Box V-1

National Budget Proposal 2012

The Government's fiscal consolidation plan, one of the cornerstones of its economic programme with the IMF, features two main goals: the achievement of a primary surplus in 2011 and an overall surplus in 2013. This is reflected in the National Budget for 2011, in which the main objective was to deliver a surplus on the primary balance. The Ministry of Finance's most recent estimate for this year is a 6.7 b.kr. deficit on a cash basis. The goals of the programme are stated on a cash basis, which implies that the goal of achieving a primary surplus in 2011 will not be met. On an accrual basis, however, there is a forecasted surplus of 3.7 b.kr. According to the national budget proposal for 2012, the latter objective – an overall surplus in 2013 – has been deferred for one year.

Balanced budget in 2014

The new medium-term plan published with the 2012 budget proposal provides for less strict consolidation measures than the long-term plan from last autumn's budget proposal. It assumes that a surplus on the overall balance will not be achieved until 2014, a year later than previously planned, and that the surplus will be smaller than originally planned. The consolidation process has therefore become more gradual in the revised Government-IMF economic programme, and performance figures are lower. The consolidation entailed in the budget proposal for 2012 can be seen in Table 1. The budget proposal for 2011 assumed that the primary surplus on a cash basis would be 5.4% of GDP at the conclusion of the plan in 2013, whereas the current proposal aims for a 4.6% surplus in 2015, two years later. The adjustment of public sector finances towards a sustainable debt path has therefore been changed as the Government-IMF programme has progressed. The original plan presented to Parliament in summer 2009 assumed that the primary balance would improve by just over 16% of GDP during the period 2009-2013. The current plan, on the other hand, aims at an improvement of up to 10% of GDP during the period; that is, the 2009 primary deficit of 6.7% will have become a 3.1% surplus by 2013. The level of austerity is therefore considerably lower than originally set forth.

Arguments for a revised plan

The Government and the IMF have two main reasons for easing the consolidation plan. First, the Government's debt position is much more favourable now than when the original plan was drafted. The primary surplus that was considered necessary for the debt position estimated in 2009 to be sustainable is higher than that considered necessary given the current estimate. The obligations undertaken in 2009 and 2010 as a result of the financial crisis have proven to be smaller than originally estimated, and the Government's expense for the recapitalisation of the banking system proved much lower.

Second, the authorities consider it appropriate to support GDP growth with less fiscal restraint. However, the effects of this revised plan will be determined primarily by the reaction of the financial markets and the monetary authorities to less restrictive fiscal policy.

Austerity measures milder in 2012 than in previous years

According to the budget proposal, the overall balance is expected to improve by about 24.4 b.kr. between 2011 and 2012. It will be negative by some 17.7 b.kr., which corresponds to a reduction of the deficit from 2.5% of GDP to 1%. In order to achieve this, it is assumed that a mixed approach will be adopted, with increased revenues and expenditure cuts. The measures in this phase of the plan amount to ½% of GDP. The budget proposal provides for measures to improve Treasury performance by 30 b.kr., including measures to increase revenues by 20.7 b.kr. and expenditure cuts amounting to 8.6 b.kr.

Table 1 Medium-term plan 2012-2015

	Projection			
B.kr.	*2012*	*2013*	*2014*	*2015*
Total revenue	521.5	545.3	579.1	610.8
Tax revenue	466.8	491.9	522.7	551.3
Total expenditure	539.2	546.6	561.8	578.9
Operating expense	210.0	215.1	221.0	225.5
Interest payments	78.4	81.9	86.2	92.4
Transfers	230.7	229.2	233.5	239.7
Maintenance	8.0	8.2	8.3	8.5
Investment	12.1	12.3	12.7	12.9
Treasury overall balance	-17.7	-1.3	17.4	31.9
as a share of GDP	-1.0	-0.1	0.9	1.6
change from last year	1.5	0.9	1.0	0.7
Treasury primary balance	39.6	57.5	77.7	95.2
as a share of GDP	2.2	3.1	4.0	4.6
change from last year	2.0	0.9	0.9	0.7

Revenues 2012

After hefty tax hikes in 2010, it is now planned, for the second year in a row, that the tax rates on major tax bases will not rise. Consequently, taxes such as personal income tax and the value-added tax will not rise. The plan provides for a reduction in the payroll tax rate, however. According to the budget proposal, direct tax code changes will yield an estimated 9.7 b.kr., and the extension of the authorisation for withdrawal of third-pillar pension savings will generate an additional 2 b.kr. Other measures intended to increase Treasury revenues include asset sales and a more stringent requirement concerning payment of dividends on Treasury assets, which should yield about 9 b.kr. All of these measures combined will generate an estimated 20.7 b.kr. in additional revenues during the year. The following tax changes are planned:

- Reduction of the permissible tax deduction for third-pillar pension savings. Estimated revenue effect 1.4 b.kr.
- Imposition of a new 10.5% tax on total salary payments of financial institutions, pension funds, and insurance companies. Estimated revenue effect 4.5 b.kr.
- Adoption of a new tax bracket for wealth tax. Estimated revenue effect 1.5 b.kr.

- The carbon tax will be calculated based on the full reference price as opposed to the current 75%. Estimated revenue effect 800 m.kr.
- The fishing fee for fishing quotas will be nearly doubled. The estimated revenue effect is 1.5 b.kr., but the full-year effect, which will first be generated in 2013, totals 4.5 b.kr.

