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German Stability Programme

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I. Introduction

In accordance with the provisions of the Stability and Growth Pact (Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and coordination of economic policies) the Member States having introduced the euro are obliged to submit annually updated stability programmes. The other EU Member States submit convergence programmes.

The first stability or convergence programmes governed by the provisions of the Stability and Growth Pact were submitted at the end of 1998 in accordance with an ECOFIN Council statement of 1 May 1998. In its report to the European Council in Helsinki on economic policy coordination the ECOFIN Council points out that updated programmes should be submitted no later than the end of the calendar year.

Germany submitted its initial stability programme in the first week of January 1999, shortly after the change of government. It is clear from the present update that the objectives set out in the original programme were carefully and realistically defined, especially in view of the fiscal policy measures envisaged in the Future Programme drawn up in the summer of 1999. There is actually every reason to believe that the projected progress on consolidation could be achieved sooner than originally expected.

The update of the German Stability Programme was approved by the cabinet on 1 December 1999. The responsible committees of both houses of the German parliament will be briefed immediately after the programme has been submitted to the Council of the European Union and the European Commission.

In format and content the programme is in line with the guidelines drawn up by the ECOFIN Council in October 1998. In accordance with the ECOFIN Council agreement and taking account of the difficulties with deadlines in the past year, a somewhat earlier submission date was chosen this year.

As the process of presentation to the cabinet including the agreement of the text between the different government departments in the run-up to cabinet submission requires a quite lengthy period of time, the updated stability programme is based on the data available at the start of November. Germany will make available at a later date information on current trends, including provisional outturn figures for 1999, for the discussion of the programme in the EU institutions at the start of the coming year.

The Federal Ministry of Finance will publish the updated stability programme and will also post it on the Internet (www.bundesfinanzministerium.de/finwiber/).

II. Outlook for the general development of the economy from 1999 to 2003

A. Global economic environment

The crises besetting the world economy, especially in Asia, Latin America and Russia, slowed down economic activity in Germany in the winter half-year 1998/99 more strongly than had been expected when last year's stability programme was submitted. Thus real growth of the gross domestic product (GDP) in Germany in 1998 at 2.2 % fell appreciably short of the estimate of some 3 % growth made at that time. However, these rates are only partially comparable on account of the conversion to ESA 95.

In the course of the current year, economic recovery, especially in the Asian region, has again imparted substantial momentum to the world economy, a development that has also been reflected in Germany's export figures. While Germany's exports of goods in the last quarter of 1998, in real terms and seasonally adjusted, were still about 4 % below the figure for the 2nd quarter of that year, they have since registered an exceptionally vigorous gain of 8 % after seasonal adjustment and in terms of the export volume of the past three months.

B. Underlying assumptions for the development of the German economy

The programme is based on the following assumptions for the period through 2000:

- Following the estimates of international organisations, global economic expansion is put at about 3 % for 1999 and about 3 ½ % for 2000.

- The figure for GDP growth in the euro area on which the projection is based will remain comparatively moderate at a good 2 % on average for 1999. The projection presupposes an increase to just under 3 % next year.

- The volume of world trade is projected to grow by a good 3 ½ % in 1999 and by a good 6 % in 2000.

- No significant changes as against autumn 1999 in the real external value of the euro are forecast for the period under review. This does not in general rule out short-term fluctuations.

- Wage policy will remain on a stability-oriented course geared to promoting employment. This assumes that wages and salaries will rise less in 2000 than in 1999.

- Price movements will be very moderate over the whole term of the projection; the stability target of the European Central Bank will not come under threat. It is assumed that the upward trend in commodity prices hitherto observed in the course of 1999 will not continue.

- Long-term interest rates will stay at a comparatively low level. The most recent increase in the ECB's central rates is unlikely to trigger any fundamental change in this trend.

- Tax relief measures will not cause any deviation from the strict consolidation course of fiscal policy.

C. Trends in Germany in 1999 and 2000

Economic indicators currently point to an appreciable acceleration in macroeconomic development in the course of the year. The government's growth estimate for this year, positing real GDP growth of some 1 ½ %, nonetheless falls short of the figure cited in last year's stability programme (2 %), which may be attributed to growth in the first half of 1999 having turned out weaker than expected.

Domestic demand has this year shown itself to be the stabilising element in macroeconomic development. Private consumption expenditure has gained in particular from an increase in real disposable income. Investment in machinery and equipment is again likely to show a disproportionate increase, and has recently been approaching last year's high growth rate. There are also good prospects that the decline in construction investment which has persisted for several years could be brought to a virtual halt in the current year. Despite marked growth in exports in the course of the year, net exports of goods and services viewed on a yearly average still exert an appreciably retarding effect on macroeconomic development.

The German government projection assumes that the upward trend in economic activity will continue in the year 2000, with GDP growing on a yearly average by 2 ½ % in real terms in the coming year. Backed up by somewhat stronger growth in domestic demand, net exports of goods and services will, other than in the current year, exert a positive effect on macroeconomic development.

