German Government Budgets 2000/2001: Tax Reform Exerts an Expansionary Impulse

German central, state and local government has been pursuing a strict fiscal consolidation course since at least 1997. In the face of at times adverse macroeconomic conditions, the three tiers of government have drastically reduced their budget deficits, namely from DM 120 billion (1996) to DM 55 billion (1999).[1] Lower economic growth has been an inevitable consequence of this restrictive stance.

This year the restrictive policy approach is being maintained, while at the same time government finances are benefiting from cyclically induced additional revenue. Even so there will be only a minor reduction in the deficit – to DM 53 billion – because of the impact of one-off effects. The DM 100 billion revenue from the auction of UMTS licences will be entered into both the financial and the national accounts statistics at the point at which the licences are issued, that is during the current year; this will produce a surplus of DM 46 billion.[2] For 2001 fiscal policy is set to embark on an expansionary course. The tax reform will reduce the tax burden on firms and households by DM 45 billion. In terms of their direct impact on the level of economic activity, the tax cuts are of far greater importance than the planned cuts on the spending side. Next year central, state and local governments together are expected to record a deficit of more than DM 70 billion.

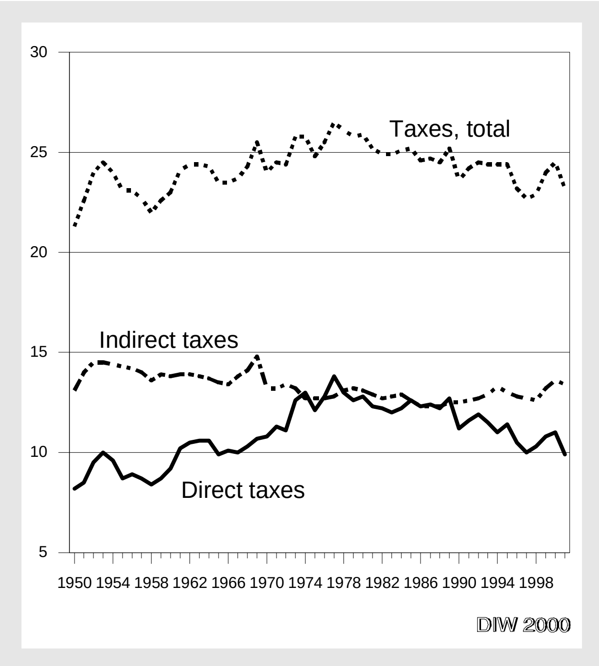
The major decisions taken on taxation policy in December of last year and the fact that the government proved able to steer them through both houses of the German parliament mark a major political breakthrough for the government. By the final stage of the tax reform, which will be reached in 2005, the tax burden on private households and firms will have been reduced by more than DM 60 billion per annum, representing almost 1% of nominal GDP. Cuts in the tax burden have been implemented in the past at regular intervals, ensuring that taxes have remained broadly constant as a share of income in spite of the progression built into the income tax system (cf. figure 1).

In contrast to the last major reform, the cuts in taxes are not to be financed through borrowing. Rather, the required resources are largely to be obtained by means of cuts on the spending side. At the end of the 1980s, spending by the three tiers of government fell as a share of GDP by one percentage point, a result facilitated by a broad-based cyclical upturn. At the start of the 1990s, however, plans to restrain expenditure foundered on the spending needs incurred by German unification. The current need to cut spending seems to be more pressing than then, not least because Germany has committed itself, under the Stability and Growth Pact signed in Dublin, to balance its budget in the medium term.

Reform of business and income taxation 2001/2005

In July 2000 the upper chamber of parliament (Bundesrat) accepted, after a long discussion and controversial negotiations, the compromise proposal on taxation reform. This reform, which will take effect from the start of 2001, consists of two parts: changes in the system of taxing incorporated companies and shareholders, and cuts in income tax in three stages between then and 2005.

Figure 1
Taxes as a % of GDP



[1] On finance statistics definitions; on national accounting definitions the deficits were DM 109 and DM 57 billion, respectively.

[2] Following a decision by Eurostat, the statistical office of the European Communities, the revenue derived from the sale of mobile telephony licences will, under the rules of the European System of National Accounts (ESNA 1995), be considered as the sale of an immaterial non-produced economic good, and will be reflected in full in the statistics when the licences are issued in 2000.

Table 1

Financial Impacts of the Tax Reform 2000

Losses (-) and gains (+) in tax revenue in billions of DM

	Reference year	Year of current effect					
		2001	2002	2003	2004	2005	2006
Reform of the income tax progression	–51 890	–28 395	1 255	–13 845	–13 210	–51 520	–52 840
Bringing forward the 2002 income tax progression[1]	–(27 840)	–28 655	1 355	–540	–	–	–
Income tax progression 2003[2]	–(13 475)	–	–	–13 600	–13 480	110	–410
Income tax progression 2005[3]	–52 170	–	–	–	–	–51 910	–52 710
Converting the income tax progression from DM to euro without steps	280	260	–100	295	270	280	280
Reform of business taxation (net)	–10 575	–16 995	–20 465	–15 495	–11 840	–11 240	–14 385
1. Corporations	–20 445	–18 245	–27 905	–28 400	–27 025	–26 975	–27 060
Reduction in rate of corp. tax from 40% to 25%	–13 965	–11 260	–14 600	–15 890	–17 135	–18 435	–19 840
Reduction in corp. tax distribution from 30% to 25%	–1 980	–5 340	–4 715	–3 280	–3 185	–3 415	–3 685
Reduction in rate of non-assessed taxes on profits from 25% to 20%	–115	–	–3 165	–2 420	–895	–615	–660
Replacement of full-credit by half-income procedure	4 985	–	3 905	5 080	5 585	5 855	6 485
Exemption from tax of sales of equity	–4 240	–1 590	–3 390	–4 120	–4 240	–4 240	–4 240
Move from full-credit procedure to definitive taxation	–4 115	–	–5 425	–6 830	–6 055	–5 080	–4 105
Other changes in tax laws[4]	–1 015	–55	–515	–940	–1 100	–1 045	–1 015
2. Unincorporated companies	–6 065	–3 980	–5 355	–6 610	–6 435	–6 595	–6 740
Reduction in income tax by 1.8 times the trading tax measurement base	–9 915	–6 940	–9 220	–12 110	–11 915	–12 765	–13 700
Abolition of the income tax progression ceiling on business income	5 160	3 610	4 800	6 655	6 765	7 480	8 270
Other changes in tax laws[5]	–1 310	–650	–935	–1 155	–1 285	–1 310	–1 310
Reform of business taxation (gross)	–26 510	–22 225	–33 260	–35 010	–33 460	–33 570	–33 800
3. Financing measures	15 935	5 230	12 795	19 515	21 620	22 330	19 415
Reduction in the degressive depreciation allowance for mobile capital goods from 30% to 20%	12 985	5 400	10 890	14 785	14 400	13 060	13 075
Reduction in the linear depreciation rate for buildings from 4% to 3%	525	–	235	805	1 280	1 670	2 085
Adjustment of official depreciation tables to utilisation periods that more closely reflect reality	3 450	715	2 660	5 150	6 990	8 560	5 220
Other changes in tax laws[6]	–1 025	–885	–990	–1 225	–1 050	–960	–965
Overall effects of Tax Reform 2000	–62 465	–45 390	–19 210	–29 340	–25 050	–62 760	–67 225

1 Basic tax-free allowance DM 14 000, initial tax rate 19.9%, top rate of tax 48.5%. — 2 Basic tax-free allowance DM 14 500, initial tax rate 17%, top rate of tax 47%. — 3 Basic tax-free allowance DM 15 000, initial tax rate 15%, top rate of tax 42%. Including reintroduction of half of the tax rate on sales of companies by owners leaving the company (once in a lifetime). — 4 Changes in the taxation of organic companies, reduction in the equity stake ceiling for the taxation of gains on capital resales (for corporations) from 10% to 1%, inclusion of profits from the sale of equity in corporations into the half-Income procedure. — 5 Increase in the tax-free allowance for sales of unincorporated companies from DM 60 000 to DM 100 000, reintroduction of the 'co-entrepreneur decree' (Mitunternehmererlass). — 6 Tightening of the rules on external financing by partners, retention of the initial savings depreciation (Ansparabschreibung – Article 7g of the income tax law).
Source: Federal Ministry of Finance.

