

Fiscal budget proposal 2016

Box 3

The medium-term fiscal plan included with the fiscal budget proposal for 2016 assumes a stable surplus on the primary balance through 2019. The primary balance is assumed to deteriorate in comparison with the 2015 budget proposal. At the same time, a smaller financial account deficit is expected, yielding a better overall outcome. The medium-term plan is summarised in Table 1. The budget proposal provides for an overall surplus amounting to 0.7% of GDP in 2016.

Table 1. Estimated Treasury performance through 2019

ISK billions	Estimate			
	2016	2017	2018	2019
Total revenues	696.3	731.0	748.8	787.4
Tax revenues	646.5	681.9	696.4	735.1
Total expenditures	681.0	689.2	714.7	739.6
Operating expenses	284.9	299.9	313.0	329.7
Cost of capital	74.4	68.4	68.7	62.9
Transfer outlays	265.7	278.7	289.7	302.0
Maintenance	10.1	10.5	10.7	10.7
Investment	45.9	31.7	32.7	34.3
Overall Treasury balance, w/expedited debt relief ¹	15.3	41.8	34.1	47.8
As % of GDP	0.7	1.7	1.3	1.7
Improvement from prior year	-0.3	1.0	-0.4	0.4
Overall Treasury balance, w/o expedited debt relief ¹	15.3	21.7	34.1	47.8
As % of GDP	0.7	0.9	1.3	1.7
Improvement from prior year	-0.3	0.2	0.4	0.4
Primary income	679.7	694.2	730.5	770.0
Primary expenditures	606.6	620.8	646.1	676.7
Primary Treasury balance, w/o expedited debt relief ¹	73.1	73.4	84.4	93.3
As % of GDP	3.1	3.0	3.2	3.3
Improvement from prior year	-0.6	-0.1	0.2	0.2
Interest income	16.6	16.6	18.2	17.4
Interest expense	74.4	68.4	68.7	62.9
Capital and financial account	-57.8	-51.8	-50.4	-45.5
As % of GDP	-2.5	-2.1	-1.9	-1.6

1. Because of expedited reduction of indexed household debt, expenditures were moved to 2014, while revenues are still collected in 2017, causing a mismatch between revenues and expenditures. In this table, the primary balance is shown excluding the expedited debt relief.

Source: Ministry of Finance and Economic Affairs.

According to the budget proposal, Treasury performance in 2015 will be somewhat stronger than was assumed in the National Budget for the year. The overall surplus for this year is now estimated at 1% of GDP instead of 0.2%, and the primary surplus is projected at 3.7% instead of 3.1%. Furthermore, cash from operating activities, an important measure of the Treasury's capacity to pay down debt, is estimated to be positive by 14.6 b.kr., whereas the plan accompanying the Budget estimated that it would be negative by 7.7 b.kr.

In many ways, economic developments have evolved differently than was assumed at the time the 2015 Budget was prepared. Domestic demand and wage changes are greater than expected. This has had a positive impact on revenue generation for the Treasury; for instance, in the first eight months, taxes on income and profits have risen by some 13% year-on-year on a payments basis. On an accrual basis, revenues are projected to be 4% above the revenue estimate in the Budget. The main economic assumptions underlying the new fiscal budget proposal are based on a macroeconomic forecast that allows for slightly weaker GDP growth than in the baseline forecast in this issue of *Monetary Bulletin*.

The estimates of Treasury debt contained in the budget proposal assume that developments will be more favourable than previously projected. The ratio of Treasury debt to GDP has fallen rapidly since peaking at 85% in 2011. Based on the assumptions in the budget proposal concerning Treasury debt, the debt ratio will also decline markedly in coming years. Treasury interest expense is projected to decline by almost 14 b.kr. through 2019. In the 2015 budget proposal, however, it was assumed that the financial balance would deteriorate, with the 60 b.kr. deficit from 2014 increasing to a 65-67 b.kr. deficit in 2015-2018. It is now assumed that the financial account deficit will total about 58 b.kr. this year and next year, and then decline by 6 b.kr. in 2017 and another 2 b.kr. in 2018. Because of the proposed sale of Landsbankinn shares, dividends from the bank will also decline, however.

