Box 2 Agreements between the Icelandic Federation of Labour (ASÍ) and Confederation of Employers (SA) on a review of wage agreements in 2002, and declarations by the Government of Iceland and Central Bank of Iceland in December 2001

The wage agreements between several major labour union organisations and the Confederation of Employers (SA) contain identical clauses stating the assumptions underlying them. A committee was to be appointed in February 2001, 2002 and 2003 specifically to assess whether these assumptions have held good. Most other wage agreements make reference to the committee's findings. At the above-mentioned dates the committee was to discuss whether the assumption of decreasing inflation had been fulfilled. If it failed, the wage section of the agreement may be revoked with three months' notice. Inflation accelerated rapidly in 2001 and most of the evidence indicated that the assumption of declining inflation would not hold up in February 2002. Great uncertainty about wage and price developments therefore prevailed during the second half of 2001. ASÍ and SA reached an agreement on December 13, 2001 that the assessment of the assumptions in the wage agreements should be postponed, from February 2002 to May the same year. At the same time the Government issued a declaration, and the Central Bank followed suit.

The agreement between ASÍ and SA also made the following stipulations:

1. *Trigger reference*
   The contracting parties agree that if the CPI is no higher than 222.5 points in May 2002, the inflation assumptions behind the wage agreements are deemed to have held good. If the assumptions are not fulfilled, the wage sections of the respective agreements may be revoked in May with three whole months' notice.
2. *Supplementary contribution to pension savings fund*
   According to current wage agreements, an employer is obliged from January 1, 2002 to pay a 2% contribution to a pension savings fund (or where appropriate a defined benefits fund) to match a 2% supplementary contribution by the wage earner. It is agreed to amend this clause whereby from July 1, 2002 employers will pay a 1% pension savings fund contribution with no contribution on the part of the wage earner. The rule on a 2% contribution to match the wage earner's 2% supplementary pension saving remains in effect and is not increased by the supplementary contribution. The above change does not apply, however, in cases where the employer's mandatory and contractual pension contributions total 7% or more. This contribution is paid to the pension savings fund department of the pension fund to which the respective wage earner belongs, unless he decides otherwise.
3. *General wage rise on January 1, 2003*
   It is agreed that the general wage increase on January 1, 2003 will be 0.40% higher than otherwise would have been the case.

The above addenda to the wage agreements concerning supplementary pension savings fund contributions and the general wage rise on January 1, 2003 are conditional on the price level reference according to item 1 above being fulfilled in May 2002 and the wage section of the agreements not being revoked. If the wage section of the agreements is revoked in May 2002, the supplementary payments do not take effect.

On the basis of this agreement by ASÍ and SA, their joint committee on wage agreement assumptions ruled that it entailed a final assessment of the assumptions behind wage agreements in 2002. At the same time, the government issued a declaration in which it stated the importance of pursuing a tight fiscal stance. The budget for 2002 assumed the same surplus as had been decided in the draft budget, despite the fact that the economic situation had worsened. It was also stated that the treasury's borrowing policy would reflect general economic developments and thereby take into account the objectives behind the unions' and employers' agreement and the position in the domestic credit market. In this regard attention would be paid both to the effect on the exchange rate and its long-term effect on domestic demand. The government also declared that it would work towards the abolition of, or a major reduction in, import tariffs on vegetables, and that national insurance charges would be reduced in 2003 from 6% to 5.73%. An increase in this charge from 5.32% to 6% had been passed as law by parliament in the autumn.

The Central Bank also issued the following statement on this occasion:

The Central Bank of Iceland welcomes the December 13 agreement between major private sector unions and employers' associations entailing the postponement of the review clause of existing wage agreements in 2002. It reduces uncertainty about the development of wages and prices in the coming year. The Bank is also of the view that conditions have strengthened for an appreciation of the króna and that the likelihood of the Bank achieving its inflation target has improved.

Central Bank interest rate changes only affect inflation with a lag. Thus, interest rate policy cannot have a decisive impact on whether the CPI will be below the reference level agreed between the labour market participants for May 2002. Nevertheless, the reference level conforms broadly with the inflation forecast, which the Central Bank published at the beginning of November. A higher exchange rate and the impact of lower vegetable prices (resulting from the abolition of import tariffs) improve the prospects for the attainment of the CPI target level in May.

Over the long term, the prospects for inflation will be influenced by the stance of monetary policy in relation to domestic demand. Important in this respect is that the fiscal budget for 2002, which parliament recently approved, shows the same surplus as the budget proposal introduced at the start of October, in spite of worse prospects in the economy for the coming year. It is very important that the fiscal budget be implemented according to plan. The Central Bank deems it important to administer the treasury's borrowing operations in the coming year in such a way that they support a higher exchange rate of the króna and the inflation target of the Central Bank. For that to happen, consideration must be given to the long-term impact of external borrowing by the treasury on domestic demand and inflation, as well as to the short-term impact on the exchange rate.

The agreement among the labour market participants improves the prospects for the forecast slowdown in the rate of inflation in 2002. At the start of November, the Central Bank forecast an inflation rate of 4% within the year 2002. If the exchange rate of the króna appreciates in the period ahead, for which all preconditions seem to be in place, inflation could be lower. In that case, conditions for a further reduction in interest rates will be created, other things remaining unchanged.