For incorporated and unincorporated companies the following changes will take effect (cf. table 1):

– As of 2001 the rate of corporation tax on retained and distributed profits will be reduced to a single rate of 25% (currently 40% and 30%, respectively).

– In taxing dividends, the system under which corporation tax paid is fully credited against income tax dues is to be replaced by the so-called half-income procedure *(Halbeinkünfteverfahren),* i.e. corporation tax is paid definitively, in return shareholders are required to pay income tax on only half of their net dividends (gross dividends minus 25% corporation tax).

- As of 2002 corporate profits resulting from the sale of shares to incorporated companies are tax-free provided the shares have been held for at least one year.
- Private shareholders may sell shares in companies without paying tax, as previously, provided the speculation threshold of one year is respected. This is conditional, however, on the shareholder not holding a 'significant' share in the company. The ceiling above which a shareholding is considered to be 'significant' will be reduced from 10% to 1% in 2002.
- Unincorporated companies are subject to income tax as currently. They are not able – as had been originally planned – to opt to be taxed as corporations.
- Those firms paying trading tax (Gewerbesteuer) are allowed to set off a fixed amount of the trading tax against their income tax dues; this amount is set at 1.8 times the trading tax measurement figure. This will mean that most companies effectively pay no trading tax.
- In order to finance the reform of business taxation, the tax base is to be broadened. For mobile capital goods the degressive depreciation rate is to be reduced from 30% to 20%, and in future a rate of 3% (rather than 4%) is to apply to commercial buildings. In addition, the official depreciation periods are to be adjusted so as to bring them closer into line with the actual useful working lives.

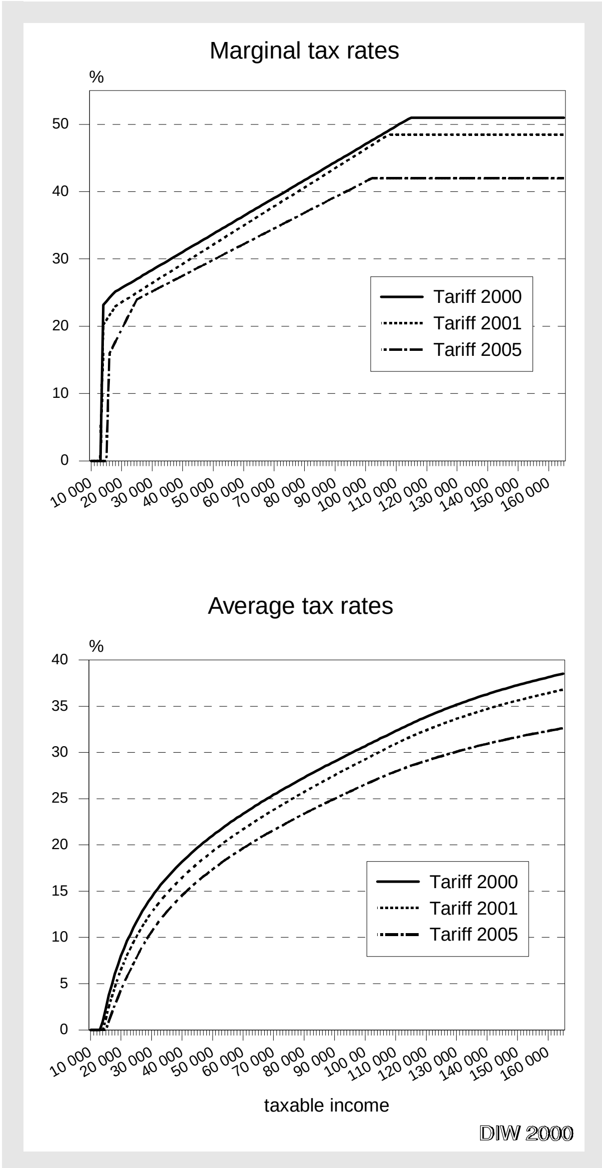
In the area of assessed income tax, starting in 2001 taxpayers are to benefit from a three-stage reduction in the tax burden:

- The tax cuts originally planned for 2002 have been brought forward to 2001. The basic tax-free allowance will rise by DM 500 to DM 14 000. The initial rate of tax will be reduced from 22.9% to 19.9%, the top rate of tax from 51% to 48.5%.
- As of 2003 the basic tax-free allowance will be increased once more, to DM 14 500. The initial rate of tax will then be just 17%, the top rate 47%.
- From 2005 the basic tax-free allowance will be DM 15 000, the initial rate of tax will be reduced to 15% and the top rate to 42%. At the same time the income threshold above which the top rate of tax is due will be reduced from DM 114 695 to DM 102 000. This means a steeper tax progression for those on middle incomes (cf. figures 2 and 3).

All in all, calculations by the finance ministry indicate that in the coming year the taxpayer will pay over DM 45 billion less in tax thanks to the reform. Of the three tiers of government, it is central and state-level government that will have to cope with the greatest part of the revenue losses. While in the coming year local government will have to face a shortfall of around DM 4.5 billion, central government will suffer losses of just under DM 22 billion and state governments DM 19 billion on the revenue side.

Figure 2

Income Tax Progression 2000, 2001 and 2005

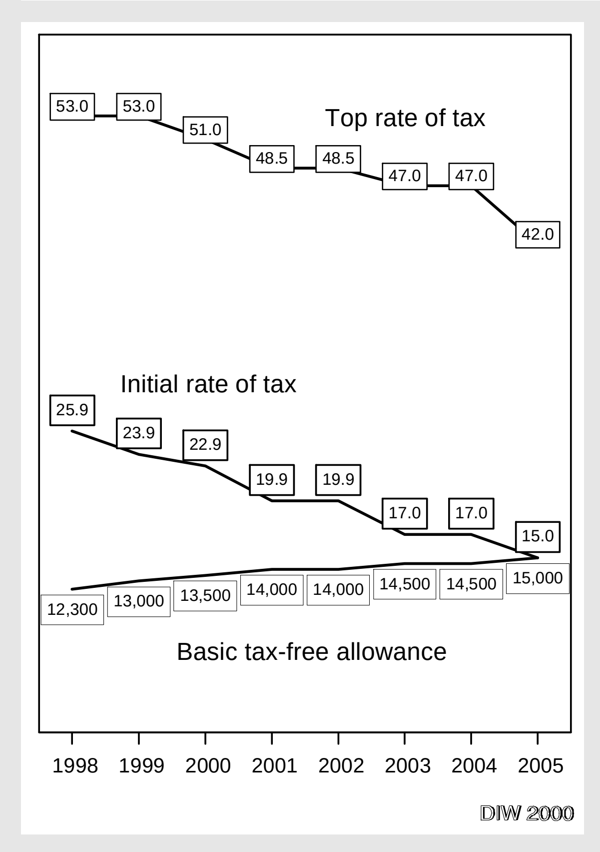


Sources: Federal Statistical Office; DIW calculations.

Tax revenues in 2000 and 2001

In the first seven months of this year, tax revenues have developed surprisingly dynamically. During this period central and state governments and the EU have taken in

Figure 3
Basic Tax-free Allowance,
Initial and Top Rates of Tax, 1998 to 2005



Source: Federal Statistical Office.

almost 6% more in revenue than during the same period last year. The numerous changes in tax laws that have come into effect last year and during the current year have both reduced the tax burden on taxpayers – particularly wage and salary earners – and imposed additional burdens. The latter effect resulted primarily from the ecological tax reform and the broadening of the tax base, especially for firms and the self-employed.

For the forecast of tax revenue for 2000 and 2001 it is assumed that nominal GDP will grow by 3.2% and 3.8%, respectively. The gross volume of wages and salaries, an important variable for estimating the revenue from wage tax, is expected to expand by 2.5% in the current and by 3% in the coming year.

The revenue from wages tax is being squeezed during the current year by the further increase in child benefit (DM –3.8 billion) and the second stage of the Tax Change Law 1999/2000/2002 (DM –8.7 billion). On top of this comes the fact that wage growth will once again prove moderate, generating only a slight increase in current receipts in the months to July (1.8%). In the remaining course of the year, the expansion of gross wages and salaries will weaken slightly, a trend that will be reflected in wage tax revenue. All in all, wage tax revenue will expand by 1.3% in the current year.