D. Medium-term growth perspectives

While in the initial years the impact of economic development on the overall result is viewed in terms of figures, in a medium-term context the projection focuses more on the expansion potential of the economy and hence on the average scope for growth. This is determined by the structure of the economy and on how it is changed by the persons engaged in the economic process. The way in which companies and the workforce respond to changes in domestic and foreign demand and in the general competitive environment is of particular importance. Major significance in this context attaches to the efficient shaping of underlying conditions by the state.

German government policy is thus directed towards the sustained promotion of economic growth and employment. To do this, the policy approach involves a balanced interaction of consolidation and structural reforms taking account of the social component. Given the pursuit of sound and credible fiscal policy by the Member States of the EU, it is assumed that the European Central Bank can ensure price stability and a favourable level of interest rates.

The growth rate of about 2 % in real terms assumed in the medium-term projection up to 2003 is roughly one half of a percentage point above average GDP growth in the past few years. Exceeding as it does by an amount regarded as realistic the hitherto registered trend, this figure will in turn require implementation of the reforms to promote growth and employment that are already in progress or planned.

E. Overview

Table 1 : Projection of aggregate economic development for the years 1999 to 2003

	1998	1999	2000	2003/00	2003/98
	Change on the year in per cent, rounded for the review period				
Use of GDP (at 1995 prices):					
Private consumption expenditure*)	2.3	2	2 1/2	2 ½	2 1/2
Consumption of general government	0.5	0	1/2	½	1/2
Gross fixed capital formation	1.4	3	3	2 ½	2 1/2
of which: public sector	- 3.9	8 1/2	- 1/2	1	2
Exports	7.0	2 1/2	7	4	4 1/2
Imports	8.5	3 1/2	6 1/2	4	4 1/2
Gross domestic product	2.2	1 1/2	2 1/2	2	2
Movement in prices (1995 = 100):					
Private consumption expenditure *)	0.9	1/2	1 1/2	1 ½	1 1/2
Gross domestic product	1.0	1	1	1 ½	1 1/2
Employment	0.4	0	½	¼	1/4

*) Including private non-profit institutions

1998: Provisional result of the Federal Statistical Office of September 1999.
1999 and 2000: Results of Inteministerial Working Group on Macroeconomic Projections, 26. October 1999.
2001 to 2003: Medium-term projection, updated in October 1999.

III. Trends in public budgets - the medium-term perspective

A. Trends in general government deficit

The German Stability Programme of January 1999 incorporated the following deficit trend on the basis of ESA 1979:

Table 2: Deficit as projected in the January 1999 stability programme

	1998	1999	2000	2001	2002
	(in % of GDP)				
General govt. deficit ratio	- 2 ½	- 2	- 2	- 1 ½	- 1

The figure for 1998 was still an estimate. The most recent calculation by the Federal Statistical Office of the 1998 general government deficit on the basis of ESA 1979 was in March 1999, when the deficit ratio for 1998 amounted to 2.0 % of GDP. This much more favourable figure for the reported deficit was mainly the result of a marked improvement in local authority finances. This was noted during discussion of the German stability programme at EU level in the spring of 1999.

The Federal Statistical Office presented figures on the development of public finances from 1991 to 1998 on the basis of ESA 1995 for the first time in September 1999. In these figures the deficit ratios up to 1997 are very close to those calculated in line with the former ESA, while the difference is rather more marked for 1998.

Table 3: Deficit trends up to 1998 - comparison ESA 95 with ESA 79

	1991	1992	1993	1994	1995	1996	1997	1998
	(in % of GDP)							
General govt. deficit ratio								
- ESA 95 (new method)	- 2.9	- 2.5	- 3.2	- 2.5	- 3.2	- 3.4	- 2.6	- 1.7
- ESA 79 (old method)	- 3.1	- 2.6	- 3.2	- 2.4	- 3.3	- 3.4	- 2.7	- 2.0

