

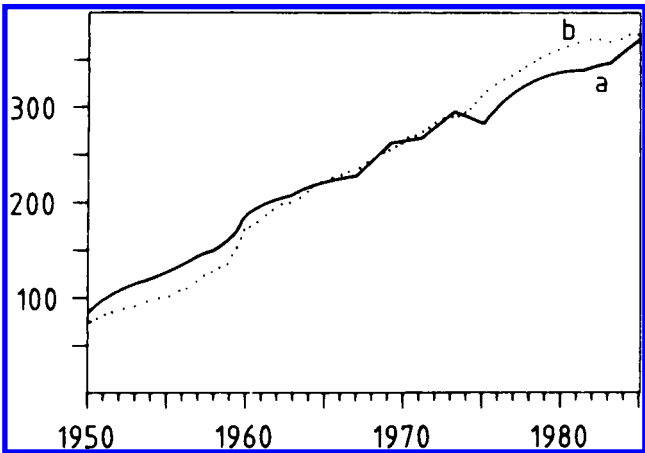
Chapter Eleven

PUBLIC FINANCE

Government revenue and expenditure

During the last hundred years the state's share in GNP has risen rapidly. Whereas it accounted for only 11 per cent in 1881 it rose

Figure 11.1: Government receipts and expenditure 1950–1985^c



Notes: ^arevenue; ^bexpenditure;
^c1970 prices, until 1959 excluding Saarland or West-Berlin

Source: Statistisches Bundesamt

to more than 15 per cent in 1913, more than 25 per cent in 1928, 31 per cent in 1960, 37 per cent in 1969 and roughly 49 per cent in 1982.¹

According to the basic law (*Grundgesetz*) the distribution of tax receipts is regulated between the three governmental units (Federal government, states and local authorities) in a way that the Federal government receives, among others, the consumption tax (without the beer tax), customs duties, state monopolies like the duty on matches (until 1983) and the turnover tax. The *Laender* receive the tax on property, the automobile tax and the beer tax, whereas the receipts of the occupation tax and the land tax go to the municipalities. The income and corporate taxes are distributed between the Federal government and the *Laender*. With the financial reform of 1969 the pay-as-you-earn income tax and the turnover tax were added to this as "communal taxes" (*Gemeinschaftssteuern*).

In demanding similar living conditions (*Einheitlichkeit der Lebensverhaeltnisse*) in the *Laender* the basic law also stipulated provisions for tax sharing between the Federal German states (*Laenderfinanzausgleich*) with the consequence that the wealthier states had to transfer part of their revenue to the less affluent. There has also been tax sharing between the Federal government and the *Laender* and between the municipalities.²

The period before the tax reform of January 1955 was characterised by high taxation demanded by the Allied Control Council, although there was a great number of tax concessions for special groups of people (like refugees) and by efforts to stimulate investment. Favouring investment and savings this policy did not, however, accord with an equal distribution of the tax burden.

The tax reform of January 1955 abolished or curtailed part of these benefits. Although income tax rates have been lowered repeatedly since 1955 mainly to make up for fiscal drag, other taxes have been raised or newly introduced, like the motor traffic tax or the mineral oil tax, which, apart from their function of providing revenue, had the purpose of improving the competitive position of the Federal Railways.³

Until the present day the turnover tax or VAT (from 1968) and the Federal share of the income and corporate taxes have been the main pillars of taxation. Compared with these, the other taxes have declined in significance, like the tobacco tax or other consumption taxes (coffee, tea) or the customs duties which, in their significance for the Federal budget, have declined mainly because of the FRG's membership in the Common Market.⁴

While the share of the Federal government's current revenue in GNP rose considerably in the 1960s and early 1970s it has, since then, risen more slowly and roughly stabilised in recent years. Although VAT rates have been raised repeatedly (from 10 per