The positive overall revenue trend primarily reflects the dynamic expansion of taxes on profits (assessed income tax, non-assessed taxes on profits, corporation tax and tax on interest income). In the months to July current receipts of taxes on profits rose by a total of 22.6%. This primarily reflects favourable corporate profitability, leading to a marked increase in pre-payments.

Assessed income tax receipts in western Germany were up by almost 65% on the previous year, representing additional revenue of more than DM 3.6 billion. The annual forecast is based on the assumption that this dynamic will tail off slightly in the coming months, not least because taxpayers can be expected to attempt to shift their income into the coming year, in order to benefit from the lower rates of income tax. Pre-payments will not expand quite as steeply, following the rapid rates of growth in the same months last year, as in the first half of the year. All in all, current receipts this year are expected to expand by almost one-fifth. This would be more than DM 1 billion more than had been assumed by the Arbeitskreis Steuerschätzung (the group of experts that forecasts tax revenue trends for the German government). Next year will see a sharp decline (–32%). This largely reflects the impact of the tax reform 2000, although technical factors relating to tax assessment will also play a part: given that in 2001 it is largely income from the tax year 1999 – when profits were weak – that will be assessed, the volume of back-payments is likely to be significantly smaller.

In eastern Germany the growth of income tax revenue has been even more dynamic, although this is not visible in the current figures. The income from tax assessments is still not sufficient to cover the reimbursements paid out of the gross revenue. In the first seven months the gap amounted to minus DM 4.2 billion, only slightly less than last year. For the year as a whole, the 'deficit' in east German income tax revenue is likely, judging by the figures so far, to be about the same as last year (DM –5.4 billion). Given the expected revenue losses incurred as a result of the tax reform 2000, the gap will be substantially wider in 2001 (DM –6.1 billion).

Revenue growth was particularly pronounced in the case of corporation tax, amounting to almost 17.5% in western Germany during the first seven months. This expansion was due primarily to the favourable profitability situation of German firms, leading to higher pre-payments. In addition, back-payments from previous, high-profit years were also considerably higher. In the coming month the dynamic is expected to weaken sig-

Table 2

Tax Revenue in Germany 1999 to 2001

	West Germany[1]			East Germany[2]			Total			West Germany[1]		East Germany[2]		Total	
	1999	2000	2001	1999	2000	2001	1999	2000	2001	2000	2001	2000	2001	2000	2001
	Actual	Estimated		Actual	Estimated		Actual	Estimated		Estimated					
	DM billion									% change on the previous year					
Joint taxes	592.7	–	–	36.3	–	–	629.0	655.4	629.6	–	–	–	–	4.2	–3.9
Wage tax[3]	242.1	246.0	239.1	19.6	18.8	17.0	261.7	264.8	256.1	1.6	–2.8	–4.1	–9.6	1.2	–3.3
Assessed income tax[3]	26.8	32.0	21.8	–5.5	–5.4	–6.1	21.3	26.6	15.7	19.4	–31.9	–1.8	13.0	24.9	–41.0
Non-assessed taxes on profits[4]	21.5	23.5	24.5	0.6	0.8	0.8	22.1	24.3	25.3	9.3	4.3	33.3	0.0	10.0	4.1
Tax on interest income[5]	11.6	13.5	14.7	0.2	0.3	0.4	11.8	13.8	15.1	16.4	8.9	50.0	33.3	16.9	9.4
Corporation tax[4]	42.7	46.0	27.8	1.1	1.4	1.5	43.8	47.4	29.3	7.7	–39.6	27.3	7.1	8.2	–38.2
Taxes on turnover[6]	248.0	–	–	20.3	–	–	268.3	278.5	288.1	–	–	–	–	3.8	3.4
Customs duty							6.2	6.4	6.3					3.2	–1.6
Federal taxes							141.3	153.9	158.6					8.9	3.1
Petroleum tax							71.3	79.5	84.0					11.5	5.7
Electricity tax							3.6	6.5	7.9					80.6	21.5
Tobacco tax							22.8	23.0	23.3					0.9	1.3
Spirits tax							4.4	4.2	4.1					–4.5	–2.4
Insurance tax							13.9	14.0	14.0					0.7	0.0
Solidarity supplement (on income taxes)							22.0	23.4	22.0					6.4	–6.0
Other							3.3	3.3	3.3					0.0	0.0
Federal state taxes	33.5	33.0	34.2	4.8	4.4	4.7	38.3	37.4	38.9	–1.5	3.6	–8.3	6.8	–2.3	4.0
Vehicle tax	11.8	11.2	13.2	2.0	2.0	2.3	13.8	13.2	15.5	–5.1	17.9	0.0	15.0	–4.3	17.4
Inheritance tax	5.9	6.2	6.5	0.1	0.1	0.1	6.0	6.3	6.6	5.1	4.8	0.0	0.0	5.0	4.8
Real estate purchase tax	9.8	9.8	9.1	2.0	1.5	1.5	11.8	11.3	10.6	0.0	–7.1	–25.0	0.0	–4.2	–6.2
Other	6.0	5.8	5.4	0.7	0.8	0.8	6.7	6.6	6.2	–3.3	–6.9	14.3	0.0	–1.5	–6.1
Local government taxes	65.5	65.2	67.4	5.9	6.5	7.2	71.4	71.7	74.6	–0.5	3.4	10.2	10.8	0.4	4.0
Trade tax	49.5	48.8	50.5	3.4	3.9	4.5	52.9	52.7	55.0	–1.4	3.5	14.7	15.4	–0.4	4.4
Real estate tax	14.6	14.9	15.4	2.3	2.4	2.5	16.9	17.3	17.9	2.1	3.4	4.3	4.2	2.4	3.5
Other	1.4	1.5	1.5	0.2	0.2	0.2	1.6	1.7	1.7	7.1	0.0	0.0	0.0	6.3	0.0
Total tax revenues	–	–	–	–	–	–	886.2	924.8	908.0	–	–	–	–	4.4	–1.8
Financial statistics definition[7]															
of which:															
Central government[8,9,10,11]	–	–	–	–	–	–	388.3	410.5	403.9	–	–	–	–	5.7	–1.6
State government[8,9,11,12,14]	297.2	308.0	296.5	64.1	65.5	64.5	361.3	373.5	361.0	3.6	–3.7	2.2	–1.5	3.4	–3.3
Local government[13,14]	91.6	93.2	92.7	8.2	8.3	8.8	99.8	101.5	101.5	1.7	–0.5	1.2	6.0	1.7	0.0

1 West Germany incl. West Berlin. — 2 East Germany incl. East Berlin. — 3 Distribution ratio central/state/local government: 42.5/42.5/15. — 4 Distribution ratio central/state government: 50/50. — 5 Distribution ratio central/state/local government: 44/44/12; distribution between west and east Germany: 91%/9%. — 6 Distribution ratio central/state government: central government 5.63%; of the remainder local government initially receives 2.2%, the remainder being divided as follows: 50.5% central government, states 49.5%; from 2000 onwards: central 50.25%, states 49.75% distribution; between west and east Germany within the framework of the system of horizontal financial compensation. — 7 Excl. EU shares, incl. para-fiscal charges. In the financial statistics West and East Berlin are counted as part of west Germany. — 8 Turnover tax distribution by the German Unity Fund added to federal, deducted from state government. — 9 Supplementary central government grants to financially weak federal states deducted from central and added to state government. — 10 EU VAT own resources and EU GNP own resources deducted. — 11 Incl. trading tax levy. Distribution ratio: central government: 19/45; state government: 26/45. — 12 Incl. community tax of the city states. — 13 Excl. community tax of the city states and after deduction of the trading tax levy. — 14 Incl. participation of west German local authorities in German Unity Fund via the increase in the trading tax levy on west German state governments. — Columns may not sum due to rounding.

Sources: Federal Ministry of Finance; DIW estimates.

nificantly, partly because the second half of 1999 had seen a marked acceleration, and partly because, due to the reform of business taxation – corporation tax is to be reduced from 40% to 25% – firms have a strong incentive to shift profits from the current to the coming year. Moreover, in tax terms it is worthwhile to invest during the current year, as the depreciation allowances are 'worth more'.