The revenues side

There are changes from previous estimates on the revenues side, due to changes in the tax system and re-evaluation of tax revenues on the basis of the new macroeconomic forecast contained in the budget proposal. Estimated total revenues for 2016 increase by 31.2 b.kr. from the estimates in the 2015 fiscal budget proposal, to a total of 696.3 b.kr., including a 37.3 b.kr. increase in tax revenues. From autumn 2014 through autumn 2016, the general revaluation of tax bases has strengthened the revenues side by about 51.6 b.kr., whereas changes to the tax structure in 2015 and 2016 reduce revenues by over 7 b.kr. each year. The payroll tax will decline by 0.14 percentage points at the beginning of 2016, the last reduction currently planned. The personal income tax is lowered and the num-

Table 2. Summary of Treasury revenue estimates on an accrual basis, 2015-2019

% of GDP	2015	2016	2017	2018	2019
Total revenues	31.4	29.9	29.3	28.3	28.2
Tax revenues	28.4	27.7	27.4	26.3	26.4
Primary income	30.6	29.2	28.7	27.6	27.6
Interest income	0.8	0.7	0.7	0.7	0.6
<i>Net of irregular items</i>					
Total revenues	31.0	29.6	29.1	28.1	28.0
Tax revenues	28.0	27.5	27.2	26.1	26.2
Primary income	30.1	28.9	28.4	27.4	27.4

Source: Ministry of Finance and Economic Affairs.

Table 3. Summary of estimated revenue effects of tax system changes in autumn 2013 on the revenue estimate for 2015-2019

% of GDP	2015	2016	2017	2018	2019
<i>Tax changes from autumn 2013</i>					
Tax changes at 143 rd legislative session	1.0	0.5	0.5	-0.4	-0.4
– increase in bank levy	1.5	1.1	1.0	0.1	0.1
Tax changes at 144 th legislative session	-0.2	-0.2	-0.2	-0.2	-0.2
Tax changes in 2016 budget proposal	0.0	-0.3	-0.6	-0.6	-0.5
Total tax changes	0.8	0.0	-0.3	-1.2	-1.1
– increase in bank levy	1.5	1.1	1.0	0.1	0.1
– other	-0.7	-1.1	-1.3	-1.3	-1.2
<i>Previous measures</i>					
Expiry of older temporary provisions	-0.4	-0.5	-0.4	-0.4	-0.4
Tax changes and tax revocation combined	0.4	-0.4	-0.7	-1.6	-1.5
– other than bank levy	-1.1	-1.6	-1.8	-1.7	-1.6

Source: Ministry of Finance and Economic Affairs.

ber of tax brackets reduced by one, as was promised in connection with the spring 2015 wage settlements. This is estimated to cost 11 b.kr. per year beginning in 2017. At the same time, unit levies will be increased by a maximum of 2.5% at the turn of the year. The cancellation of import duties on clothing and footwear at the beginning of 2016 is estimated to lower the CPI by approximately 0.5%. When import duties on specialty products are also lowered at the turn of the year, the combined effect is expected to total about 1% if the reductions are passed through in full to prices. Tax revenues will increase by 5.2% between the 2015 plan and the 2016 budget proposal, or about 1.8% in real terms, although they will decline relative to GDP, falling from 28.4% to 28%. The revenue estimates are summarised in Table 2.

A number of systemic changes have been made since autumn 2013, during the tenure of the current Government. Excluding the bank levy, which was ear-marked for a specific function, the combined reduction in revenues as a result of these measures amounts to 1.6% of projected year-2016 GDP. As a share of GDP, the accumulated revenue effect in the years afterwards is similar. Revenues from the bank levy are estimated at 1.1% of GDP. Table 3 gives a clearer view of the itemised effect of the changes. The table shows the estimated impact of the measures on revenues each year. The reduction of unit levies in real terms is included. Older temporary provisions that expire include the wealth tax and the energy tax on electricity.