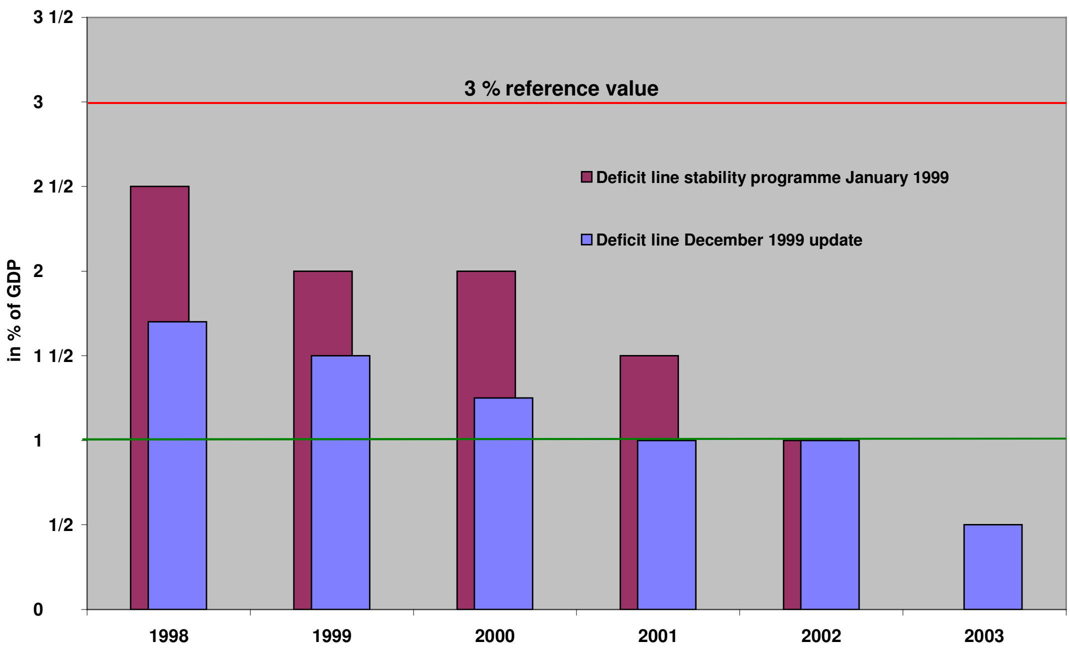
However, the difference stems less from the change in method than from the inclusion of statistical data that were not yet available for the March publication by the Federal Statistical Office. Thus the transition from ESA 1979 to ESA 1995 has resulted in only a slight change in the deficit ratio reported in Germany.

Whether or not the implementation of ESA 1995 will also produce a slight change in the expenditure and revenue ratios cannot at present be definitely stated, since there is as yet no standard European provision on how the totals of government expenditure and revenue should in future be calculated. Hence full comparability throughout Europe still remains to be established. The present update of the stability programme therefore dispenses with any more pronounced differentiation between expenditure and revenue.

The following presentation of expenditure and revenue follows the data reported by the Federal Statistical Office. Netting-out operations reducing government expenditure are effected to a lesser extent than in the presentation on the basis of ESA 79. Thus government sales are now reported under revenue rather than under negative expenditure.

The figures reported under ESA 95 show a deficit reduction from 1.7 % of GDP in 1998 to ½ % of GDP in 2003. The deficit line during this period is shaped largely by limitation of the rise in government spending, which additionally allows perceptible relief to be afforded on taxes and social charges.

Figure 1: Deficit ratio - development to the year 2003



As against the stability programme of January 1999, lower deficits are expected for the years up to 2001. This is the outcome both of the more favourable initial position in 1998 and of the federal government's future programme takes effect in 2000 and incorporates substantial savings.

The original deficit target of 1 % of GDP set in the German stability programme is expected to be attained as early as 2001. Adequate scope will thus be created below the 3 % deficit ceiling for the automatic stabilisers to take effect.

Despite the more favourable deficit assessment in the preceding years, no further deficit reduction will be effected in 2002, the final year of the stability programme of January 1999. This is the outcome of the tax relief provided for that year under the Tax Relief Act, which is both substantial and indeed crucial for the promotion of growth and employment. Relief is planned in a volume of roughly one half of a percentage point of GDP.

The deficit-reducing effect of restrictions on government spending will then come into play again in 2003 and may be expected to enable the medium-term deficit target to be undercut by about one half of a percentage point. In this way public finances will be progressively stabilised, which among others will help to establish a more secure basis on which to deal with the problems posed by the foreseeable demographic trends.

Table 4: Deficit ratio, government spending ratio, tax and social charges ratio - development to the year 2003

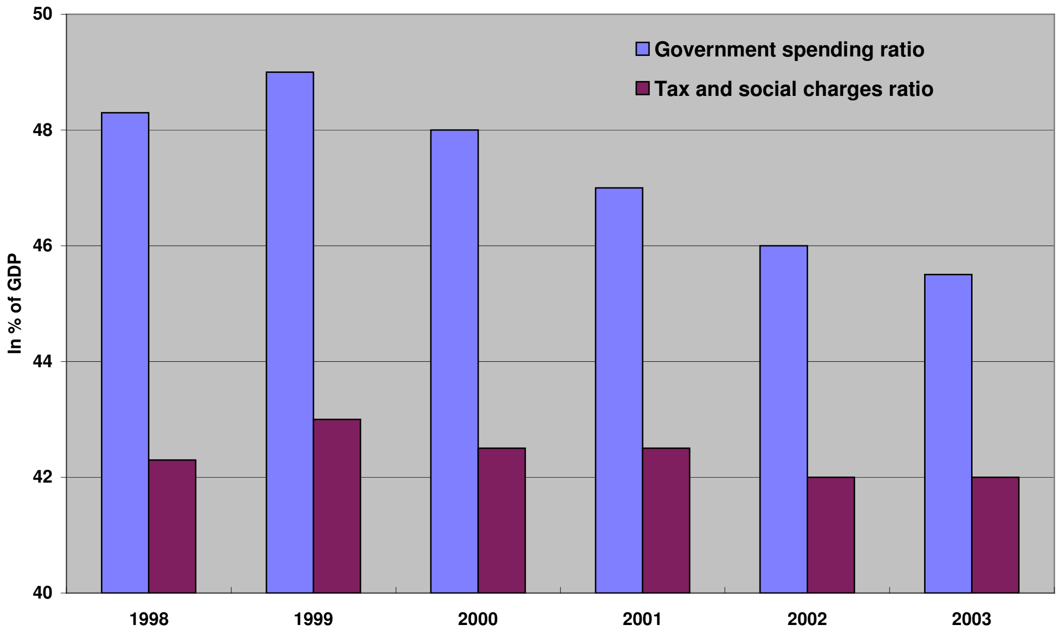
	1998	**1999**	**2000**	**2001**	**2002**	**2003**
	(in % of GDP)					
Govt. spending ratio	48.3	49	48	47	46	45 ½
Tax and social charges ratio	42.3	43	42 ½	42 ½	42	42
General govt. deficit ratio	- 1.7	- 1 ½	- 1 ¼	- 1	- 1	- ½

