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Fifty years of the Economic Outlook

The **Economic Outlook** will be published on October 3rd. At this juncture, it should be noted that an economic report bearing this name has played an important role in government reporting on the state of the economy. It began with a report published by the Development Bank of Iceland in 1955 and was continued under its auspices until 1966. In 1972, the research department of the Development Institute published the **Economic Outlook** until 1974 when the National Economic Institute was established and took over its publication. The Institute also issued the series **The National Economy** (Úr þjóðarbúskapnum) which contained papers on economic issues. This publication continued until 2001 when the Ministry of Finance took over the forecasting tasks of the National Economic Institute. This issue of the **Economic Outlook** therefore marks the fiftieth year from its initial publication.

Reports on the state of the Icelandic economy probably began with the **Economic Reports** (Skýrsla um landshagi) edited by Jón Sigurðsson from 1858 to 1875 and published by the Icelandic Literary Society (Hið Íslenska Bókmenntafélag) in Copenhagen. These reports contained a host of statistical information on the country and its people and were remarkable for the contributions by Jón Sigurðsson on the state of the country and its needs. Reports on the Icelandic economy go much further back. For example, it is known that Gissur Ísleifsson, the bishop of Skálholt, registered all farmers in the country in the year 1100. Other reports were made in earlier centuries but they are lost today. A statistical report, **Landshagsskýrsla**, was published in 1896 to 1907, containing valuable information on the state of the economy. Statistics Iceland was established in 1914 and has been charged with the task of accumulating public statistics since then.

The difference between economic statistics reports and reports on the state of the economy is that statistics reports contain information on most aspects of the economy, where definitions and methods of measurement are of prime importance. Reports on economic developments and prospects concentrate on the analysis of the economy on the basis of available economic data and in light of economic theory. Economic reports are expected to provide advice to the government in the area of economic policy, based on analysis and systematic use of economic data in a macroeconomic forecasting model where a forecast is made of the most likely future prospect of the economy, taking into account economic policy measures. Modern macroeconomic reports deal with two major aspects of economic policy, both having a profound effect upon the economy, fiscal and monetary policy. Such reports also increasingly address the long-term effects of organisational changes upon economic growth. In the new issue of the **Economic Outlook**, the Ministry of Finance outlines its national economic forecast for the years 2005 to 2010 and includes a discussion on the use of fiscal policy over the business cycle.

At this fiftieth anniversary of this publication, the opportunity has been used to publish the **Economic Outlook** in a new graphic format, both in print (only in Icelandic) and on the Ministry's website.

Treasury finances in 2004

The Treasury balance, including and excluding irregular items. The Treasury's revenue surplus amounted to 2 billion krónur last year, compared to a 6.1 billion krónur deficit the year before. Excluding irregular items, such as the sale of assets, pension fund commitments and tax claims written off, the 2004 surplus amounted to 23 billion compared with a 1 billion deficit the year before on a comparable basis. The reason why these two balance measures are employed is that such irregular items

cause large fluctuations in the Treasury balance without being associated with the core operations of the Treasury or with direct expenditure decisions. The largest deviations appear in two items, the sale of assets and the expensing of pension commitments. Asset sales were negligible in 2004, compared to an 11 billion revenue in the previous year. Pension fund commitments are difficult to predict beforehand. They are on one hand based on wage increases in the reference group of pension fund members and on the other hand on actuarial assumptions. This is the case in 2004 when such commitments increased by 8 billion krónur due to revised assumptions on life expectancy. Several years ago, the Minister of Finance decided to begin payments to the pension funds of government employees to better prepare the funds for meeting their future pension commitments and prevent a projected exhaustion of their resources in the next ten years, in which case the outpayments of the funds would have hit the Treasury with full force. The cumulative sum of such special payments amounted to nearly 80 billion krónur by the end of 2004, including interest and price indexation. The interest on these inpayments is now such that it is beginning to offset the cost of the funds from the accumulating increase in pension rights and it thereby reduces the fluctuations in the Treasury balances for this reason.

Financial balance. The financial balance of the Treasury amounted to 11 billion krónur in addition to a 9.6 billion krónur prepayment to the pension funds of government employees. The Treasury used the financial surplus to repay long-term debt. At the end of the year, Treasury debt amounted to 253 billion compared with 277 billion the year before. The debt/GDP ratio stood at 28.6 per cent at the end of 2004, having declined by 5.6 per cent over the year. At the end of 1999, the ratio stood at 41.2 per cent.

Treasury revenue. Revenue amounted to 302 billion krónur in 2004, equivalent to 34.2 per cent of GDP, compared with 33.8 per cent in 2003. Revenue from indirect taxes amounted to 131 billion krónur, almost half of total revenue. The increase in income reflects the expansion of the economy and increasing real incomes.

Treasury expenditure. Total expenditure amounted to 300 million krónur, 33.9 per cent of GDP, compared with 34.6 per cent in 2003. Health, social security and social services constitute the largest expenditure categories. A total of 142 billion was allocated for these purposes, about half of total expenditure. Interest payments amounted to 14.2 billion, declining by 7.2 per cent from the previous year. The share of interest in total Treasury expenditure amounted to 4.7 per cent, compared with 7.7 per cent in 1999. Their share has declined by 3 percentage points in the last five years, equivalent to a decline in interest costs of 9 billion measured in 2004 figures.

Abolished taxes

Regardless of differing political opinions with regard to the size of the public sector, the cost of public services is primarily financed with taxes. According to an international classification, the main categories of taxes are: Taxes on income and profit, social security taxes, taxes on payrolls and labour, net wealth taxes, taxes on goods and services, other taxes.

The understanding of the economic impact of individual taxes and tax rates has increased and led to wide ranging tax reforms. Since 1991, decisions have been reached on the abolition of a number of taxes in this country, such as: Turnover tax on businesses, a special tax on commercial and office premises, an income surtax on higher incomes, a net wealth surtax, the net wealth tax.

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 requirement	-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. turnov. Jan-June	9.8	8.7
Ret. turnov. Jan-June	5.3	9.0
Unemploy. in % August	2.9	1.8