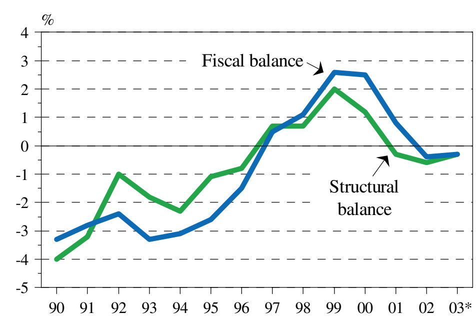
Box 3 The economic cycle and public sector finances over the past decade

The public sector as a whole refers to central and local government, excluding enterprises owned by them (such as power companies and harbours) but including the social security system, which in Iceland is in fact almost entirely run by the State. Statistics Iceland (and previously the National Economic Institute) compiles statistics for public sector finances in accordance with international standards for national accounting. These are the most complete available statistical data series for public sector finances. In certain respects their presentation diverges from the principles employed for the fiscal budget and state accounts (which produce the result shown in the first two lines of Table 4 on p. 19) and corresponding local government accounts. The most important differences are that gains on sale of assets are not included among revenues, corrections of pension fund liabilities due to retroactive revisions of assumptions are not included among outlays, tax collection write-offs are deducted from revenues and not classified as outlays, and various state service charges are deducted from outlays instead of being entered on both the revenue and outlay sides. Lower figures are thus yielded for central and local government revenues and outlays than those presented in budgets and accounts. Nonetheless, the Treasury result according to these accounts remains similar to the bottom line of Table 4.

The accompanying chart shows the public sector result with and without cyclical adjustment. It shows the result and output gap as a proportion of GDP over the past twelve years along with estimates for 2003 and 2004, based on data from Statistics Iceland for 2002 and the Ministry of Finance's estimates of year-on-year changes in 2003. After a persistent deficit over the period 1985-1996, which reached as much as 4½% of GDP in the contraction years 1993-1994, the public sector achieved balance in 1997 and over the following years a surplus was formed which roughly corresponded to the extra revenue that the Treasury earned from excessive national spending as represented by the current account deficit. At the same time, central and local government revenues from direct taxation (income and net wealth taxes, and national insurance contributions) grew from 16% to 20% of GDP, while outlays remained close to 40% of GDP. Thus it seems reasonable to claim that the public sector deficit was eradicated with more revenues from direct taxation, and that the ample surplus in 1999-2000 was connected with strong overheating, a current account deficit and private sector debt accumulation.

Public finances 1990-2003

% of GDP



* Forecast. *Sources:* Statistics Iceland, Ministry of Finance and Central Bank of Iceland.