The expenditures side

There is some consolidation on the expenditures side. Most operational categories increase by 1% in real terms, although old-age pensions, pharmaceuticals, and pension obligations increase more. It is assumed that the consolidation targets in the expenditure framework for 2016 will be 0.5% for the school system and health care and nursing home institutions, and 0.75% for other institutions and functions. This reduces the level of consolidation from the spring plan by 3.3 b.kr., and in addition, the scope for spending is increased by about 3.5 b.kr., to 7.5 b.kr. Offsetting this, expenditures due to several irregular items are reduced by 5.1 b.kr. in comparison with the spring plan. Primary expenditures therefore increase by 13 b.kr. from the spring plan. Operating expense as a share of GDP declines by 0.5 percentage points, however. The same applies to operational and consumption transfers, which decline by 0.6 percentage points of GDP.

According to the budget proposal, central government wage costs will increase by 9.5% in 2016, which represents a reassessment of the wage assumptions in the 2015 Budget, primarily due to projected wage increases in H2/2015, which will affect annualised wage costs for 2016. In 2017-2019, wage costs are expected to rise by 3.7-4.7%, somewhat in excess of the inflation forecast. The assumption was made before the arbitration panel ruling in the cases involving nurses and university-educated public employees, and it can be expected to generate increased expenditure pressures. The results of the wage negotiations were highly uncertain. This was why a new budgetary allocation has been created so as to provide the scope to absorb deviations – particularly in the wage, exchange rate, and price assumptions in the budget proposal – and fulfil unforeseen obligations that may accrue each year. This allocation totals approximately 6 b.kr.

The target set in the spring plan, to maintain the investment level at 1.2% of GDP during the period, remains and has been extended. This provides the scope, from 2017 onwards, for new investment projects in place of those concluded during the period.

Table 4 provides a summary of the changes in the Treasury outcome in 2016, from the spring fiscal plan (prepared in April) to the 2016 budget proposal.

Table 4. Outlook for central government finances for 2016 – changes from the spring plan

<i>Accrual basis</i>	<i>B.kr.</i>
<i>Treasury outcome in 2016, according to spring 2015 plan</i>	
Primary balance	71.5
Interest balance	-60.5
Overall balance	11.0
<i>Changes in Treasury outcome in 2016, as compared with spring 2015 fiscal plan</i>	
<i>Changes in primary income</i>	
Individuals' personal income tax	0.9
Income tax on legal entities	7.8
Value-added tax	1.5
Alcoholic beverages tax	3.1
Payroll tax	2.8
Other changes in revenues	-1.5
Total changes in primary income	14.6
<i>Changes in primary expenditure</i>	
Scope for expenditures in excess of assumptions in spring plan	3.5
Reduced consolidation compared with assumptions in spring plan	3.3
Reassessment of wage costs and exchange rate assumptions	11.3
Contribution to the Housing Financing Fund	-1.0
Write-downs of indexed mortgage loans	-2.9
Other changes in expenditures	-1.2
Total changes in primary expenditure	13.0
<i>Changes in interest balance</i>	
Prepayment of loan to Central Bank of Iceland	4.0
Payments on foreign loans	3.7
Other changes in interest expense (higher interest rates, etc.)	-4.5
Reduced interest income on general loans granted	-1.2
Higher interest income on Treasury accounts with the Central Bank	1.2
Other changes in interest income	-0.2
Total changes in interest balance	3.0
Total changes in overall balance	4.6
<i>Treasury performance in 2016 according to fiscal plan autumn 2015</i>	
Primary balance	73.1
Interest balance	-57.8
Overall balance	15.3

Source: Ministry of Finance and Economic Affairs.