3 The fiscal consolidation plan[1]

3.1 Objectives and revision of the plan

In the wake of the financial system collapse in Iceland, a fiscal action plan was formulated in collaboration with the International Monetary Fund (IMF). The plan aims to achieve a balance in the public finances and in the national economy, thereby creating the conditions for renewed economic growth and development. The policy declaration of the governing coalition parties states that a plan for balancing the Treasury's operations no later than 2013 is a paramount priority in the area of public sector finances. This policy of the government was elaborated further and introduced in a special report presented by the Minister of Finance to Parliament in June 2009. The social partners and other stakeholders were consulted on the chief fiscal objectives in the plan.

The aims of the economic programme formulated by the government and the IMF are simple and clear. The programme aims to attain a primary surplus in government finances by 2011 and a sizeable overall surplus by 2013, when the interest balance is included. The size of the surplus at the end of the period is intended to enable the government both to begin reducing Treasury debt and to fulfil the estimated obligations stemming from an agreement concerning settlement of the Landsbanki Icesave accounts in the UK and Netherlands. These do not appear in government finances at this point, however, as a final conclusion has not yet been reached. For the longer term, primary emphasis is placed on returning government operations to sustainability and ensuring that Treasury debt levels are acceptable and bear lower interest expense, which will provide greater scope for expenditures in other categories.

Fiscal sustainability is a fundamental premise for Iceland to be able to maintain its place among the other Nordic welfare states, which is an explicit objective in the coalition parties' policy declaration. An unchanged or substantial deficit, with the vast disparity that currently exists between revenues and expenditures, would rapidly lead to further

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[1] This is a translation of Chapter 3 in the first volume of the budget proposal for 2011, which provides a general overview of the Government's medium-term fiscal policy.

adversities and would result in an unsustainable or unmanageable debt level. The Treasury’s interest expense would grow each year along with attempts to finance the deficit and would ultimately necessitate still further expenditure cuts. Delays in achieving sustainability in public finances therefore will only have the result that coming generations will not be able to enjoy the social welfare system that has until now been a matter of broad-based consensus in Icelandic politics. Consequently, the goal has been set to lower total Treasury debt below 60% of GDP for the long term.

The cornerstones of the Government’s economic policy are a realistic plan for economic reconstruction and a credible fiscal strategy aimed at a balanced budget. In addition to the main objectives described above, the goals of the Government and the collaboration agreement with the IMF are as follows:

- To transform fiscal policy so as to achieve sustainability, with public sector debt stabilised at a manageable level.
- To stabilize the exchange rate of the Icelandic króna and build confidence in monetary policy.
- To reconstruct and restructure the nation’s financial system and its supervisory framework.
- To enable households and businesses to restructure their debt.

The Icelandic economy sustained a severe shock in the fall of 2008, when the country requested the assistance of the IMF and its economic credibility had suffered a heavy blow. In general, it can be said that the primary aim of the collaboration with the IMF was to generate credibility and restore confidence in the Icelandic economy. The second aim was to stabilise the exchange rate, thus anchoring inflation expectations and preventing further deterioration of the balance sheets of households and businesses. The third aim was to recapitalise and restructure the Icelandic financial system, which is one of the fundamental preconditions for providing households and businesses with the assistance and service that they need. The fourth goal was to generate a balance in public finances and ensure their sustainability. The decisions and measures that have been taken in economic and fiscal affairs have been guided by these goals and aim at creating renewed conditions for the growth of the economy.

Economic growth stemming from sound, profitable investments and improving operational conditions for industries is the main prerequisite for attaining equilibrium in public finances in the coming years. The objective is a sustainable growth of the economy that is based on realistic production of valuable goods and services instead of debt accumulation and that does not lead to a disruption of economic equilibrium. In this way, the Treasury and the municipalities' revenue base will grow, there will be less need for austerity measures and expenditure cuts, and it will subsequently be possible to begin retiring debt and to regain social welfare services that need to be scaled back for the time being.

A number of milestones have been reached since the current Government took office. Confidence in Government policy has clearly grown: for example, the credit default swap (CDS) spread on sovereign debt has fallen significantly, the króna has appreciated without FX market intervention by the Central Bank, the recapitalisation of the banking system is complete, and a number of measures have been adopted in order to assist distressed households and businesses. It can be expected that attention will be directed more towards public finances in the near term, as returning them to an acceptable state is clearly a formidable task. Without sound public sector finances, it is unlikely that Icelanders will experience economic stability and enjoy a strong social welfare system over the long term. Consequently, it is likely that, in the years to come, the credibility of Iceland's economic reconstruction will be evaluated largely from the standpoint of the state of public finances and the fiscal policies in place at each juncture.