The consolidation of public budgets is based as before on restricting the rise in government spending. The rate of increase of government spending will remain well below the yearly average growth (3 ½ %) of nominal GDP.

The government spending ratio (which is not quite equivalent to that as defined in ESA 79) will rise in 1999 temporarily to 49 % of GDP, inter alia as a consequence of the increase in child benefits. It will however be progressively reduced in the years up to 2003 by a total of 3 ½ percentage points of GDP to 45 ½ %. In this process the share of public-sector investment in the gross domestic product will not decline but will be held steady at just under 2 %. Interest expenditure during this period will stand at roughly 3 ½ % of GDP.

The decline in the government spending ratio will enable both the deficit ratio and the tax and social charges ratio to be reduced. On account of the structural shift between taxes and social charges resulting from the reduction in non-wage labour costs which has been set in train and will continue to operate, the combined tax and social charges ratio gives in a longer-term review a truer picture of the load imposed by the state on the citizen than if the tax ratio and the social charges ratio are looked at separately. While the tax and social charges ratio will increase in 1999, it will subsequently be brought down from 43 % in 1999 to 42 % in 2003. There will be a marked decline in 2002, the year in which the principal measures under the Tax Relief Act take effect.

Figure 2: Government spending ratio, tax and social charges ratio - development to the year 2003



The reduction of the general government deficit will be borne by the budgets of the Federation, the Länder and the local authorities. A substantial contribution towards reducing government deficits will be made by the federal government's future programme adopted in the summer of this year.

The social insurance funds registered in 1998 a surplus of DM 7.8 bn, or roughly 0.2 % of GDP. This surplus is expected to rise appreciably in 1999, as the claims equalisation reserve corresponding to one month's disbursement under the statutory pensions insurance will have to be replenished. The surplus will decline again as from the year 2000.

Table 5: Deficit by levels of government
(Maastricht definition)

	1998	1999	2000	2001	2002	2003
	- DM bn -					
Federation incl. special funds	- 67.1	- 70 to - 75	- 55 to - 60	- 45 to - 50	- 40 to - 45	- 30 to - 35
Länder and local authorities	- 5.2	0 to - 5	0 to - 5	0 to + 5	0 to + 5	+ 5 to + 10
Social insurance	+ 7.8	appr. + 15	appr. + 10	appr. + 5	appr. + 5	appr. + 5
General government	- 64.5	- 55 to - 65	- 45 to - 55	- 35 to - 45	- 30 to - 40	- 15 to - 25
General govt. deficit in % of GDP	- 1.7	- 1 ½	- 1 ¼	- 1	- 1	- ½

B. Trends in government debt

The debt ratio amounted in 1998 to 60.7 % of GDP. In the current year the debt ratio at 61 % of GDP is still roughly at the pre-year level, despite the declining deficit ratio. This is essentially a reflection of the moderate increase of 2 ½ % in nominal GDP in this year.