Negative effects on tax revenue may arise as early as the current year in connection with the sale by auction of the UMTS licences. If it is assumed that the licences depreciate during their full utilisation period (20 years),[3] and that all the companies that have acquired licences are already earning corresponding taxable profits and immediately offset the depreciation allowances against their tax dues, then even in the current year the loss of corporation tax revenue could already amount to as much as DM 2 billion; next year the figure is just DM 1.25 billion because the rate of corporation tax will then be lower. Of course, not all the firms that have acquired a UMTS licence at the auction are earning correspondingly high profits, so that the actual revenue losses will be below the ceilings indicated above.

All in all, corporation tax receipts in western Germany are expected to be almost 9% higher this year than last, representing DM 4 billion more than had been expected by the Arbeitskreis Steuerschätzung. The following estimation of corporation tax revenue for 2001 is based on the tax laws still currently in force, whereby the reduced revenue resulting from the Tax Reform 2000 (DM –14.2 billion) is subtracted from the estimated result. Overall, for the year 2001 corporation tax receipts of just DM 28 billion (–39.6%) are expected.

Unlike the case with income tax, current receipts from corporation tax in eastern Germany have been positive for several years now, i.e. gross receipts are higher than the investment incentives and the reimbursements to the Bundesamt für Finanzen paid out of the gross revenue. In the first seven months of the year, current receipts were up by almost one-third. If the current receipts are adjusted for the amounts reimbursed, the rate of growth amounts to more than 45%. In terms of the factors affecting revenue trends in the remaining months of this year, similar considerations to those for the forecast on corporation tax in western Germany apply. Current receipts for the year as a whole will be up by 27%. Unlike in western Germany, revenue is expected to continue to expand next year (by 7%), in spite of the effects of the reform of business taxation. The estimation includes the additional income – DM 500 million – resulting from changes in taxation laws in recent years.

Favourable profitability trends among incorporated firms have meant that considerably more dividends were paid out this year, a trend reflected in the yield from non-assessed taxes on profits. In the first seven months of the year, current receipts in Germany as a whole rose far more strongly (at 14.3%) than had been expected by the Arbeitskreis Steuerschätzung in their last forecast. Even if the reimbursements to the Bundesamt für Finanzen are subtracted, the increase remains considerable (12%). For the year 2000 as a whole, the increase is expected to amount to more than 10%. Compared with the outcome expected by the Arbeitskreis Steuerschätzung, the additional revenue represents more than DM 3.5 billion. Assuming that the dynamic expansion of dividend payments normalises once more, following the rapid rates of growth in the current year, growth of 4% is to be expected next year.

As far as turnover taxes are concerned, it seems – on the basis of the result during the first seven months (+5.4%) – that the rate of growth for the year as a whole will be slightly higher than that of turnover. Overall revenue from turnover taxes is expected to expand by just under 4% in the current year. In 2001 it will probably grow in line with the rate of expansion of final domestic demand (3.4%).

Revenue from the taxes that accrue solely to central government, which, because the consumption of a number of taxed products has reached the saturation point, normally increases only marginally, will rise more than proportionately this year (9%). The fact that next year central government taxes as a whole will increase only moderately (3%) is due to the solidarity surcharge on income tax, which, in the wake of the tax reform 2000, will decline (–6%).

Whereas this year revenue from the taxes accruing solely to central government is expected to decline (–2.5%), significant growth is expected next year (4%). The evolution of revenue from local government taxes is determined primarily by trading tax, which will decline this year (–0.4%). Both pre-payments and back-payments from previous years are lower. On top of this comes the fact that the depreciation allowances on the cost of acquiring the UMTS licences could lead to a revenue shortfall already in this year. Overall, local authority tax revenues will stagnate in the current year, whereas a slight expansion can be expected next year, as trading tax revenues will expand because the lower depreciation rates will generate additional receipts.

Alongside the revenue from the sale of UMTS licences, the German finance minister can count on cyclically induced additional revenue in the current year of tens of DM billions. This year overall tax revenue will expand by just under 4.5%, equal to additional receipts of almost DM 925 billion. Compared with the prognosis made by the Arbeitskreis Steuerschätzung this spring, government revenue will be DM 13 billion higher. In 2001 current receipts will decline by just under 2%, due to the revenue losses resulting from implementation of the Tax Reform 2000 (DM 45 billion).

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[3] According to the German finance ministry the costs of the UMTS licences can be depreciated during the full utilisation period, as the licence ends after 20 years.

Table 3

Revenue and Expenditure of German Central, State and Local Government[1]

	Central government[2,3]			Special assets[4]			State government[2]						Local government						Total		
							West Germany[5]			East Germany			West Germany			East Germany					
	1999	2000	2001	1999	2000	2001	1999	2000	2001	1999	2000	2001	1999	2000	2001	1999	2000	2001	1999	2000	2001
	Actual	Estimated		Actual	Estimated		Actual	Estimated		Actual	Estimated		Actual	Estimated		Actual	Estimated		Actual	Estimated	
	in DM billion																				
Revenue	452.8	454.0	454.3	55.6	42.1	44.7	378.4	386.3	375.4	97.2	98.0	97.4	235.5	237.5	235.4	50.8	51.4	51.9	1067.2	1078.1	1069.9
Taxes	388.3	410.5	403.9	–	–	–	297.2	308.0	296.5	64.1	65.5	64.5	91.6	93.2	92.7	8.2	8.3	8.8	849.4	885.5	866.4
Transfers from other levels of government[6]	7.3	4.6	4.6	29.6	21.5	19.6	34.8	32.7	33.1	18.3	17.6	17.9	66.6	67.8	67.2	32.0	32.6	32.7	–	–	–
State equalisation	–	–	–	–	–	–	7.8	7.7	7.5	6.7	6.7	6.6	–	–	–	–	–	–	–	–	–
Income from economic activities	20.0	11.0	10.0	–	–	–	7.1	7.1	7.2	0.9	0.9	0.9	13.1	13.0	12.5	2.4	2.3	2.2	43.5	34.3	32.8
Levies and charges	7.4	7.2	7.2	–	–	–	8.3	8.4	8.5	0.9	0.9	1.0	29.0	28.6	28.2	4.3	4.3	4.3	49.9	49.4	49.2
Sales of assets[7]	18.2	9.2	17.1	0.2	0.1	4.6	6.0	5.0	5.0	0.2	0.2	0.2	12.7	12.0	11.6	2.7	2.6	2.6	40.0	29.1	41.1
Other sources	11.6	11.5	11.5	25.8	20.5	20.5	17.2	17.4	17.6	6.1	6.2	6.3	22.5	22.9	23.2	1.2	1.3	1.3	84.4	79.8	80.4
Expenditure	504.1	495.7	497.4	45.0	39.6	39.7	391.5	396.2	399.8	103.1	104.3	105.6	230.6	234.9	236.8	51.2	51.6	52.0	1122.5	1131.1	1142.0
Personnel costs	52.7	53.3	54.4	15.5	15.2	15.0	155.3	157.8	160.6	26.7	27.2	27.8	61.7	62.6	63.7	15.2	15.1	15.1	327.1	331.2	336.6
Current material costs	40.0	41.0	41.8	0.9	1.0	1.0	37.9	38.7	39.6	8.0	8.2	8.4	44.2	44.9	45.6	9.6	9.8	10.0	140.6	143.6	146.4
Interest payments	80.4	82.8	80.3	8.4	8.4	8.5	31.8	32.5	33.2	5.6	5.9	6.2	8.8	8.6	8.5	1.7	1.7	1.7	136.1	139.3	137.8
of which: to other levels of government	–	–	–	–	–	–	0.3	0.3	0.3	–	–	–	0.3	0.3	0.3	–	–	–	–	–	–
Current transfers to	273.8	262.3	262.7	7.2	4.0	3.8	121.7	123.5	123.5	35.8	36.5	37.1	71.2	72.9	74.6	10.8	11.3	11.6	362.5	363.3	368.3
Other levels of government	23.4	21.1	20.8	2.8	0.0	0.1	56.1	57.7	57.5	24.5	25.1	25.6	6.9	7.0	7.0	0.3	0.3	0.3	–	–	–
State equalisation	–	–	–	–	–	–	14.5	14.4	14.1	–	–	–	–	–	–	–	–	–	–	–	–
Special assets	29.5	21.4	19.5	–	–	–	0.1	0.1	0.1	–	–	–	–	–	–	–	–	–	–	–	–
Social insurance	140.1	148.0	152.5	1.5	1.4	1.3	0.5	0.5	0.5	0.1	0.1	0.1	0.2	0.2	0.2	0.1	0.1	0.1	142.5	150.3	154.7
Income support	47.5	40.0	38.7	0.3	0.3	0.3	14.1	14.3	14.5	4.9	5.0	5.1	44.5	45.8	47.0	6.5	6.8	7.0	117.8	112.2	112.6
Firms	26.4	25.0	24.5	2.6	2.2	2.1	18.7	18.5	18.5	0.0	0.0	0.0	5.1	5.2	5.4	1.9	1.9	1.9	54.7	52.8	52.4
Abroad	5.2	5.1	5.0	–	–	–	1.2	1.2	1.2	–	–	–	–	–	–	–	–	–	6.4	6.3	6.2
Social institutions	1.5	1.5	1.5	–	–	–	11.8	12.0	12.3	2.3	2.4	2.4	10.3	10.5	10.7	1.6	1.7	1.8	27.5	28.1	28.7
Other	0.2	0.2	0.2	–	–	–	4.7	4.8	4.8	4.0	3.9	3.9	4.2	4.2	4.3	0.4	0.5	0.5	13.5	13.6	13.7
Investment	13.9	13.7	14.2	–	–	–	11.2	11.0	10.8	4.3	4.3	4.4	36.4	37.8	36.3	12.0	11.8	11.7	77.8	78.6	77.4