Table 11.1: Federal government revenue 1950–1985^a

	<i>Total</i>	<i>Taxes</i>			<i>Customs</i>	
		<i>Turnover</i>	<i>Direct</i> ^b	<i>Min. oil</i>	<i>Tobacco</i>	
1950	12.4	4.9 (39.5%)	--- ---	0.1 (0.8%)	2.1 (16.9%)	0.7 (5.6%)
1955	26.1	11.1 (42.5%)	4.1 (15.7%)	1.1 (4.2%)	2.6 (10.0%)	1.8 (6.9%)
1961	44.7	17.9 (40.0%)	10.4 (23.3%)	3.3 (7.4%)	3.9 (8.7%)	3.1 (6.9%)
1965	59.0	24.3 (41.2%)	16.0 (27.1%)	7.4 (12.5%)	4.7 (8.0%)	2.9 (4.9%)
1970	87.3	26.8 (30.7%)	27.3 (31.3%)	11.5 (13.2%)	6.5 (7.4%)	2.8 (3.2%)
1975	123.0	34.2 (27.8%)	48.8 (39.7%)	17.1 (13.9%)	8.9 (7.2%)	0.08 ^c (0.1%)
1980	189.5	56.9 (30.0%)	75.8 (40.0%)	21.4 (11.3%)	11.3 (6.0%)	0.08 ^c (0.04%)
1985	235.9	62.1 (26.3%)	93.9 (39.8%)	24.5 (10.4%)	14.5 (6.2%)	0.06 ^c (0.03%)

Notes: ^ain DM thousand million

^bFederal government's share of income and corporate taxes

^cexcluding share of Common Market (EEC)

Source: Statistisches Bundesamt, *Statistische Jahrbuecher*.

cent in 1968 to 14 per cent in 1983) the relative contribution of in direct taxes to revenue has diminished. Social security contributions have risen fastest—between 1970 and 1981 the share of social security contributions to GNP rose from 11 per cent to 14 per cent, because of demographic developments, more generous benefits and weaker economic growth after the first oil shock. Although the share of total direct taxes changed little their structure changed significantly. Wage receipts increased much faster than other direct taxes, mainly because of the rising share of wage incomes in total income, the progressive income tax schedule and the growing number of taxpayers in the steepest part of the schedule.⁵

Tax evasion and the shadow economy have created particular problems. By international standards the difference between take-home pay and labour costs for the employers is large and the high tax burden has contributed to shadow economy activities. Although the extent of those activities is difficult to assess their share in GNP was probably only 1 to 2 per cent in the early 1960s but might have reached more than 10 per cent in the early 1980s.⁶

According to the Federal German basic law the Federal government, the *Laender* and the local authorities have different tasks to fulfil. In the early 1980s the main areas of Federal government expenditure were social security and defense. The *Laender* spent most on education and the municipalities on the health service. From the 1950s onwards there has been a tendency for the Federal government to intervene in the financial affairs of the *Laender*, assisting in costly higher educational reform programmes, the improvement of the regional economic structure and the agricultural sector.⁷

After the initial high outlays on the Federal armed forces the share of defense expenditure fell significantly. Since 1953 expenditures on social security (excluding outlays of social security agencies) and housing have been falling relative to other outlays, because government expenditure on these items in the years immediately after the Second World War had been particularly high.⁸ While the share of outlays on public security has risen only slowly that on research and education (especially higher education) more than doubled in the period 1950 to 1985 owing to an educational policy which aimed at substantially increasing undergraduate figures. Between 1965 and 1975 student numbers in higher education grew by about 10 per cent per annum. Owing to demographic pressures—the structure of the Federal

German population has been steadily ageing—and costly health policy outlays have risen.

Table 11.2: Expenditure of the Federal government, the regional and the local authorities by functions, 1950–1985^a