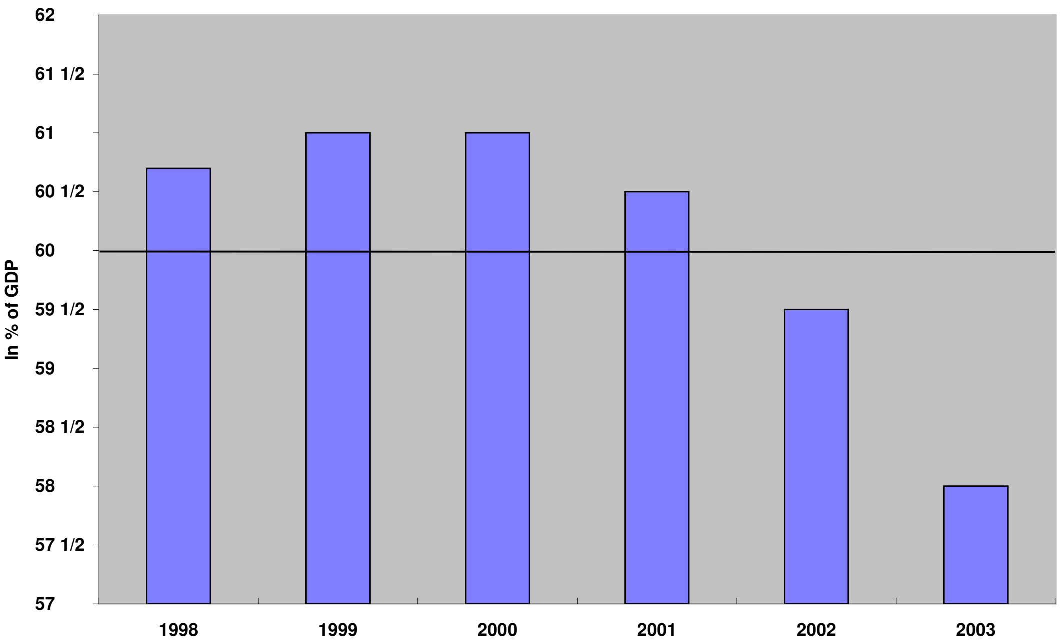
From the year 2000 onwards the debt ratio will decline to 58 % in the year 2003. The 60 % ceiling will be undercut for the first time in 2002 at 59 ½ % of GDP. This is in line with the target set in the stability programme of January 1999.

Table 6: Debt ratio - development to the year 2003

	1998	1999	2000	2001	2002	2003
	(in % of GDP)					
Debt ratio	60.7	61	61	60 ½	59 ½	58

It is assumed in calculating the debt ratio that the privatisation proceeds of central, regional and local government, which do indeed reduce government debt while not affecting the level of general government deficit, will amount to 1 % of GDP in 1999, as in 1998, but will thereafter register a marked decline.

Figure 3: Debt ratio - development to the year 2003



C. Effects on general government deficit and government debt of a change in the macroeconomic benchmark data

The general government deficit and government debt would be affected as follows by a change in the macroeconomic benchmark data.

- If average annual growth in the years from 2001 to 2003 were to be one quarter of a percentage point higher than assumed in the projection, this would

- generate additional revenue from taxes and social security contributions and would reduce the government's labour market spending.
- On a purely computational basis, this would reduce the deficit by 0.25 % of GDP in the year 2003.
- Adjusted to take account of the higher denominator, government debt would be reduced by a good 0.5 % of GDP in 2003. Relating the new debt figure to the increased GDP would improve the debt ratio by about 1 %.
- If average annual growth in the years from 2001 to 2003 were to be one quarter of a percentage point lower than assumed in the projection, this would (on a purely computational basis) lead to a corresponding deterioration in public finances.

Calculations such as these must of course always be treated with caution. This is especially true in view of the fact that at the moment in Germany a stable correlation between growth trends and tax revenue cannot be identified.

D. Effects of interest rate movements

Given the complex structure of government debt, the effects on public budgets of a change of 1 percentage point in market rates cannot be precisely quantified. But an indication of the substantial significance of interest rate movements may be gauged from the level of government debt, estimated at 58 ½ % of GDP for 2003. A change of one percentage point in the average rate of interest charged on government debt in the year 2003 would, on a purely computational basis, impose burdens on or afford relief to public budgets in the order of 0.5 % of GDP.

IV. Measures to limit government spending and promote growth and employment

A. Future oriented fiscal programme to secure employment, growth and social stability

The policy approach of the federal government is geared to promoting growth and employment. As before, the government's primary goal is to bring down unemployment.

To attain this goal it is essential for public finances to be put on a sound footing. Only by maintaining strict expenditure discipline and low public-sector deficits the government's interest payment obligations can be limited thus creating fiscal, scope and establishing the necessary conditions for

- undertaking future-oriented tasks, such as research, development and education;
- cutting taxes and social charges to promote growth and employment;
- the use of automatic stabilisers;
- dealing with the problems posed by the foreseeable demographic trends.

Moreover, low levels of public-sector deficits and a credible fiscal policy course in the EU Member States are needed to ensure conflict-free interaction with monetary and wage policies. They are an essential aid to ensure permanently low price and interest rate levels.

Against this background the government has set itself the target of achieving a balanced budget at the latest by the year 2006. With this target in mind, a future oriented fiscal programme to secure employment, growth and social stability was adopted in the summer of 1999 and tabled for discussion in parliament. The programme combines extensive savings with fundamental structural reforms and measures to set the policy course for the future, thus taking account of the various demands made on a policy approach designed to promote growth and employment.

The central elements of the future programme are

- the savings package 2000 to 2003, setting a course for the structural and sustained consolidation of the federal budget;
- the reorganisation of the family benefits system which, in conjunction with the income tax cuts already agreed, will afford appreciable relief to families and thus help to strengthen private demand;
- further stages of the ecological tax reform, which by imposing higher taxes on energy consumption is intended to encourage the careful use of resources and to help reduce and stabilise contributions to the statutory pensions insurance.

These measures will be combined with a reform of buisiness taxation to enhance the competitive ability of firms investing in Germany.