Table 3 (continued)

	Central government[2,3]			Special assets[4]			State government[2]						Local government						Total		
							West Germany[5]			East Germany			West Germany			East Germany					
	1999	2000	2001	1999	2000	2001	1999	2000	2001	1999	2000	2001	1999	2000	2001	1999	2000	2001	1999	2000	2001
	Actual	Estimated		Actual	Estimated		Actual	Estimated		Actual	Estimated		Actual	Estimated		Actual	Estimated		Actual	Estimated	
Capital transfers to	34.9	34.3	35.8	1.3	1.2	1.2	28.4	27.7	27.1	21.3	20.9	20.4	4.2	4.1	4.1	1.6	1.6	1.6	49.3	48.4	48.5
Other levels of government	20.1	19.6	20.5	–	–	–	11.4	11.0	10.6	10.2	10.1	9.7	0.5	0.5	0.5	0.2	0.2	0.2	–	–	–
Abroad	4.0	4.0	4.0	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	4.0	4.0	4.0
Other	10.8	10.7	11.3	1.3	1.2	1.2	17.0	16.7	16.5	11.1	10.8	10.5	3.7	3.6	3.6	1.4	1.4	1.4	45.3	44.4	44.5
Loans and shares	8.4	8.3	8.2	11.7	9.8	10.2	5.2	5.0	5.0	1.4	1.3	1.3	4.1	4.0	4.0	0.3	0.3	0.3	29.1	26.7	27.0
of which: to other levels of government	1.0	1.0	1.0	–	–	–	1.0	1.0	1.0	–	–	–	–	–	–	–	–	–	–	–	–
Financial balance	–51.3	–41.7	–43.1	10.6	2.5	5.0	–13.1	–9.9	–24.4	–5.9	–6.3	–8.2	4.9	2.6	–1.4	–0.4	–0.2	–0.1	–55.2	–53.0	–72.1
Financial balance	–	57.7	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–	46.4	–
	% change on the previous year																				
Revenue	5.3	0.3	0.1	–38.8	–24.3	6.2	3.7	2.1	–2.8	1.9	0.8	–0.6	2.0	0.8	–0.9	1.2	1.2	1.0	3.5	1.0	–0.8
Taxes	9.7	5.7	–1.6	–	–	–	6.0	3.6	–3.7	3.6	2.2	–1.5	4.9	1.7	–0.5	5.1	1.2	6.0	7.4	4.3	–2.2
Expenditure	3.6	–1.7	0.3	–32.9	–12.0	0.3	1.6	1.2	0.9	0.2	1.2	1.2	2.4	1.9	0.8	0.4	0.8	0.8	3.3	0.8	1.0
Personnel costs	1.2	1.1	2.1	–1.5	–1.9	–1.3	1.8	1.6	1.8	1.5	1.9	2.2	1.3	1.5	1.8	–0.7	–0.7	0.0	1.3	1.3	1.6
Current material costs	3.6	2.5	2.0	.	11.1	0.0	2.2	2.1	2.3	2.6	2.5	2.4	5.7	1.6	1.6	0.0	2.1	2.0	3.9	2.1	1.9
Interest payments	43.1	3.0	–3.0	–72.0	0.0	1.2	1.9	2.2	2.2	5.7	5.4	5.1	–4.3	–2.3	–1.2	0.0	0.0	0.0	2.3	2.4	–1.1
Current transfers to	–2.6	–4.2	0.2	37.7	–44.4	–5.0	3.8	1.5	0.0	–0.8	2.0	1.6	–0.3	2.4	2.3	2.9	4.6	2.7	8.0	0.2	1.4
Other levels of government	–2.1	–9.8	–1.4	–	.	.	2.7	2.9	–0.3	0.8	2.4	2.0	0.0	1.4	0.0	50.0	0.0	0.0	–	–	–
Social insurance	15.8	5.6	3.0	–6.3	–6.7	–7.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	15.4	5.5	2.9
Income support	–2.1	–15.8	–3.3	10.0	–9.1	0.0	–2.1	1.4	1.4	.	2.0	2.0	–0.7	2.9	2.6	1.6	4.6	2.9	0.6	–4.8	0.4
Firms	44.3	–5.3	–2.0	–16.3	–16.0	–4.5	–8.8	–1.1	0.0	.	.	.	4.1	2.0	3.8	0.0	0.0	0.0	–0.2	–3.5	–0.8
Investment	3.0	–1.4	3.6	–	–	–	1.8	–1.8	–1.8	4.9	0.0	2.3	4.6	3.8	–4.0	–7.0	–1.7	–0.8	2.0	1.0	–1.5
Capital transfers	–2.8	–1.7	4.4	–43.5	–7.7	0.0	–2.7	–2.5	–2.2	–3.2	–1.9	–2.4	7.7	–2.4	0.0	.	0.0	0.0	–2.8	–1.8	0.2
Loans and shares	–7.7	–1.2	–1.2	–12.7	–16.2	4.1	–27.8	–3.8	0.0	7.7	–7.1	0.0	24.2	–2.4	0.0	–25.0	0.0	0.0	–11.3	–8.2	1.1

1 By financial-statistical definition, excl. hospitals with their own accounting system. — 2 Supplementary transfers to financially weak states and tranfers of petroleum tax within the regionalisation of short-distance passenger traffic substracted from central, added to state governments. — 3 The transfer of Bundesbank profits has been recorded in full as federal government revenue; the difference to DM 7 billion has been recorded as a federal government transfer to the Erblastentilgungsfonds. — 4 Cf. table 4. — 5 Incl. Berlin. — 6 Incl. Special Assets (Sondervermögen) des Bundes (1999: DM billion 2.7). — 7 Real assets and shareholdings. — Columns may not sum due to rounding.
Sources: Federal Statistical Office; DIW calculations and estimates.

Table 4

Revenue and Expenditure of the Central Government Special Assets (Sondervermögen)