	1950	1956	1961	1965	1970	1975	1980	1985
total	28.1	59.9	95.3	140.6	196.3	344.4	486.8	574.9
defense	4.7	7.3	13.2	18.9	19.8	33.6	41.8	51.7
(%)	16.7	12.2	13.4	13.4	10.1	9.8	8.6	9.0
law and order	1.1	2.5	3.7	5.3	7.9	17.9	25.4	30.4
(%)	3.9	4.2	3.9	3.8	4.0	5.2	5.2	5.3
research, education, higher education	2.1	5.2	9.6	15.9	27.6	61.5	85.1	94.9
(%)	7.5	8.7	10.0	11.3	14.1	17.9	17.5	16.5
social security	7.6	15.6	22.2	31.3	40.4	81.4	100.1	116.1
(%)	27.1	26.0	23.3	22.3	20.6	23.6	20.6	20.2
health service and recreation	1.0	2.2	3.8	6.3	10.2	16.1	15.1	26.9
(%)	3.6	3.8	4.0	4.5	5.2	4.7	3.1	4.7
housing, regional planning	3.5	5.8	7.6	10.3	10.7	12.0	21.5	20.0
(%)	12.5	9.7	8.0	7.3	5.5	3.5	4.4	3.5
state assistance to the economy	1.9	4.3	6.3	10.2	14.4	16.1	13.0	17.9
(%)	6.8	7.2	6.6	7.3	7.3	4.7	2.8	3.1
transport and communication	1.3	3.7	6.9	11.3	17.6	32.9	40.5	37.5
(%)	4.6	6.2	7.2	8.0	9.0	9.6	8.3	6.5
others	4.9	13.3	22.0	30.3	48.1	72.9	144.3	179.5
(%)	17.4	22.2	23.1	21.5	24.5	21.2	30.0	31.2

Note: ^ain DM thousand million, until 1959 without Saarland

Source: Statistisches Bundesamt and own computations

In 1980 payments and transfers for social security comprised 17 per cent of total household incomes and one-third of total Federal government outlays. Social security expenditure has been influenced by a changing population, by accelerating inflation

during the 1970s and especially by the strong secular growth of real benefits provided to individuals.⁹

During the 1970s the share of investment outlays in total government expenditure fell. Government consumption rose more than 25 times in the period 1950 to 1985 and the number of people employed in the public sector grew by about 250 per cent.¹⁰

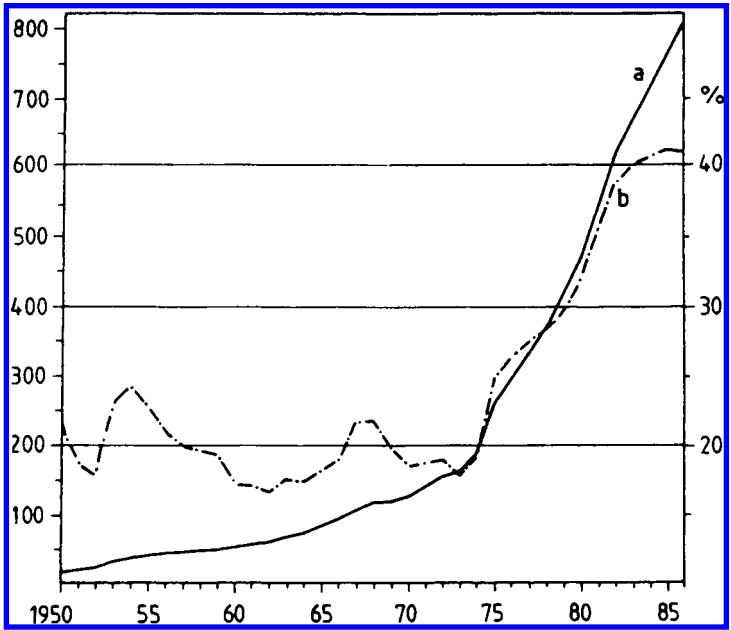
In connection with high public spending and a rapidly increasing public debt during the 1970s outlays for debt service grew rapidly. Whereas until 1966 the share of interest payments in public expenditure amounted to less than 3 per cent and was still below 4 per cent in 1974 it rose to 8 per cent in 1982. Between 1970 and 1983 payments for debt service rose almost eightfold from DM 6.55 thousand million to DM 50.69 thousand million.¹¹ Government subsidies were another matter of concern which, in spite of the declared intentions of government members to cut them drastically, rose from DM 490 million in 1950 to DM 11,780 million in 1970 and DM 36,920 million in 1985.

Public debt

From 1950 to 1985 the debts of the Federal government and the regional and local authorities rose from DM 20,634 million to DM 760,192 million. Whereas the share of the public debt in GNP was below 20 per cent during the first half of the 1970s it rose to over 31 per cent in 1980 and over 41 per cent in 1985.

