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MINISTRY OF FINANCE IN ICELAND

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Medium-term fiscal policy targets of Nordic countries

The Nordic countries have in common a multi-year framework for the conduct of fiscal finances. A common emphasis is an emphasis on restraint on the growth of public consumption and that public finances on average deliver a surplus. What follows is an overview of the key policy goals of Denmark, Finland, Norway, Sweden and Iceland.

The Danish authorities set themselves a three-year target for public finances, which is that public consumption should not increase more than 0.5 per cent in real terms annually. Transfer payments, interest and investment expenditure are therefore not part of the medium-term policy targets. The government also sets a surplus objective for the operation of public finances. Denmark has been publishing medium-term targets and projections for public finances along with the annual budget since the 1960's. In the annual budget of the Danish government there is also a policy framework for general government finances, including expenditure targets for the central and local governments.

In Finland, the Government has set targets to reduce debt and to operate public finances with a surplus over the business cycle, including that it not exceed a deficit of 2.75 per cent of GDP in a recession. Finland places two-thirds of government expenditure under a budget-frame limit. The limit applies to all expenditure items except interest payments, volatile components and contributions to the European Union. Supplementary budgets also come under the limit with some room to meet unforeseen expenditures. The aim of the Government is to restrain expenditure such that the Treasury will deliver a surplus in 2007 at the end of the present Government's term of office. In order to reach the target the Government has presented a proposal for cutbacks in all ministries when deciding on the budget frames.

The Norwegian authorities have set guidelines for the allocation of the earnings of the Petroleum Fund. An emphasis is placed on distributing only earnings in excess of 4 per cent per annum. The underlying growth rate of government expenditure is 1.5 per cent a year in real terms and the authorities have targets to operate public finances with a surplus on average. The Norwegians consider it necessary to exercise fiscal restraint because projections show that the Petroleum Fund will not suffice to finance the imminent ageing of the population, i.e. the cost of paying old-age pensions in the context of the current payments system.

In Sweden the authorities aim to operate public finances with a surplus of 2 per cent on average over the business cycle. The general government in Sweden is defined to include the central and local governments in addition to the pension system which at present renders the bulk of the surplus. The aim is to prepare public finances for increased expenditure associated with the ageing of the population. Sweden places an overall limit, or frame, for central government expenditures at current prices for the next three years following the fiscal year. The budget limit covers all expenditures except interest and pension payments. Sweden places a limit on Treasury expenditure as well as a goal for the general government. The policy thus has an implicit goal of reducing public debt.

The Icelandic Government has a stated medium term target of restraining public consumption growth of central government to 2 per cent annually in real terms and that of transfer payments to 2.5 per cent. Investment expenditure is varied to off-set business cycles. The target is to run the Treasury with a surplus over the business cycle which implies a reduction in the debt of the Treasury. Iceland does not set a medium term target for general government sector. As a result, local governments set their own plans independent of the Government's fiscal policy.

Registration of real property leases for VAT qualification

Regulation 577/1989 has been amended with regulation 1056/2005 pertaining to the conditions that must be met for a lease of real property to qualify under VAT rules. A VAT registration of a real property lease has the purpose of making the choice between leasing and owning real property tax-neutral. Such registration does not apply to residential property.

The amendment pertains to the qualification for such registration. Previously, the lease itself had to be publicly notarised, and a certificate attesting thereto had to be filed along with the application for a VAT-qualifying registration. This demand was deemed to be cumbersome since the lease could contain clauses that neither the lessor or the lessee would wish to reveal in publicly accessible registers. Significant business interests might at stake. This regulation amendment is intended to meet such criticism. Henceforth, it is stipulated in the amended regulation that the lessee files a declaration for an unencumbered registration and registers it with a public notary rather than notarising the lease itself. The lease must, as before, be filed with the Internal Revenue Service along with an application for an unencumbered registration.

The number of double-taxation agreements

Activity in the drafting of double-taxation agreements has been unusually lively in recent weeks. Discussions with India were initiated in the first half of November and are expected to be finalised early next year. The agreement with Greece was completed at the beginning of December which leaves only two countries amongst the EU-25, Cyprus and Slovenia, where agreements are still incomplete. The drafting of an agreement with the latter has commenced, whereas discussions with Cyprus are expected to take place next year.

Iceland and Ukraine finalised an agreement earlier this week. Representatives from the two countries met in Kiev in the middle of last year. All told, Iceland has concluded 32 agreements with 36 states; a joint agreement exists between the Nordic countries.

Twenty-three agreements are already in force and three await ratification, i.e. for Italy, Malta and Hungary. Another six await signature; with Austria, Greece, Croatia, Mexico, South Korea and Ukraine. In addition to ongoing discussions with Slovenia and India, discussions are under way with Romania which are expected to be completed early next year. A revision of an existing agreement with Germany was completed by the middle of this year, and the intention is to complete the agreement between Iceland and the United States by the middle of next year. According to the above, Iceland will have completed double-taxation agreements with at least 40 countries before the end of next year of which 15 have been concluded in the past five years.

In recent years, Iceland has aimed at concluding double-taxation agreements with all OECD and EU member countries. Amongst the OECD countries, Australia, Japan, New Zealand and Turkey remain, and Cyprus and Slovenia remain amongst the EU countries. The intention is to seek agreements with new markets where Icelandic companies are entering, such as in Bulgaria, Chile and South Africa among others. It should be noted that the aims and purpose of double taxation agreements are not always agreed between the contracting countries. More often than not, the actual agreement negotiations are preceded by a long process of formal and informal contacts, some lasting for several years. Japan, an important market for Iceland, is a case in point. Ever since 1998, informal communications have taken place between the two countries at the initiative of Iceland for the purpose of commencing on a double-taxation agreement. An informal negotiation meeting took place in Tokyo in 2003 at the behest of the Icelandic embassy. Formal dates for the actual negotiations have yet to be determined.

Treasury revenue, January-October		
12 month changes %	2003-2004	2004-2005
Total tax revenue	14.9	20.8
Income taxes	19.8	22.6
Social security taxes	10.3	15.6
Asset taxes	25.9	35.4
Indirect taxes	12.6	19.6
Total revenue	8.1	47.2

Treasury expenditure, January-October		
12 month changes %	2003-2004	2004-2005
Administration	7.2	4.9
Social affairs	8.3	7.0
Economic affairs	7.4	-3.3
Interest	-8.0	41.8
Other	-0.6	76.4
Total expenditure	6.7	10.0

Treasury finances, January-October		
Million krónur	2004	2005
Cash from operations	-2,848	20,294
Net financial balance	6,425	68,671
Debt redemption	-30,856	-61,557
Gross borr. requirement	-30,680	3,814
Net borrowing	30,408	9,048
Overall cash balance	-272	12,862

Economic indicators		
12 month changes %	2003-2004	2004-2005
Inflation – Dec.	3.9	4.1
Core inflation – Dec.	3.5	4.6
Wage index – Oct.	5.3	6.9
Total turnover – Jan.-Aug.	9.6	9.2
Retail turnover – Jan.-Aug.	4.3	6.3
Unemployment (%) – Nov.	2.8	1.7

Ed. Thorsteinn Thorgeirsson: mail: thorsteinn.thorgeirsson@fjr.stjr.is – Dir. Baldur Guðlaugsson. Website: http://ministryoffinance.is