B. Savings package 2000 to 2003: Structural consolidation of the federal budget

The savings package will progressively reduce net borrowing in the federal budget over the coming years. As set out in the government draft of June/July 1999, net borrowing (in the financial statistics definition) will decline from DM 53.5 bn in 1999 to about DM 30 bn in 2003.

However, the volume of the savings package goes beyond that of the deficit reduction. Were it not for the measures incorporated in the savings package, the net borrowing over the next four years on total would have been more than DM 150 bn higher than envisaged now. In the year 2000 it would already have been in the order of DM 80 bn, hence about DM 30 bn higher.

Table 7: Financial impact of the savings package (DM bn)

	2000	2001	2002	2003
Central govt. relief	30 ½	39	43	50

Central government expenditure will decline by 1 ½ % in 2000 as against 1999. On the basis of this reduced expenditure volume, spending growth in the succeeding years will be held on average to less than 2 % a year. The federal government will thus be in line with the resolutions of the Financial Planning Council.

A large number of individual measures will contribute to the consolidation of the federal budget. In the center of these are measures to stabilise the welfare state, to reduce subsidies and to slim down the administration.

- The following measures in particular are central to the stabilisation of the welfare state:

  - To adapt the pensions system to cope with the demographic pressures of the coming decades, pension increases in 2000 and 2001 will be geared to maintaining real incomes, i.e. pensions will be raised in accordance with the inflation rate of the preceding calendar year. From 2002 onwards, pensions will in principle increase as before in line with the development of employment incomes. The details will be settled within the framework of a longer-term pension reform to be adopted in the coming year. By accepting this temporary ceiling on pension rises, pensioners will be helping to bring down government debt and relieve the pressure on future generations. In the same way as pensions, increases in other welfare payments such as unemployment benefits and unemployment assistance will also be geared to the rate of inflation in 2000 and 2001. The relief afforded by these measures to the federal government will amount to some DM 3 bn in 2000 and will increase to more than DM 6 bn during the period covered by the financial plan.

  - Unemployment assistance payments will be restricted to persons who have previously drawn unemployment benefits. Social security contributions paid on behalf of persons drawing unemployment assistance will in future be linked to the amount of assistance actually paid out. At present the basis of assessment is 80 % of the gross earnings such persons had before becoming unemployed. This measure will afford the federal government relief of some DM 5 ½ bn a year.

- The reduction of subsidies in the field of financial assistance includes in particular the following measures:

  - Gas oil grants paid to farmers will be reduced.
  - There will be progressive cuts in subsidies paid under the spirits monopoly arrangements. The remaining assistance is to be concentrated more closely on smaller distilleries, especially those operating in conjunction with family agricultural smallholdings.
  - The payments made under the joint activity for improvement of the agricultural structure and of coastline protection and the federal grant to agricultural accident insurance will be reduced.
  - Government subsides to low-rent housing will be reduced in line with requirements.

- Additionally, cuts will be made in tax subsidies, among them the following:

  - The tax exemption of interest earned on capital-forming life assurance policies and annuity insurance policies with capital payment options will be extensively restricted, though this will apply only to new contracts.
  - The term for interest receivable on tax refunds and payable on subsequent tax demands will no longer be limited to four years. This will generate extra revenue of DM 0.5 bn (accrual method).

- Streamlining the government sector and slimming down the public service will also afford relief both to the federal budget and to the budgets of the Länder and local authorities.

  - As a contribution by public service officials to consolidation, pay increases in the next two years will be geared to securing real income in line with the arrangements for pensioners and other recipients of welfare payments. This will also apply to the remuneration paid to retired public service officials.
  - Limiting income growth in the public service will generate savings running into billions in the personnel costs of central, regional and local government. The Länder and the local authorities will benefit in particular from this measure, as their personnel costs account for a larger share of aggregate

expenditure. This is one measure to ensure that the total package will not result in a shift of burden to regional and local levels of government.

- The number of posts in the federal administration will be further reduced over the coming four years. Accordingly, the linear reduction of posts by 1.5 % a year will be continued. The government departments will as before be accorded the high degree of flexibility they require to achieve their personnel savings.
- The guiding principle of the enabling state aims at setting up an administration that is geared to efficiency and closeness to the citizen and free from superfluous bureaucracy. The modernisation of the federal administration will be consistently pursued in accordance with this concept. This includes closing down or streamlining authorities and agencies, restructuring on the basis of organisation and personnel requirement studies and developing and introducing new management and steering instruments (such as cost and results accounting or controlling). Decisive significance attaches to the reduction of state activity to the essential governmental tasks and the encouragement of private initiative and personal provision.
- The aim of the federal government is an administration geared to the principle of economic efficiency. The federal budget establishes the financial basis on which this can be achieved.

Should any measures in the savings package that require the consent of the Bundesrat fail to achieve a majority vote in that body, the federal government will take steps to ensure that the intended consolidation effect of such measures is in fact achieved. If consolidation in the required amount cannot be achieved in the course of legislation, the federal government will adopt other suitable measures in good time.