Until the 1960s the major part of the public debt did not arise from government borrowing, but consisted of "old debts" taken over from the "Third Reich" and from foreign debts which were added after the agreement on repaying German pre-war debts at the London conference of 27 February 1953.¹² During the 1950s and the first half of the 1960s the government did not contract any significant debts. Owing to the first recession of the post-war period (1967), which the Federal government tried to overcome by two investment programmes, the public debt rose significantly, but by 1969 the government's net borrowing was again reduced substantially. The deep recession of 1974/5 and anticyclical fiscal measures caused another steep rise of the public debt: from 1974 to 1975 public borrowing rose two and a half times. During the period 1975–7 the Federal, regional and local authorities incurred more internal debts than they had done during the whole preceding 25 years.

Figure 11.2: Public debt 1950–1985



Notes: ^aamount (left scale); ^bshare of GNP (right scale)
^ccurrent prices in DM thousand million, before 1959 excluding Saarland

Source: Deutsche Bundesbank, *Monatsberichte*.

Although the government's anticyclical policy during the recession was in line with Keynesian fiscal policy prescriptions, its behaviour during the time after the crisis was not: in the period from 1977 to 1982 continuously high deficits were incurred in good and bad years alike. The government, partly under foreign pressure to act as an "engine of growth", did not even avail itself of the favourable economic conditions of the late 1970s to slow down new borrowing. Mainly as a consequence of the second oil shock and higher unemployment public expenditure in 1980 rose by 8 per cent.¹³

Throughout the 1970s the Federal government's share of the public debt increased from a little more than one-third to about one-half, while the local authorities' share declined from one-third to one-fifth. From 1983 to 1985 considerable progress was made in the consolidation of the public debt by pursuing a policy

Table 11.3: New public debt and interest rates 1974–1985

Year	New public debt in DM thousand million	in per cent of GNP	Capital market interest rates in per cent	Real interest rates in per cent
1974	27.3	2.8	10.6	3.5
1975	63.8	6.2	8.7	2.7
1976	48.0	4.3	8.0	4.3
1977	31.2	2.6	6.4	2.6
1978	39.6	3.1	6.1	1.9
1979	46.6	3.3	7.6	3.6
1980	57.1	3.8	8.6	3.8
1981	75.7	4.9	10.6	6.6
1982	69.9	4.4	9.1	4.7
1983	55.0	3.3	8.0	4.8
1984	46.2	2.6	7.8	5.8
1985	36.5	2.3	6.9	4.7

Sources: Rudolf Hickel and Jan Prieue, "Die Finanzpolitik seit 1974 auf dem Pruefstand. Argumente fuer ein umweltorientiertes Langzeit-Beschaefigungsprogramm", *Aus Politik und Zeitgeschichte*, vol. 36 (1986), p. 8; *Monatsberichte der Deutschen Bundesbank*.

of retrenchment which had already been started in the midst of the 1981/2 recession, before the CDU-FDP government took office.¹⁴

There has been a growing debate on aspects of the "crowding out problem", namely on the issue as to what extent the large credit demand of the public sector increased interest rates and thereby prevented businessmen from investing in industry.¹⁵ The dramatically increased public debt of 1975 could not have had this effect, because in that year interest rates fell and continued to fall until 1978. In 1979 the picture changed, however: from 1979 to

1981 a growing public debt coincided with a worldwide trend of rising interest rates. It is therefore possible—but cannot be proved—that during those three years business demand for credit was crowded out. On the other hand, it can be shown that both in 1973/4 and 1980/1 rising interest rates preceded a fall in business investment *and* growing public deficits. If there was a crowding out, then it was probably a crowding out caused by monetary rather than fiscal policy. In view of unfavourable business expectations and high interest rates businessmen preferred monetary wealth formation to the formation of tangibles.¹⁶

Financial and social policy

In the early years of the Federal Republic of Germany financial policy provided important incentives for investment without which the “economic miracle” would hardly have been possible.¹⁷ In view of the high taxes of the early 1950s industry had practically no other choice but to invest as much as possible in order to avoid surrendering most of their profits to the inland revenue. The policy objective of high growth and high employment was achieved by changing the allocation of resources, curbing consumption and strengthening investment. The promotion of housing construction was another objective high on the agenda of fiscal policy.¹⁸

In that period social policy was mainly assigned the task of assisting war victims, widows, orphans, bombed-out persons, expellees and refugees (“Federal Provisions Act” of 1950).¹⁹ The “equalisation of burdens act” of 1952 compensated institutions and persons who had lost their property during the war or their savings by the default of the NS government’s debts.²⁰ In addition, the Federal government provided assistance for housing construction by subsidising mortgages and granting tax concessions (housing construction act of 1951) and by providing subsidies for building society savings. During the 1950s more than 5 million housing units were completed, 63 per cent of them with public money.