	German Unity Fund			Railway assets			Inherited-debt management fund			Other funds[1]			Total		
	1999	2000	2001	1999	2000	2001	1999	2000	2001	1999	2000	2001	1999	2000	2001
	Actual	Estimated		Actual	Estimated		Actual	Estimated		Actual	Estimated		Actual	Estimated	
	DM billion														
Revenue	6.5	6.5	9.5	19.2	18.6	18.2	12.9	2.0	2.0	17.0	15.0	15.0	55.6	42.1	44.7
Transfers from other levels of government	6.5	6.5	9.5	13.1	13.5	8.6	9.5[2]	1.0[3]	1.0	0.5	0.5	0.5	29.6	21.5	19.6
Sales of assets	–	–	–	0.2	0.1	4.6	–	–	–	–	–	–	0.2	0.1	4.6
Other sources[4]	–	–	–	5.9	5.0	5.0	3.4	1.0	1.0	16.5	14.5	14.5	25.8	20.5	20.5
Expenditure	5.8	5.8	5.8	19.3	18.6	18.2	3.4	0.7	0.7	16.6	14.5	15.0	45.0	39.6	39.7
Personnel costs	–	–	–	15.5	15.2	15.0	–	–	–	–	–	–	15.5	15.2	15.0
Current material costs	–	–	–	0.2	0.3	0.3	0.7	0.7	0.7	–	–	–	0.9	1.0	1.0
Interest payments	5.8	5.8	5.8	–	–	–	–	–	–	2.6	2.6	2.7	8.4	8.4	8.5
Current transfers to	–	–	–	3.6	3.1	2.9	2.7	0.0	0.0	1.0	0.9	0.9	7.2	4.0	3.8
Other levels of government	–	–	–	–	–	–	2.7	–	–	0.1	0.1	0.1	2.8	0.1	0.1
Social insurance	–	–	–	1.5	1.4	1.3	–	–	–	–	–	–	1.5	1.4	1.3
Pensions, allowances	–	–	–	–	–	–	–	–	–	0.3	0.3	0.3	0.3	0.3	0.3
Firms	–	–	–	2.1	1.7	1.6	–	–	–	0.5	0.5	0.5	2.6	2.2	2.1
Other	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
Capital transfers	–	–	–	–	–	–	–	–	–	1.3	1.2	1.2	1.3	1.2	1.2
Loans and shares	–	–	–	–	–	–	–	–	–	11.7	9.8	10.2	11.7	9.8	10.2
Net effect	0.7[5]	0.7[5]	3.7[5]	–0.1	0.0	0.0	9.5[5]	1.3[5]	1.3[5]	0.4	0.5	0.0	10.6	2.5	5.0

1 ERP, LAF, compensation fund, coal industry fund. — 2 Including the additional receipts out of Bundesbank profits. — 3 Since 1999 interest payments have come directly out of the central government budget. — 4 In the case of the European Recovery Programme including income from loans and the repayment of loans. — 5 Surpluses are used to repay principal.
Sources: Federal Statistical Office; DIW estimates.

Public spending in 2000 and 2001

The extremely restrictive stance on the spending side will be maintained next year. Spending by the three tiers of German government is expected to expand by just 1%.

Pay settlements in the public sector have exerted a dampening effect on spending trends. Allowing for the rise in civil services salaries – which were even lower than the average – public sector pay has risen by 1.4% this year, with 1.8% envisaged for next year. Net job losses are expected to continue in all tiers of government, with staffing levels in eastern Germany, in particularly, still too high, even though in recent years the adjustment process there has been striking, especially in local authorities.

Current spending (excluding transfers) is also expected to grow by a similar order of magnitude, although it will be influenced by, for instance, higher energy prices and higher costs of rental. This item also covers the cost of military procurement, which had been virtually stagnant for some years, but has recently risen.

The rate of growth of spending on debt servicing has also declined markedly in recent years. Falling deficits, low interest rates on capital and money markets, and the substitution of low-interest loans for high-interest outstanding debts are the decisive factors here. In spite of a renewed increase in the deficit in 2001, interest expenditure will continue to expand relatively moderately. Although slightly higher interest rates are expected, given the monetary policy stance and the demand for capital, the increased burden resulting from the higher deficit will not be felt in the budget until 2002. By contrast, the savings on interest payments resulting from the planned reduction in outstanding government debt – with the help of the UMTS receipts – will have an effect on spending as early as 2001; this impact is assumed to be worth DM 5 billion.

Current transfers, the other major spending item, accounting for one-third of all expenditure, are affected by a number of contradictory influences. Whereas the grants to the pension insurance fund will expand, spending on unemployment and to finance labour market policy measures will decline. This year an allocation of DM 7.7 billion was made in the central government budget for these purposes, but in fact only around DM 5 billion will probably be required. Next year central government will probably not have to provide any grant at all, as the Federal Labour Office (the public employment service) will almost certainly post a surplus. It is therefore being considered whether responsibility for financing structural policy adjustment measures should be passed on from central government to the Federal Labour Office. Central government compensation grants to the pension insurance scheme, on the other hand, are rising by almost DM 8 billion (net), as it has assumed responsibility for financing the additional pension claims for child-raising periods.

The decline in central government spending on social transfers primarily reflects the impact of the federal government's austerity programme. Spending on unemployment assistance (Arbeitslosenhilfe) was cut sharply. Spending on other social benefits has also declined, including benefits for war victims. Local government spending on minimum social benefit (Sozialhilfe) on the other hand, which declined and stagnated in recent years, will rise once more, primarily because central government has abolished unemployment assistance for those with no previous contribution periods, leading to an increase in the number of people entitled to claim social benefit. All in all, current spending on social transfers will stagnate in the current year, and next year it will grow by just 1%.

It is difficult to forecast public capital spending trends. Following an extended period of contraction, public investment was bolstered in 1999, and further growth is expected this year. Given the revenue losses resulting from the tax reform, policymakers in all tiers of government are likely to seek opportunities for making cuts. These are likely to be found primarily in public capital spending, the most flexible spending category. Local authorities, in particular, are effectively obliged to keep their budgets in balance primarily through variations in their capital spending, as their scope for borrowing, unlike that of central and state-level government, is tightly circumscribed. It is still unclear how central government savings of DM 5 billion in interest payments, in the context of the sale of UMTS licences, will affect government spending. The only thing that is clear is that the funds should be made available for investive purposes.

Trends by tier of government

Moderate spending trends, cyclically induced additional revenue and the receipts from the sale of wireless telephony licences together mean that in the current year, central, state and local government budgets will close with a huge surplus, totalling DM 46 billion. Without the UMTS receipts there would have been a deficit of DM 53 billion, slightly less than in 1999. Next year, however, a deficit of DM 72 billion is expected. This increase reflects, alongside tax reform, primarily one-off effects at central government level. Moreover, the special assets of central government (Sondervermögen) will earn substantially lower surpluses than last year.

According to the estimations presented here, in the current year the central government budget will post a surplus of DM 58 billion; without the UMTS receipts, there would be a deficit of DM 42 billion. This figure is substantially lower than envisaged in the budget plan (DM 49 billion). Tax revenues are higher than planned, while on the spending side the budgetary position has benefited from reduced payments to the Federal Labour Office. For these reasons, the fact that personnel spending is higher than budgeted, because the rise in collectively agreed pay rates had been underestimated, makes scarcely any difference. The significant revenue losses in some areas on the revenue side – at DM 8 billion the profits transferred to government by the Bundesbank have halved, as have privatisation receipts, falling to DM 9 billion – will also be more than offset. Some of the receipts from privatisation will be used to finance the deficit on the funds set up to support the postal service prior to privatisation (Postunterstützungskassen).

Next year's trends will be dominated by the revenue losses resulting from tax reform; of these DM 22 billion will apply to central government. To some extent these

Germany – Selected Seasonally Adjusted Economic Indicators[1]