C. Reducing the income tax burden and reorganising the family benefits system

The policy of the federal government is directed equally to consolidating public finances and to providing tax relief to promote growth and employment. In the period from 1999 to 2002, the Tax Relief Act 1999/2000/2002 is designed to provide total net relief of some DM 20 bn (about ½ % of GDP).

- As early as 1999, relief was afforded in particular to people on low incomes and to families by bringing down the basic rate of tax from 25.9 % to 23.9 %, by stepping up the basic personal allowance from DM 12,365 to DM 13,067 and by increasing child benefits from DM 220 to DM 250.

- Further perceptible improvements in the tax situation of dependent employees, families and small businesses will follow in 2000 and 2002 when two further stages of the Tax Relief Act 1999/2000/2002 come into effect. The basic tax rate will be gradually reduced to 19.9 % while the top rate will be cut to 48.5 %.

- The changes in the family benefits system as required by the Federal Constitutional Court will be implemented in two stages in 2000 and 2002:

  - A standard child-care allowance of DM 3,024 for children up to the age of 16 (offset with child benefits received) will be introduced in addition to the tax-free child allowance in the first stage in 2000. Child-care expenses will cease to be tax-deductible. These measures will result in a total tax revenue shortfall of about DM 1.7 (accrual method). The federal government will bear DM 1 bn of this.
  - Additionally, child benefits for the first and second child will be increased by DM 20 to DM 270 a month as from 1 January 2000. The increase in child benefits will result in a total tax revenue shortfall of about DM 3.8 bn (accrual method). The federal government will bear DM 1.6 bn of this.
  - The federal government will decide in 2001 on the changes to be made in the family benefits system as from 2002, taking account of the family and fiscal policy requirements obtaining at that time. This will include in particular implementing the findings of the Federal Constitutional Court on the allowance to be made for the parental care requirements of children.

D. Ecological tax reform and reduction of non-wage labour costs

The first stage of the ecological tax reform took effect on 1 April 1999. Mineral oil excise duty on motor fuels was increased by DM 0.06 per litre and on light heating oil by DM 0.04 per litre. The duty on natural gas was increased by DM 0.0032 per kilowatt-hour and an electricity tax of DM 0.02 per kilowatt-hour was introduced. To avoid endangering jobs, special arrangements were made for the manufacturing industry and for agriculture and forestry.

In tandem with the increase in energy prices, the contribution rate to statutory pensions insurance was reduced as from 1 April 1999 from 20.3 % to 19.5 %. In this way, market-based incentives are created to encourage more economical use of resources that is of benefit to the economy as a whole. At the same time, the conditions for employment are improved by making labour less expensive - a factor input that has hitherto borne a disproportionately heavy burden of taxes and non-wage labour costs.

The ecological tax reform serves in addition to speed up structural change in the German economy. More effective use will be made of the potential for innovation in conserving energy and ecologically benign technologies will be aided in achieving a breakthrough. This will further reinforce Germany's position as a world leader in environmental protection products, enabling German businesses to penetrate new markets. This is a further contribution to the modernisation of the German economy.

Retaining the special arrangements for industry, the ecological tax reform is to be continued in further stages in the period from 2000 to 2003. The rates of duty on motor fuels will be increased each year by DM 0.06 per litre, while the electricity tax will be raised each year by DM 0.005 per kilowatt-hour. The additional revenue thus generated is to be used to further reduce and to stabilise the contribution rate to statutory pensions insurance.

E. Reform of business taxation

The momentum for growth and employment is largely imparted by the investment decisions taken by private corporations. The framework imposed by the tax system is an essential factor in shaping these investment decisions. The federal government will create an attractive and internationally competitive tax environment for corporations investing in Germany with a fundamental reform of business taxation to take effect on 1 January 2001.

From 2001 onwards, a uniform tax rate of only 25 % will apply at corporate level. The system of full imputation of corporation tax, which is complicated and not suitable for application throughout Europe, will be discontinued. To make allowance for the tax imposed at corporate level, only half of the dividends distributed by the corporation will be included in the shareholder's personal income tax base. Similarly favourable tax conditions will be created for unincorporated enterprises.

In accordance with the benchmark data adopted by the cabinet in June 1999, the reform of business taxation will afford corporations net relief of some DM 8 bn in the first year of application. The federal government has made a general provision as from 2001 in the new financial plan for the share of this relief which it will have to bear.

V. Making provision for adverse demographic trends: Reforms in the field of social insurance

A. Structural reform of the pensions system

The strong upward trend in the cost of the statutory pensions insurance has been checked by a special arrangement for 2000 and 2001. To put the system of statutory pensions insurance on a permanently sound footing, especially in view of the upcoming demographic challenges, the federal government intends to put a structural reform of the pensions system into effect in the coming year.

