Box V-1

National budget proposal for 2013

A surplus on the primary balance was the main objective of the National Budget for 2012. According to the most recent estimates from the Ministry of Finance and Economic Affairs, the primary surplus measured 1.8% of GDP, whereas the budgetary target was 2%. The Budget also contained a medium-term plan for fiscal performance in coming years, which provides for an overall surplus of just under 1% of GDP in 2014. The budget proposal for 2013 confirms the 2012 medium-term plan, as there is very little difference between the two as regards performance targets. Performance in 2013 is projected to be the same as was provided for in the 2012 Budget, and an overall surplus of 1% of GDP is still targeted for 2014; however, the primary surplus for 2015 is now estimated at 5% of GDP instead of the previous 4.6%.

Overall balance slightly negative in 2013

The original plan prepared in consultation with the International Monetary Fund (IMF) in 2009 provided for an overall surplus of 2% of GDP in 2013, whereas the revised plan assumes that the overall balance will only improve by 23 b.kr. year-on-year in 2013. The overall balance will be negative by 2.8 b.kr., or 0.1% of GDP. It is assumed that a mixed approach involving revenue increases and expenditure cuts will be followed in order to achieve this. The consolidated measures in this phase of the plan amount to 0.4% of GDP. The budget proposal provides for measures to improve Treasury performance by 30 b.kr.: revenue-increasing measures amounting to 22.9 b.kr. and spending cuts totalling 6.7 b.kr.

Table 1 Estimated public sector performance through 2016

ISK billions	*2013*	*2014*	*2015*	*2016*
Total revenues	570.0	611.8	650.5	672.7
Tax revenues	508.8	546.6	581.4	609.5
Total expenditures	573.1	594	612.7	625.3
Operating expenses	225.9	233.1	240.2	248.5
Cost of capital	88.1	91.9	95.5	93.8
Transfer outlays	236.7	247.5	255.3	261.0
Maintenance	8.7	9.1	9.5	9.7
Investment	13.8	12.4	12.1	12.3
Overall Treasury balance	-2.8	17.8	37.8	47.4
as % of GDP	-0.1	0.9	1.8	2.1
improvement from prior year	1.3	1.0	0.9	0.3
Primary Treasury balance	60.4	82.9	104.4	112.1
as % of GDP	3.2	4.2	5.0	5.1
improvement from prior year	1.4	1.0	0.8	0.1

Source: Ministry of Finance and Economic Affairs.

2013: the revenues side

According to the budget proposal for 2013, changes in taxes and excise taxes are estimated to generate 9 b.kr. and, as in this year's Budget, asset sales are assumed to generate 8 b.kr. Other measures decided upon in previous years entail increases in carbon and energy taxes in the amount of 5.9 b.kr.

These measures combined are projected to generate 22.9 b.kr. in additional revenues. No change is anticipated in the principal tax bases, such as individual and corporate income taxes and capital gains tax. The general payroll tax will also remain unchanged, although the unemployment insurance tax will decline by 0.3 percentage points. The following tax changes are planned:

- It is assumed that the general payroll tax will rise by 0.3 percentage points to cover increased growth of expenditures in the social security system. The revenue-generating effect of this is estimated at 3.3 b.kr. Alongside that increase, the unemployment insurance tax is estimated to decline by 0.3 percentage points, from 2.45% to 2.15%, in line with declining unemployment. The overall payroll tax percentage will therefore be unchanged year-on-year.
- The financial administration tax currently imposed on financial and insurance companies' wage payments will be raised and a two-tier structure adopted. Concurrent with this, the special financial administration tax on these firms' profit will be abolished. The revenue-generating effect of these changes is estimated at 0.8 b.kr.
- Hotel accommodation services will be taxed at the general 25.5% value-added tax rate instead of the previous 7% as of 1 May 2013. The revenue-generating effect of this is estimated at 2.6 b.kr. in 2013.
- Excise taxes on motor vehicles owned by rental firms will be raised in two stages in 2013-2014 and adjusted to equal those on individuals' motor vehicles. The revenue-generating effect of this is estimated at 0.5 b.kr. in 2013.
- The system for excise taxes on food will be changed to as to take greater account of nutritional objectives. The revenue-generating effect is estimated at 0.8 b.kr.
- The tobacco tax will rise by 15% in excess of the general price level, and the tobacco tax on snuff will be doubled. The revenue-generating effect is estimated at 1.0 b.kr.

Table 2 Selective revenue-generation measures, 2013-2016

ISK billions at current price levels	*2013*	*2014*	*2015*	*2016*
Carbon tax	3.6	3.8	4.1	4.3
Energy taxes	2.3	2.4	2.5	2.6
Previous assumptions, total	5.9	6.3	6.5	6.8
Financial administration tax	0.8	1.0	1.3	1.5
Value-added tax	2.6	3.5	3.8	3.8
Excise taxes on food	0.8	0.8	0.8	0.8
Excise taxes on motor vehicles	0.5	1.0	1.1	1.0
Tobacco tax	1.0	1.0	1.0	1.0
Payroll tax	3.3	4.2	4.8	5.1
Tax system changes 2013, total	9.0	11.5	12.8	13.1
Asset sales	8.0	8.0	8.0	-
Other	-	3.0	11.8	12.7
Other measures, total	8.0	11.0	19.8	12.7
Total	22.9	28.8	39.1	32.7

Source: Ministry of Finance and Economic Affairs.