Already in 1953 the Federal government declared its objective to extend the social security system. During the 1950s only a small part of this “social reform” was put into effect, such as the payment of family allowances (*Kindergeldgesetz* of 1954) and the agricultural acts of 1955 which aimed at improving the position of farmers by raising their incomes to those in industry. The index-linked “dynamic pension” of 1957 provided for a periodic adjustment of old-age and

invalidity pensions in line with the development of employees' incomes.²¹ In 1959 and 1961 attempts at a wider distribution of wealth were started.

After impressive growth rates had been achieved in the 1950s the stabilisation of this process played a major role in the financial policy of the 1960s, especially during the recession of 1966/7. Stabilisation policy did not start then, however, because even in the 1950s the Federal government and the *Laender* had occasionally used the policy tool of an anticyclical fiscal policy in the construction sector.²² In the late 1960s Schiller's *Globalsteuerung* ran into problems, partly because of insufficient coordination between Federal government, regional and local authorities.

During the 1960s and especially after the social-liberal coalition's taking office in 1969, there were attempts at "strengthening the social net". At the end of the 1960s continuing wage payment for up to six weeks in case of illness was stipulated. The "employment promotion act" of 1969, which granted allowances for participation in vocational training, further training and re-training, put new emphasis on an active labour market and on employment policy, mainly with the objective of improving the mobility of the labour force. Needy university students were supported by cost of living payments (*Bundesausbildungsfoerderungsgesetz* of 1971).²³

After the dramatic increase in outlays in 1974 which resulted in large deficits, fiscal policy between mid-1975 and mid-1982 vacillated between expansion and consolidation, although an expansive stance with rising public deficits was predominant.²⁴ In March 1977 the government decided upon an "investment programme for the future" (*Zukunftsinvestitionsprogramm, ZIP*) which provided DM 16 thousand million for the improvement of the transport system, an efficient and ecological energy supply, provisions for water supply, the protection of the environment and vocational training. After an expansive phase between 1978 and 1981 a restrictive period followed from 1982 onwards owing to large government debt and high interest payments. This policy had already been inaugurated in September 1981 by the social-liberal coalition government with cuts in the social security system.²⁵

Whereas total social security expenditure from the social insurance funds had increased at an average rate of 11 per cent per annum between 1965 and 1969, the average rate of increase had reached 16.5 per cent in the period 1970-5. There was a "cost explosion" in the health service: total health expenditure almost

trebled during the 1970s. As a result of unemployment benefits increases during the recession of 1974–5 the Federal Labour Office's total expenditure rose from DM 4 thousand million in 1970 to 22 thousand million in 1980.²⁶ Because of growing unemployment and reduced wage growth the Federal German social system ran into difficulties.²⁷ As a consequence, services were reduced or became more costly for the insured as in the health service, in old age or invalidity pensions and in the eligibility requirements for unemployment payments.²⁸ In view of the still growing outlays for the social security system this policy of cutting back social security benefits was continued after the *Wende* of September 1982.

Notes

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7. Wetter, "Die wirtschaftliche Bedeutung des Staates", pp. 323–5.

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19. Heinz Lampert, "The development and the present situation of social policy in West Germany", *Zeitschrift fuer die gesamte Staatswissenschaft*, vol. 138 (1982), pp. 351–66 for this and the following. Also Gerhard Kleinhenz and Heinz Lampert, "Zwei Jahrzehnte Sozialpolitik in der BRD. Eine kritische Analyse", *Ordo*, vol. 22 (1971), pp. 103–58.

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28. Lampert, “The development and present situation of social policy in West Germany”, p. 9.