

Box V-1 Government involvement in wage settlements: Cost to the Treasury

In connection with the signing of the private sector wage settlements on February 17, the Government issued a declaration containing various pledges, some with a specified time frame and some without. The Government's primary contributions consist of raising the tax-free income threshold by 20% in excess of price levels and lowering the corporate income tax rate from 18% to 15%, effective in 2009. It has also pledged to reduce income-linked cutbacks of child allowances and asset-linked reductions in mortgage interest allowances, and to raise the unemployment benefits in line with the rise in the lowest wage rates. Other pledges include raising rent subsidy allowances and easing the eligibility requirements for receipt of rent subsidy so as to include more households, increasing the number of loans pledged for subsidised residential rental housing with preferential interest rates, relaxing the collateral requirements on loans for rental housing, contributing to a Worker Rehabilitation Fund, and increasing the amount allocated to continuing education and adult education.

According to the Central Bank's estimates, the cost to the Treasury as a result of these pledges will approach 47 b.kr. over the forecast horizon – that is, from 2008 through 2010 – after accounting for the demand effect of the measures involved.¹ This is rather more than was assumed when the measures were announced on February 17. These costs will rise still further in 2011-2012, to about 41 b.kr., when the effects of the hike in the personal allowance have emerged in full.

In addition to the effect on Treasury revenues and expenditures, these measures will stimulate demand. The estimated net effect on the Treasury is negative in the amount of 1% of GDP. The net cost to the Treasury due to the lower corporate income tax rate and the higher tax-free income threshold totals some 36 b.kr. during the forecast horizon, but the impact will be significantly larger in 2011-2012. Contributions for continuing education, allowances and benefit payments, and rental apartments amount to some 21 b.kr. over the forecast horizon and a total of 39 b.kr. over the period 2008-2012.

Counterbalancing this to some extent are increased tax revenues due to greater economic activity, increases in households' disposable income, and lower corporate taxes. Revenues from consumption taxes therefore rise by around 10 b.kr. over the forecast horizon. The announced measures are estimated to increase private consumption growth by three-fourths of a percentage point in 2009 and by nearly 1½ percentage points in 2010. The impact on national expenditure growth is similar. The GDP growth effect is rather less – about one-fourth of a percentage point in 2009 and one-half of a percentage point in 2010 – because a part of the increase in demand will be directed at imported goods and services. The effects of the measures on the economy will be rather greater in 2011-2012.

1. The assessment does not take into account the cancellation of stamp fees on loans for the purchase of a buyer's first home. This measure is scheduled to take effect on July 1, 2008, according to the legislative bill that has been presented before Parliament. Neither does the assessment take into account the various unscheduled pledges, such as the reduction of goods prices, concerning which the Government promised to exert its influence.