



September 22, 2005

Government aid case before the EFTA Court

On September 21st a trial was held before the EFTA Court in the case of the EFTA Surveillance Authority (ESA) versus the Government of Iceland where the charge was that Iceland had not implemented ESA's decision in connection with Act no. 31/1999 on international trading companies.

The origin of the case was that ESA came to the decision on February 25th 2004 that the exemptions from general taxation laws that were accorded to international trading companies by Acts no. 31/1999 and 29/1999 embodied government aid to such companies that were not in accordance with the EEA-Agreement. The main argument of ESA was that the unlawful government aid was embodied in a lower income tax rate for the international trading companies in comparison with other companies (5 per cent instead of 30 per cent and later 18 per cent) as well as an exemption from paying net wealth tax (which by now has been abolished). In the ESA decision it was also demanded that Iceland should claim retroactively the amount of government aid thus extended to these companies. ESA did not agree with the points of view of Iceland that such differentiation were justified, nor did it think that it mattered that the Act on international trading companies had been abolished with Act no. 133/2004 and the tax exemptions with Act no. 143/2003. The latter Act included a sunset clause whereby companies that had received an operating licence before March 1st 2004 would be allowed to continue operations until January 1st 2008.

Following ESA's decision, correspondence and meetings took place between ESA and the Icelandic authorities as to how the decision of ESA should be implemented. These deliberations ended when ESA filed a case against Iceland before the EFTA Court where it charged that Iceland had not implemented ESA's decision of February 25th 2004 and had thereby not fulfilled Iceland's commitments under the EEA-Agreement.

In Iceland's brief before the Court, it was pointed out that ESA's handling of the case contained serious flaws, that ESA had in part exceeded its authority, that the demand for reimbursement was in conflict with precedent verdicts from the European Court of Justice and was conflict with the principle of lawful expectations. Furthermore, Iceland maintained that it has already implemented ESA's decision since statistical information showed that there was actually no government aid on the basis of the above Acts where the EEA-Agreement would apply.

A verdict is expected before the end of the year.

Outsourcing

One of the options available to the public authorities, when they decide to provide a particular service or implement a certain task is to tender it in the market on a privatisation basis rather than take on the task themselves. The idea behind such outsourcing is in part used to take advantage of competition in areas that hitherto have been monopolised by government. The aim is to use outsourcing to improve services, increase their variety, introduce innovations and save money. At the same time, certain risks and uncertainties associated with providing the service is transferred from the public authorities to the specialised service contractor in return for fair compensation.

Several such government tasks have been outsourced in recent years and turned out well, such as the design and construction of the Hvalfjörður tunnel, the construction and operation of the Sóltún nursing home and the

operation of a crafts and trades school in Hafnarfjörður.

When the government and the City of Reykjavik decided to build a music and convention centre it was decided at an early stage to take advantage of co-operation with private parties in its construction. The reason was, in addition to the above, that the operation of the building would not only be funded by public entities and intended for public events, but that the advantages of private sector participation would be used to bring life to the building through a variety of musical and conference events in addition to other happenings. Furthermore, such a co-partnership was expected to mean that some aspects of operating the building would be arranged more efficiently in its final design. It was thought important that this large investment would be designed with the best efficiency as its guiding light.

In the preparatory stage of the project, the route was chosen to begin by precisely defining the requirements of the building and the artistic activity that was to take place there. Instead of using the conventional method of tendering for offers from private entities, it was decided to commit a certain appropriation from the government and the City over the contract period. Due to the complexity of the project, it was decided that the project would be implemented on a negotiated contractual basis instead of a conventional private project tender. Such a procedure allows for discussions between parties where the private participants can align their offer of participation to the wishes of the public entities over the contracting period. In addition, the public entities have the option to narrow the selection of private participants as the negotiations progress.

In the tender, it is stipulated that participants are called for that are prepared to finance, design, build, operate and own a music and convention centre that fulfils the defined requirements in return for a fixed annual contribution for the next 35 years. Since the contribution was already fixed, the competition of the competing would-be participants consisted only of improving the quality of their offer over the tender period without an extra cost to the public authorities. In the end, one party, Portus Group, won the contract. This party will design, build and operate a spectacular music and convention centre at Reykjavik harbour.

Iceland dispenses advice

Last week, a senior official from the Ministry of Finance of Montenegro came to Iceland to learn about the economic and fiscal policy in this country. Montenegro is federated with Serbia and has a population of 650,000. These two states are almost fully separate and each has its own currency. It is thought likely that the two states will separate entirely in the near future, even next year. Montenegro is making an effort to improve the social fabric of the country. Hydropower is the main power source of the country and it has several aluminium plants, and aluminium is the main export earner. The authorities have in recent years made an effort to introduce market principles to the economy. The privatisation of aluminium companies has begun and the privatisation of communications companies is being prepared.

Economic developments in Iceland have attracted the attention of the Montenegro authorities, and the Minister of Finance of the country has expressed interest in letting the Ministry of Finance in Iceland advice Montenegro on the basis of its experience in managing fiscal finances. In the recent visit, general economic policy, public expenditure, fiscal budget drafting and budget implementation, tax issues and the presentation of government and national accounts were discussed.

Treasury revenue, January-July		
12-month changes %	2003-2004	2004-2005
Total tax revenue	12.7	18.7
Income taxes	11.7	15.2
Social security taxes	10.5	16.2
Asset taxes	18.4	49.8
Indirect taxes	13.7	19.1
Total revenue	2.0	23.0

Treasury expenditure, January-July		
12-month changes %	2003-2004	2004-2005
Administration	5.9	1.8
Social affairs	15.6	7.8
Economic affairs	4.9	-1.1
Interest	-13.5	58.0
Other	-1.4	13.7
Total expenditure	10.0	9.1

Treasury finances, January-July		
Million krónur	2004	2005
Cash from operations	-16,005	4,596
Net financial balance	-14,165	15,802
Debt redemption	-29,142	-33,343
Gross borrowing requirem.	-47,683	-19,790
New borrowing	39,386	13,305
Overall cash balance	-8,296	-6,486

Economic indicators		
12-month changes, %	2004	2005
Inflation - September	3.4	4.8
Core inflation -September	2.8	4.8
Wage index - August	5.2	6.7
Tot. turnover, Jan-June	9.8	8.7
Ret. turnover, Jan-June	5.3	9.0
Unemploy. in % August	2.9	1.8