Table 2 contains a summary of the estimated revenue effect of the revenue generation measures planned for 2012-2015. According to the table, the revenue-generating measures planned for 2012 are to remain in effect unchanged until 2015, except for the provisions related to third-pillar pension savings. Revenues from asset sales and dividends are also assumed to remain unchanged throughout the period.

Table 2 Special revenue measures 2012-2015

Cash basis, b.kr.	*2012*	*2013*	*2014*	*2015*
Personal income tax	1.4	1.4	1.4	1.4
Payroll tax on financial institutions	4.5	4.5	4.5	4.5
Wealth tax	1.5	1.5	1.5	1.5
Carbon tax	0.8	2.1	2.8	3.5
Fishing fee	1.5	4.5	4.5	4.5
Dividends	2.0	2.0	2.0	2.0
Property sales	7.0	8.0	8.0	8.0
Other			3.0	3.0
Third-pillar pension savings tax	2.0			
Total	20.7	24.0	27.7	28.4

The carbon tax will change, however, due to planned expansion of the tax base. In addition, duties levied on alcoholic beverages, tobacco, and fuel will rise in line with the general price level, by about 5.1%.

Expenditures 2012

A more relaxed consolidation plan allows for considerably more moderate restrictions on Treasury expenditures than have been imposed over the past three years. Treasury expenditures will be reduced by an estimated 8.6 b.kr. in 2012. In 2013-2015, the adjustment will be even milder, with the ministries expected to cut expenditures by about 5 b.kr. per year through austerity measures. The majority of the 8.6 b.kr. contraction in expenditures in 2012, or 6.6 b.kr., is achieved through a direct cutback in allocations to Government ministries. The cutback is based on a 3% reduction in general administration and service and a 1.5% cut in social security functions (healthcare, benefits, and health insurance). In addition, the Treasury's share in the funding of the Icelandic Student Loan Fund will be reduced temporarily by 1 b.kr., the Ministry of Welfare will cut costs by 600 m.kr. due to a one-year deferral by healthcare institutions of austerity measures provided for in the budget

Table 3 Restraint measures, economic breakdown

In millions of kr.	*Decrease*	*Total turnover*	*Reduction %*
Operations	-4,409	189,568	-2.3
Transfers	-3,992	208,007	-1.9
Maintenance and capital expenditure	-182	20,836	-0.9
Total	-8,584	418,411	-2.1

proposal for 2011, and the special supplementary contribution to the Municipal Equalization Fund will be reduced by 350 m.kr. An economic breakdown of the austerity measures is shown in Table 3. Together they amount to just under 8.6 b.kr., or 0.5% of GDP. If this plan materialises, these will be the smallest in scope of the post-crisis austerity measures, which totalled 2.6% of GDP in 2009, 3.5% in 2010, and 1.4% in 2011. Over the period 2009-2012, the measures will total 8% of GDP, or 124,9 b.kr., with measures affecting operations totalling 43.1 b.kr., measures related to transfers totalling 34 b.kr., and cuts in maintenance and initial expenses amounting to 31.3 b.kr. The temporary freeze on wages and benefits in 2009 and 2010 generated the remaining 16.5 b.kr.

The inflationary effects of the budget proposal are considerable, or 26.7 b.kr. in all. First, the wage base in the proposal rises in line with new wage settlements. The pay increases in question are estimated at just over 6.6 b.kr. in 2011, with the average public sector employee's salary rising by 5%. Second, social security and unemployment benefits have increased to reflect this year's new wage settlements. The reference point for the increase was the contractual increase in the lowest wages, 12,000 kr. (an 8.1% rise). The increases in these benefits total approximately 6.8 b.kr. on an annualised basis. Budgetary allocations in the proposal therefore increase by 13.4 b.kr. as a result of the wage settlements. This is in addition to the 13.3 b.kr. in wages, exchange rate, and price level calculations in the budget proposal for 2012.

Short-lived fiscal rule

In the budget proposal for 2011, the authorities adopted a fiscal rule providing for a ceiling on nominal expenditures in an attempt to bolster the credibility of public sector finances and strengthen their countercyclical role. That change made it even more important for the authorities that inflation remain low.

The budget proposal for 2011 set forth a binding nominal expenditure framework for the following two years, under which the Government pledged to Parliament that it would not seek allocations exceeding the budget framework. The expenditure framework for each year included estimated changes in wages, exchange rate, and price levels. The plan was based on the strategy that for the first two years – 2011 and 2012 – the framework would be binding in nominal terms if prices should deviate from assumptions by less than 1.5%; otherwise, the expenditure categories concerned could be revised. The plan allowed for a 5 b.kr. contingency fund to meet unexpected price deviations and obligations. In other respects, all decisions and deviations were to be accommodated within the overall framework, which was not to be amended later on; therefore, all increases made to individual expenditure categories were to be offset with comparable reductions in other expenditures. According to this rule, the expenditure framework was set at 381.4 b.kr. for 2011 and 395 b.kr. for 2012. In 2011, however, expenditures are expected to total 399.7 b.kr., which is 18.3 b.kr., or 4.8%, over the budgeted amount. In 2012, they are expected to total 407.2 b.kr., some 12.2 b.kr. (3.1%) over the amount provided for in the framework. The increased expenditures are attributable in large part to the increases in wages and social security benefits provided for in this year's wage settlements, as the 2011 National Budget did not allow for any rises in wages or benefits.

The long-term plan in the budget proposal for 2012 omits the binding two-year nominal expenditure framework and provides only a guideline framework for 2013-2015. The fiscal rule included in the 2011 budget proposal therefore appears to have been abandoned only a year after its adoption.