Table 2 contains a summary of the estimated revenue effect of the revenue-generation measures planned for 2013-2016, other than those already legislated. First among these are revenues from the carbon and energy taxes that will expire at the end of 2012 if the legislative framework is not changed. The table also shows the combined revenue-generating effect of the changes that are to take effect in 2013. The tax code changes planned for 2013 are not assumed to be temporary; therefore, they will continue to generate revenue in subsequent years. Revenues from asset sales are assumed to remain unchanged through 2015. The carbon tax will change during the period because of planned expansion of the tax base. In addition, taxes levied on alcoholic beverages, motor vehicles, mileage, and fuel will rise in line with the general price level, by about 4.6%.

2013: the expenditures side

Treasury expenditures will be reduced by an estimated 6.7 b.kr. in 2013. In 2014-2016, the consolidation will be broadly similar, with the ministries expected to cut expenditures by about 5 b.kr. per year through austerity measures. The majority of the 6.7 b.kr. contraction in expenditures in 2013, or 4 b.kr., is achieved through a direct cutback in allocations to Government ministries. The cuts differ by function, with reductions estimated at 1.75% of turnover for general administration, supervision, and services; 1.2% of turnover for benefits systems, health insurance, and universities; and only 0.5% of turnover for law enforcement institutions. The budget proposal sets no streamlining requirements for hospitals, health centres, healthcare institutions, and geriatric institutions. In addition, the largest single consolidation measure in the proposal is the plan to reduce the Unemployment Insurance Fund's expenses by allowing the expiry of the temporary provision authorising payment of unemployment benefits for a period of four years instead of three. It is assumed that ancillary measures will be adopted on behalf of those dropping off the unemployment register, however, so that the saving is estimated at 1.8 b.kr. An economic breakdown of the austerity measures is shown in Table 3. Together they amount to just under 6.7 b.kr., or 0.4% of GDP.

Table 3 Austerity measures, economic breakdown

Accrual basis, ISK billions	*Reduction 2013*	*Turnover 2012*	*Reduction %*
Operations	-1.6	206.5	-0.8
Transfers	-4.5	220.6	-2.0
Maintenance and investment	-0.6	20.6	-2.9
Total	-6.7	447.7	-1.5

Source: Ministry of Finance and Economic Affairs.

If this materialises, next year's consolidation measures will be similar in scope to the 2012 measures. For comparison purposes, consolidation measures amounted to 2.6% of GDP in 2009, 3.6% in 2010, 1.4% in 2011, and 0.5% in 2012. In 2009-2013, measures on the expenditures side will total 8.5% of GDP, or 135.8 b.kr. at year-2013 prices. Of that total, measures affecting operations amount to 50.9 b.kr., measures related to transfers total 38.9 b.kr., and cuts in maintenance and investment amount to 26.9 b.kr. The temporary freeze on wages and benefits in 2009 and 2010 generated the remaining 19.1 b.kr.

The total increase in expenditures over the 2012 Budget amounts to 29.5 b.kr., including, first of all, 9.5 b.kr. allocated to Government emphases in line with, among other things, declarations related to the 2013-2015 investment plan and measures related to children's affairs (see Table 4). Second are changes in expenditure pledges related to various Government-operated systems, which amount to 3.1 b.kr. Adjustments due to changes in wages, exchange rate, and price level from 2012 total 13.3 b.kr., and interest expense is estimated to rise by 10.3 b.kr. The rise in interest expense next year is largely due to the planned restructuring of the bond issued by the Treasury to the Central Bank of Iceland for the Bank's takeover of the financial institutions' collateralised and overnight loans in the wake of the banking system collapse. The bond now bears indexed interest, and the plan is to convert it to a non-indexed bond. Interest expense is estimated to rise by 5.7 b.kr. because of this, as all of the interest on the non-indexed bond will be posted to the Treasury's profit and loss account; however, if the bond is indexed, real interest is posted to the profit and loss account, while indexation is recognised in the balance sheet as revaluation. Increases on the expenditures side therefore total 36.2 b.kr., offset by some 6.7 b.kr. due to the above-mentioned consolidation measures, leaving a net total of 29.5 b.kr.

Table 4 Selective measures on the expenditures side

	B.kr.
Child benefits	2.5
Transport-related construction	2.5
Interest rebates/housing benefits	1.0
Development aid	1.0
Childbirth Leave Fund	0.8
Icelandic Research Fund and Technology Development Fund	1.3
Regional programmes	0.4
Total	9.5

Source: Ministry of Finance and Economic Affairs.

New fiscal policy framework on the horizon

A bill of legislation intended to create a stronger fiscal policy framework, currently in preparation by the Ministry of Finance and Economic Affairs, is expected by the end of the year. The bill has been prepared following consultation with the IMF and other foreign experts on ways to strengthen the fiscal framework in Iceland. The possibility of adopting fiscal rules to anchor public sector finances over the medium term is under consideration. It is assumed that fiscal policy will be defined in the discussions during the upcoming spring Parliamentary session and will be reflected in summer budget preparation work and autumn Parliamentary discussions on the fiscal budget.