The following benchmark data have been established for the structural reform of the pensions system:

- Basic protection against poverty in old age and in the case of permanent disability.
- Revenue from the next stages of the ecological tax reform to be used to reduce and stabilise pension contribution rates.
- A supplementary, fully-funded old-age provision to be set up.
- Pensions for occupational and general disability to be reorganised within the pensions system.
- Independent old-age provision for women to be improved and to include scope for individual options.

These tentative elements of the reform still require thorough coordination within the federal government.

Once the necessary reforms have been put in place, the statutory pensions insurance will in principle be capable of coping with the impending challenges posed by demographic change, i.e. the negative shift in the ratio of contributors to pensioners. But how intensive the changes to be made in the statutory pensions system will have to be in order to respond to this demographic shift will be determined largely by the state of the economy as a whole, and in particular by the number of jobs that will be available in future. It is for this very reason that the federal government gives high priority to measures promoting growth and employment.

B. Health-care reform

The federal government will also conduct a comprehensive reform of the system of statutory health insurance to make sure that it is able it to meet current and future requirements. A law to reform statutory health insurance as from the year 2000 has been drafted and submitted to parliament. The objective of the reform is to maintain the current standards of excellence in the provision of health care while ensuring that contribution rates to the statutory health insurance are stabilised on a lasting basis.

The reform incorporates the following principal elements:

- Reorganisation of hospital funding;
- closer coordination of in-patient and out-patient treatment;
- placing greater emphasis on the provision of treatment by general practitioners;
- safeguarding the quality of medical treatment, among others through independent, professional assessment of medical technologies;
- stabilising contribution rates and facilitating cross-sectoral provison with the aid of a global budget;
- improving the quality and efficiency of pharmaceuticals supply by introducing a "positive list";
- placing greater emphasis on rehabilitation;
- extending patient rights and patient protection;
- reducing overprovision in outpatient care;
- ensuring that persons drawing small pensions get a fairer deal for their contributions.

The law was passed by the Bundestag, the lower house of German parliament, on 4 November 1999, but still requires the consent of the upper house (the Bundesrat).

VI. Other structural reforms to promote growth and employment

The federal government intends to implement numerous other structural reforms to promote growth and employment going which go beyond the measures described here. These reforms are set out in detail in the national report on structural reforms submitted by the federal government at the end of November 1999 within the framework of the Cardiff process. Hence only a few examples of such measwes are presented here:

- With the aim of further speeding up the implementation in national law of EU Directives relating to the single market, Germany has set up an intensive monitoring procedure in early 1998. Within this procedure the legislative branch (Bundestag) and the executive branch (federal government) cooperate closely and lend political weight to ensure that the necessary progress is made.

Between May 1998 and May 1999, this procedure has already achieved a dramatic reduction in the implementation deficit from 5.4 % to 2.4 %.

- Deutsche Post AG is at the centre of the federal government's privatisation agenda. In addition, the government plans to further reduce its holdings in Deutsche Telekom AG and in the course of the second stage of the 1999 rail reform to lay the foundations for Deutsche Bahn AG to go public.

- The opening of the telecommunications market has been finalised since 1 January 1998. On the basis of studies by the regulatory authority for telecommunications and posts and the monopolies commission, the federal government will consider whether and to what extent the regulatory framework needs to be further developed.

- A central point of emphasis in the federal government's policy approach remains the promotion of small and medium-sized enterprises, among others by encouraging reasearch and development activity, assisting business start-ups, modernising training and strengthening the venture capital markets.

- The principal aims of the Fourth Financial Market Promotion Act, which is currently in preparation and is to be submitted in the course of the year 2000, are to modernise the law relating to forward exchange transactions, to effect further improvements in securities and stock exchange supervision and to streamline the rules on business takeovers.

VII. Summary and outlook

Germany's economic and fiscal policy is in line with the requirements of the Stability and Growth Pact.

- The federal government has already set the course for well-founded growth, the creation of jobs and a credible, stability-oriented fiscal policy in the coming years in the future oriented fiscal programme to secure employment, growth and social stability.

- The savings incorporated in the future oriented fiscal programme will guarantee lasting structural consolidation of the federal budget in the coming years with a positive impact on the trend in the general government deficit.

- Extensive tax relief for families, dependent employees and enterprises and the consistent implementation of structural measures to make the markets more flexible will perceptibly improve the conditions for promoting growth and employment.

- Assistance targeted specifically to small and medium-sized enterprises will mobilise the significant job-creation potential available especially in this sector.

- Structural reform, particularly in the field of statutory pensions insurance, will help to make the social security systems ready to take up the challenges of the future.

- The deficit targets set out in the first German stability programme of January 1999 will be met without deductions. The medium-term deficit target of 1 % of GDP is now expected to be met in 2001 (one year earlier than originally planned) and undercut in 2003. This will create more favourable conditions for addressing future tasks, for the operation of the automatic stabilisers and for coping with burdens imposed by the expected demographic trends.

- As already outlined in the stability programme of January 1999, government debt will again be brought down as from 2002 to below the reference figure of 60 % of GDP.

- The federal government is convinced that the German Stability Programme attains the objectives set out in the Stability and Growth Pact and that it will serve to support a common European monetary policy.