		Unemployment		Vacancies		Orders in manufacturing (volume)[2]													
						Manufacturing						Intermediate goods industry		Capital goods industry		Durable consumer goods industry		Non-durable consumer goods industry (incl. semi-durable goods industry)	
						Total		Domestic		Abroad									
		in 000s				1995 = 100													
		month	quarter	month	quarter	month	quarter	month	quarter	month	quarter	month	quarter	month	quarter	month	quarter	month	quarter
1997	J	4 258		331		102.6		96.5		113.5		103.5		102.1		103.0		98.0	
	F	4 260	4 260	332	329	103.6	103.4	98.0	97.5	113.8	114.0	106.0	105.3	101.2	101.6	103.2	103.2	100.3	99.1
	M	4 263		325		103.9		97.9		114.7		106.4		101.6		103.4		99.1	
	A	4 310		319		105.3		98.5		117.6		106.4		105.9		103.3		97.8	
	M	4 375	4 365	320	321	105.0	105.4	98.5	98.5	116.5	117.8	106.9	107.4	104.4	104.9	103.2	103.8	96.9	97.2
	J	4 411		325		106.0		98.6		119.4		108.9		104.5		104.9		96.9	
	J	4 444		331		106.4		99.2		119.3		109.4		105.2		103.9		96.4	
	A	4 475	4 472	339	338	107.5	107.5	99.1	99.3	122.5	122.3	109.3	109.6	108.6	108.0	103.2	104.1	95.6	96.1
	S	4 498		345		108.6		99.5		125.2		110.1		110.2		105.1		96.3	
	O	4 508		353		109.4		101.1		124.2		111.7		110.2		104.3		97.3	
	N	4 494	4 494	367	365	109.8	109.9	101.8	101.6	124.0	124.6	112.6	112.1	110.2	110.8	103.5	104.3	97.9	97.8
	D	4 482		378		110.4		101.9		125.6		112.0		112.1		105.0		98.3	
1998	J	4 438		382		111.2		103.8		124.6		112.3		114.2		106.6		96.2	
	F	4 425	4 425	391	391	111.6	111.6	104.2	104.0	124.8	125.2	112.5	112.2	114.5	115.0	108.1	107.9	97.0	96.6
	M	4 414		404		112.0		104.1		126.2		111.8		116.2		108.9		96.6	
	A	4 373		418		109.8		102.3		123.5		110.7		111.8		109.3		94.8	
	M	4 311	4 316	432	428	111.7	110.6	103.9	102.8	125.9	124.6	112.0	111.1	115.2	113.4	109.5	108.6	96.1	96.5
	J	4 265		437		110.2		102.3		124.4		110.5		113.1		107.1		98.6	
	J	4 228		438		110.4		103.4		123.1		109.4		114.7		110.2		97.0	
	A	4 192	4 189	443	440	108.5	109.5	102.4	103.1	119.6	121.1	109.1	109.3	110.3	112.6	108.0	109.2	97.1	96.5
	S	4 150		441		109.6		103.4		120.7		109.4		112.8		109.4		95.4	
	O	4 117		439		107.8		100.5		120.9		107.4		110.6		109.6		93.7	
	N	4 118	4 126	434	434	107.7	107.7	100.8	100.4	120.1	120.8	107.2	107.4	110.2	110.2	111.6	110.6	93.1	93.1
	D	4 143		430		107.6		100.0		121.5		107.7		109.8		110.6		92.4	
1999	J	4 092		443		107.4		99.9		121.0		108.5		107.8		109.8		94.6	
	F	4 082	4 082	449	447	107.4	107.2	98.9	99.3	122.8	121.6	107.4	108.4	109.7	107.9	109.6	109.2	92.5	93.0
	M	4 073		452		106.9		99.2		120.9		109.4		106.3		108.2		91.9	
	A	4 085		451		111.1		102.4		126.9		112.2		113.1		109.5		97.1	
	M	4 105	4 103	446	446	108.1	110.3	99.7	101.5	123.3	126.1	109.3	111.0	109.2	112.5	108.4	110.4	94.5	93.9
	J	4 121		444		111.6		102.3		128.1		111.6		115.3		113.4		90.1	
	J	4 118		452		112.2		101.7		131.0		114.7		112.6		110.3		95.3	
	A	4 117	4 119	455	457	116.6	114.6	104.8	103.1	138.0	135.3	116.5	116.0	121.3	117.2	116.2	113.2	95.4	94.6
	S	4 123		466		115.0		102.9		136.8		116.7		117.7		113.2		93.0	
	O	4 108		476		118.0		107.4		137.2		119.1		122.7		113.3		95.3	
	N	4 078	4 067	483	482	120.2		107.4		143.2		121.4		124.8		113.7		98.6	
	D	4 017		490															

1 Seasonally adjusted by the Berlin Method (BV4). With this method, the addition of a new figure can cause changes in seasonally adjusted figures earlier in the time figures even if the original, unadjusted, figures remained unchanged. Quarterly figures are calculated from seasonally adjusted monthly figures. — 2 Also adjusted for working days.

Sources: Federal Labour Office and Federal Statistical Office.

shortfalls are to be 'interim financed' using privatisation receipts; DM 17 billion has been earmarked for this purpose in the budget. Yet the revenue losses resulting from tax reform narrow the tax base in a lasting way (ignoring the boost to growth given by the reduced tax burden). Overall, central government tax revenue (excluding UMTS receipts) is expected to more or less stagnate in both the current and the coming years. Spending will decline this year and will barely increase next year; the savings on interest payments will be higher than the additional capital spending. Savings are also to be expected in grants to the Federal Labour Office and social benefits. The deficit will amount to DM 43 billion, slightly higher than this year, but still significantly below the figure of DM 46 billion in the budget plans.

The financial situation of the central government 'special assets' (Sondervermögen) will deteriorate substantially during the current year, so that they will generate only a marginal surplus; next year this is expected to increase once more to DM 5 billion. The main factor in the current year is the decline in Bundesbank profits; profits in excess of DM 7 billion are transferred to the Erblastentilgungsfonds (a fund set up to manage debt arising out of unification) for debt repayment. In 1999 this was more than DM 9 billion; this year not even DM 1 billion was transferred, with no significantly higher figure pencilled in for 2001. In recent years (and also this year), the burden on the central government budget was eased by the fact that grants to the German Unity Fund were reduced by DM 3 billion per year to just DM 6.5 billion; next year the plan is to return to the schedule originally agreed, and thus to pay in DM 9.5 billion. The financing structure of the railway assets (Bundeseisenbahnvermögen) will also shift substantially during 2001, as central government plans to reduce its grant by DM 5 to just under DM 9 billion; the gap is to be closed by receipts from sales of housing stock and other real estate. No major changes are expected in the other special assets (including the European Recovery Programme).

In spite of the only slight increase in spending, the financial position of state (Land) governments will improve only marginally this year, and will actually worsen next year. In the prognosis presented here, spending by the west German Länder will increase by less than 2% in 2000, and just under 1% in 2001. For the east German Länder a rise of almost 1% is expected in both years. State-level budgets are particularly labour-cost-intensive and thus benefit more than proportionately from the moderate pay settlements; they weigh slightly heavier in eastern Germany as a result of the continued harmonisation of pay levels between the regions. The revenue shortfalls resulting from the tax reforms will lead the Land governments to lower their allocations to their local authorities. Normally the transfers paid to local government are linked to the evolution of tax receipts and to the resources from the inter-state redistribution of tax revenue (Länderfinanzausgleich). Even so, the deficits in state budgets will rise once more: in western Germany to DM 24 billion (2000: DM 10 billion) and in eastern Germany to more than DM 8 billion, compared with DM 6.5 billion in the current year.

In the wake of the improvement in their financial position, in 1999 local authorities were able to increase their investment for the first time in many years. This year, too, an increase in real capital investment is forecast. Given that tax reform will tear holes in local government budgets, the recovery phase for public investment is expected to be of short duration. Even if local authorities benefit from higher grants from central to the Land governments, their capital spending is almost certain to decline in 2001 (–4%). In eastern Germany there will be no break in the declining trend; due to the extremely weak tax base of east German local authorities they have already exhausted their scope for borrowing, forcing them to prune their capital spending. Tax reform will exacerbate these problems.

Alongside the revenue losses resulting from tax reform, local authorities face a further shortfall in income from licences and other charges and from the profits of municipal utilities. The liberalisation of the regulations governing the energy sector has put energy utilities under severe competitive pressure, squeezing profits. This not only reduces the profits transferred to local authority budgets; it also makes it more difficult to cross-subsidise within combined municipal energy-supply and transport companies. On balance the surpluses posted by west German local authorities will decline substantially this year, to DM 2.5 billion; for next year a deficit of as much as DM 1.5 billion is forecast, despite cutbacks in capital spending. In both the current and the coming years the budgets of east German local authorities will be virtually balanced.[4]

Fiscal policy considerations

Fiscal policy is under the influence of two contradictory trends. In the current year the goal of reducing spending retains the upper hand: on balance the budgets of the three tiers of government exert a restrictive effect on the German economy. Next year it is tax reform that domi-

[4] In past years substantial numbers of municipal facilities and institutions have been 'spun off' and thus removed from local government budgets, a process that has continued. This distorts comparisons with earlier years.

