurance Report. Moreover, additional benefits which are not prescribed by the constitution and which are also provided for in the 1999 Pension Reform Bill should be deferred.

Main elements of the Federal Government's pension reform plan

In order to reduce the contribution rate to the statutory pension insurance scheme by 1 percentage point, the Federal grant is to be raised accordingly (i.e. by about DM 15 billion). To finance the additional expenditure by the Federal Government, value added tax is to be raised by 1 percentage point.

A **demographic correction factor** to take account of the longer periods during which pensions are now drawn as a result of increased life expectancy is to be introduced into the pension adjustment formula, and this will lead to a gradual lowering of the net basic pension level. However, it is not to fall below 64 % of net wages. The "demographic factor" will be applied as long as it does not lead to a reduction in pensions.

To **reform the occupational disability pension**, a two-stage pension payable in the event of reduced earning capacity will be introduced. If the person concerned is still able to work three to six hours per day, a "pension owing to reduced earning capacity" will be granted in future; if the person concerned is able to work less than three hours per day, a "pension owing to a complete loss of earning capacity" will be granted. In future, occupational risks will not be borne by the pension insurance scheme (establishment of the "abstract perspective"). The same actuarial deductions as those for other early retirement pensions will apply. In future, however, the period between the ages of 55 and 60 will be counted in full, instead of as one-third.

The early retirement pension for women and the early retirement pension paid as a result of unemployment or after a period of age-induced part-time work will no longer be granted from 2012. Instead, the **right to premature retirement will only be granted, in principle, to persons insured on a long-term basis** (i.e. to persons who have paid contributions for at least 35 years during statutorily relevant periods) from the age of 62, and a reduction of the pension by up to 10.8 % (3 x 3.6 % p. a.) will have to be accepted.

A **special regulation for older persons** (i.e. those born before 1942) **insured on a long-term basis** enables these persons to retire at the age of 60 at the earliest without having to incur deductions, if they provide evidence that they have paid compulsory contributions for 45 years.

In order to give more preferential treatment to persons responsible for child-rearing, first, contribution periods during child-rearing will no longer be set off against child-rearing periods from July 1, 1998 onwards; instead, they will be taken into account additionally (impact of the decision of the Federal Constitutional Court of March 12, 1996). Second, the valuation of the child-rearing periods will be raised successively from 75 % to 100 % of average income. The privileges will then directly entail financial burdens, since they are intended to apply to the number of existing pension recipients, too.

In order to **stabilise the trend in the contribution rate**, this rate is to be adjusted in future only if the fluctuation reserve in the following year is expected to be either below one month's expenditure or above 1 ½ months' expenditure. So far the amount aimed at has been exactly one month's expenditure.

In the field of company retirement pension schemes, a decrease in non-forfeitable expectancy periods is envisaged from the present ten to eight years (from 1999) and to five years (from 2008). In addition, the age limit for a non-forfeitable expectancy is to be lowered from the present 35 to 33 years (from 1999) and to 30 years (from 2008). Moreover, the adjustment regulations will be given more concrete shape. In principle, a pension increase will be deemed appropriate if it is in line with the increase in the consumer price index of four-person middle-income households or with the net wages of comparable persons still employed by the enterprise. The obligation, arising from judicial decisions, to make adjustments later for those adjustments previously omitted because of economic difficulties will cease to apply. A pension increase is also to be deemed sufficient if the employer undertakes from the outset to adjust the company pension by 1% annually.

probably be sufficient to finance the deficits of the Federal Labour Office, provided that the reversal of the trend in the labour market which is expected by many observers really takes place.

*Statutory
health
insurance
scheme*

In the second quarter of 1997 the statutory health insurance institutions recorded a deficit of DM 1½ billion compared with one of almost DM 4 billion a year before. The improvement in the result is attributable above all to the reduction in expenditure on benefits of just over 2 %, mainly as a result of the 1996 Contribution Relief Act. For example, expenditure on sickness benefits and on treatment at health resorts declined by more than 20 %. The health insurance institutions also spent less on health appliances and health aids than a year before (– 6 ½ %). The largest share in the economies was achieved in western Germany. In the second quarter contribution receipts were 1½ % higher, in all, than a year before. In the west, in view of the stagnating basic wage total, this was at-

tributable mainly to the higher pension payments which formed the basis of the contribution assessment for the health insurance of pensioners. In the east, by contrast, perceptible increases in the contribution rate made themselves felt. In August the average contribution rate was almost 14.0 % in the east and just under 13.6 % in the west.

In the first half of 1997, the deficit of the health insurance institutions was DM 4 billion, whereas a year before it had been almost DM 7½ billion. Owing to the higher contribution payments towards the cost of medical prescriptions, resulting from the New Regulation Acts, which came into force on July 1, 1997, another improvement in the results can be expected in the further course of the year. Moreover, the additional contribution of DM 20 annually per member, payable from 1997 to 1999, will affect receipts for the first time in the second half of the year; this contribution is to be used to finance the maintenance investment of hospitals.