Germany – Selected Seasonally Adjusted Economic Indicators[1] (continued)

		Employment in mining and manufacturing		Manufacturing output[2)]										Retail trade turnover		Foreign trade (Special trade)[2)]			
				Manufacturing		Capital goods industry		Durable consumer goods industry		Non-durable consumer goods industry (incl. semi-durable goods industry)		Construction industries				Exports		Imports	
		in 000s		1995 = 100										1995 = 100		DM bill.			
		month	quarter	month	quarter	month	quarter	month	quarter	month	quarter	month	quarter	month	quarter	month	quarter	month	quarter
1997	J	6 481		101.7		103.2		102.5		100.8		87.4		100.7		68.6		60.0	
	F	6 466	6 465	102.7	102.4	103.2	103.0	100.5	100.4	101.4	101.3	95.7	92.3	98.5	99.1	70.7	212.1	62.5	185.7
	M	6 448		102.8		102.5		98.3		101.8		93.8		98.0		72.8		63.2	
	A	6 435		103.4		104.5		103.8		99.6		91.8		99.8		69.4		60.0	
	M	6 420	6 421	102.9	103.9	103.5	105.0	98.1	101.9	100.9	100.5	88.0	89.9	98.9	99.7	73.9	217.6	65.8	189.0
	J	6 411		105.3		107.1		103.7		100.9		89.9		100.3		74.3		63.2	
	J	6 401		105.8		106.6		104.9		101.0		89.8		98.6		74.3		65.2	
	A	6 393	6 394	104.6	105.4	105.3	106.3	99.3	102.3	100.8	100.9	88.1	89.1	97.3	98.4	75.7	228.2	66.0	197.7
	S	6 389		105.7		106.9		102.6		100.9		89.4		99.4		78.2		66.4	
	O	6 389		106.7		107.5		101.4		101.8		89.8		100.3		76.5		67.4	
	N	6 388	6 387	107.5	107.4	108.1	107.9	104.2	103.3	101.8	101.8	90.1	89.7	97.4	99.0	78.2	234.5	68.6	202.7
	D	6 386		108.1		108.2		104.3		101.9		89.1		99.2		79.8		66.7	
1998	J	6 387		108.7		110.4		104.5		101.7		91.3		99.9		80.0		70.5	
	F	6 390	6 391	109.6	109.6	112.3	112.5	107.8	107.4	100.5	100.8	89.7	89.7	99.8	99.5	79.9	239.3	68.8	207.6
	M	6 397		110.4		114.8		109.9		100.3		88.0		98.8		79.3		68.3	
	A	6 407		109.1		112.3		105.0		101.5		85.6		100.0		82.0		71.6	
	M	6 408	6 408	111.2	109.9	115.1	113.2	109.5	106.8	101.6	101.4	88.6	87.0	100.5	99.7	80.2	242.2	66.7	208.9
	J	6 411		109.3		112.3		105.8		101.0		86.9		98.5		80.0		70.6	
	J	6 415		110.0		114.6		109.0		100.9		87.4		100.7		79.9		69.1	
	A	6 418	6 416	109.9	109.8	114.0	113.9	108.9	109.5	100.5	100.6	87.1	87.0	100.2	100.4	79.2	236.8	68.3	205.3
	S	6 415		109.4		113.0		110.7		100.4		86.5		100.4		77.6		67.9	
	O	6 409		109.9		114.1		112.5		99.8		85.5		99.3		79.3		68.0	
	N	6 403	6 404	109.2	109.3	113.4	113.9	109.0	110.3	100.3	100.1	84.9	84.8	101.0	100.4	78.4	234.3	66.6	203.9
	D	6 403		108.8		114.1		109.3		100.1		84.0		101.0		76.6		69.3	
1999	J	6 413		109.5		111.7		109.9		101.0		89.1		98.8		77.9		65.5	
	F	6 406	6 404	108.6	108.8	110.6	110.6	108.6	109.0	101.4	101.3	83.9	86.1	99.9	100.9	78.5	234.9	67.8	201.5
	M	6 394		108.4		109.4		108.5		101.6		85.4		103.9		78.5		68.2	
	A	6 373		111.3		112.5		114.1		102.3		87.3		98.9		79.7		68.2	
	M	6 368	6 366	108.0	109.9	109.1	111.2	111.5	113.4	100.0	101.2	83.4	85.1	98.7	99.8	78.2	238.8	71.5	208.3
	J	6 359		110.3		111.9		114.7		101.4		84.5		101.9		80.9		68.6	
	J	6 354		109.8		110.5		107.0		102.2		83.4		100.1		82.1		70.3	
	A	6 351	6 350	112.0	111.3	114.1	113.2	114.6	109.8	102.8	102.6	85.5	84.2	101.3	100.3	82.4	248.1	72.7	216.0
	S	6 348		112.2		114.9		107.7		102.8		83.8		99.5		83.6		73.0	
	O	6 347		111.3		115.2		107.9		102.7		85.3		100.2		83.7		72.8	
	N	6 346		111.9		114.9		109.5		102.0		85.3		101.9		88.0		76.5	
	D																		

1 Seasonally adjusted by the Berlin Method (BV4). With this method, the addition of a new figure can cause changes in seasonally adjusted figures earlier in the time figures even if the original, unadjusted, figures remained unchanged. Quarterly figures are calculated from seasonally adjusted monthly figures. — 2 Also adjusted for working days.
Sources: Federal Labour Office and Federal Statistical Office.

nates fiscal policy developments: it will lead to substantial falls in tax revenue and give the economy an expansionary boost that will more than offset the restrictive stance on the spending side. From a cyclical point of view, the cuts in the tax burden come at the right time, as they will boost the expansionary forces in the German economy. The export dynamic, which has so far been driving economic growth, is expected to weaken.

Particularly strong expansionary effects are to be expected from the reform of income taxation. The fact that the second stage of the Tax Change Law 1999/2000/2002 has been brought forward means that next year private households will have almost DM 30 billion in additional disposable income. Much of this will be spent on raising consumption, thus stabilising the economic upturn. Particularly in 2001, the reform will substantially reduce the tax burden on low and medium-income households, whereas it is those on higher incomes that benefit most from the tax progression planned for 2003. The changes to the 2005 progression are more to the advantage of average earners. Taking all three stages together, the extent to which disposable household income is increased is really very substantial.

The reform of business taxation will improve conditions on the supply side and make Germany a more attractive location for foreign investors. On the other hand, the incentives to invest in real capital will decline, because of the significant deterioration in the conditions for depreciation. The discussion on the financial impact of the reform centres on the question of whether unincorporated companies will in future be treated less favourably in tax terms than comparable corporations, because of the different tax rates. This question cannot be readily answered, because of the large number of influencing factors. These include the extent to which profits are distributed, the salary paid to executives of the corporation, capital deployed and its rate of return.

Generally speaking,[5] an unincorporated company pays less in tax than a corporation if its profits are less than DM 45 000. If they are higher, the tax advantages and disadvantages depend on the extent to which profits are distributed. If the annual profit is DM 1 million, none of which is distributed, the corporation has a tax advantage of around DM 63 500 over the unincorporated company. If half of the profits are distributed, the advantage melts to less than DM 6 000. If the profits are distributed in full, the advantage is on the side of the unincorporated company, which would pay almost DM 52 000 less in tax than the corporation and its shareholders together. Where profits are fully distributed, the unincorporated companies are in a more favourable position if profits are higher than DM 300 000.

Although the tax reform is to be welcomed in principle, it must be asked whether the repeated turnarounds in fiscal policy are conducive to macroeconomic growth: this year fiscal policy is restrictive, next year expansive and in 2002 most likely contractionary once more. Spending should be more constant and at the same time generally less restrictive. What is the macroeconomic sense in fiscal policy pursuing, on the one hand, a rigorous austerity policy in order, on the other and after a delay, to finance tax cuts with the resources saved? Economic growth will only receive a perceptible stimulus if the tax cuts are greater than the savings, implying the need to borrow, and/or the available resources are deployed in a more productive way. Numerous austerity packages have been initiated in recent years – the scope for an unproductive deployment of resources have become much smaller. Yet the cutbacks also hit public spending on infrastructure; between 1994 and 1999 public investment was reduced by one-quarter. Local authorities frequently have no option but to react to revenue losses in this way.

Many areas of the public infrastructure in Germany are already in a deplorable state, while in east Germany there is still a substantial need for improvement to bring it up to west German standards. This is true not only of fixed public capital, but also of spending on education and science; the decline in spending in this area in recent years is a cause for serious concern.

It would be disastrous if the growth impulses that are built into the tax reform were to be offset by cuts on the spending side. The promise of cyclically induced additional tax revenue and the scope for reducing interest payments opened up by the UMTS receipts reduce the pressure to make further savings. Additional cuts in taxes, which would increase this pressure once more, are to be rejected, at least at the present juncture.

Dieter Teichmann and Dieter Vesper

[5] It is assumed that, in corporations, the pay of the managing director reduces profits by up to DM 200 000: this is subject to private income tax. Profits exceeding this figure are subjected, to the extent that they are distributed, to the half-income procedure (see above).