In the above-mentioned report on the fiscal consolidation strategy, it was planned that the improvement in the primary balance – that is, operating performance excluding interest income and expense – would average about 3-4% of GDP per year. The greatest progress would be made in the first two years, in 2010 and 2011. Based on the operating performance in 2009 on an accrual basis and the estimated performance for 2010, as presented in this budget proposal, the primary balance will improve by approximately 4% in 2010, if irregular one-off revenues from the Central Bank's Avens agreement and the pension funds' purchase of The Housing Financing Fund bonds are excluded. The book value of Treasury revenues generated by the agreement totals 17.5

bi.kr. Next year, the aim is that the improvement in the primary balance will be only slightly smaller, or 3.8%, followed by about 2.5% in 2012 and about 2% in 2013. In 2013, it is expected that the primary surplus will total just over 5% of GDP and that the overall surplus will be 2.5% of GDP. After that, the Treasury balance will need to be kept at that level for a number of years so that it will be possible to diminish the debt burden gradually and thereby reduce interest expense.

The original consolidation plan, introduced last summer, envisaged an improvement in the primary balance that would total over 16% of GDP during the period covered by the plan; that is, 2009–2013. Obviously, such planning concerning future developments in public finances entails considerable uncertainty and must undergo regular review in light of circumstances, so as to reassess the need for policy action. A number of determining factors may develop differently than forecasts indicated, causing progress towards set objectives to become either less or more than anticipated so that the assessed need for adjustment in the Treasury balance may change to some extent with each review. Current plans aim for a 12% improvement in the primary balance during the period under consideration. The main reason for this easing of the consolidation path is that economic developments in 2009 were much more positive than previous forecasts had indicated. In the Ministry of Finance's macroeconomic forecast from May 2009, for example, it was estimated that GDP would contract by 10.6% in 2009, while preliminary figures according to Statistics Iceland's June 2010 macroeconomic forecast suggest that the contraction was 6.5%. Furthermore, the Treasury's debt level and associated interest cost burden have turned out to be less than originally estimated, and the outlook for recovery of claims to finance the Icesave liabilities of the Depositors' and Investors' Guarantee Fund (DIGF) has improved; thus there is hope of a more favourable outcome in that matter than previously expected. Finally, the outcome of the public finances was much more favourable in 2009 than had been projected, as revenues were considerably higher than estimates allowed for and expenditure targets were fully realised.

The economic programme formulated by the Government and the IMF allowed for reviews at quarterly intervals, with the first review scheduled in February 2009. The review was delayed for a number of reasons. Completing the valuation of the new banks proved more time-consuming than expected, as did the initiation of negotiations with the old banks' creditors concerning the settlement of the assets that were taken over. Furthermore, the change of Cabinet in February 2009 and the Parliamentary elections that spring made an impact on the timing. It is also clear that the Icesave dispute with the British and Dutch authorities delayed the first review, which took place in October 2009.

In April 2010, the Executive Board of the IMF approved the second review of the programme, as Iceland had achieved all of the objectives set for that review. This was an important milestone because it opened up access to nearly 100 bi.kr. in loan facilities from the IMF and Iceland's partner countries. This year, it is estimated that some 80 bi.kr. of the Treasury's bilateral loan facilities will be used, including close to 30 bi.kr. remaining from authorised facilities associated with the first review of the economic programme. The funds thus released will bolster the Central Bank's foreign exchange reserves and will secure the Treasury's foreign currency funds in advance of the refinancing of foreign loans maturing in 2010 and 2012, which total about 235 bi.kr. The completions of the second review shows the confidence that the IMF Executive Board and Iceland's partner countries has in Iceland's ability to achieve its objectives. This strengthens considerably the ability of the authorities to meet their obligations.

During the finalisation of the budget bill, it was assumed that the third review of the IMF programme would be discussed by the IMF Executive Board on the 29th September. The Government has worked persistently towards fulfilling all objectives so that the review can take place without delay, as Fund staff have recommended to the Executive Board. Delays in the third or fourth review of the programme would cause delays in further loan facilities from partner countries. Such delays could mean, first and foremost, that it would be riskier to lift the capital controls so that the controls might have to remain in place longer than they would have otherwise. It is unlikely, however, that delays in IMF reviews or associated loan facilities would affect Iceland's credit rating because concerns about the Treasury's ability to pay the loans maturing in 2011 and 2012 have diminished greatly. If there are no further delays, Iceland's IMF programme will come to a close in late summer next year.

3.2 Medium-term plan through 2014

The Government's fiscal consolidation plan has been reviewed in light of changed circumstances and is reissued here in this budget proposal, which thereby represents the Government's policy for revenue generation and expenditure targets in the coming years. The Government Financial Reporting Act, no. 88/1997, stipulates that, with the budget proposal for each year, a medium-term fiscal plan must be presented for a three-year horizon beginning at the end of the fiscal year covered by the proposal. As a result, the plan presented here has been extended until year-end 2014.

Estimated Treasury finances through 2014

ISK Billion	Proposal 2011	Estimate 2012	Estimate 2013	Estimate 2014
Total revenue	**477,4**	**533,2**	**599,4**	**629,3**
of which: Tax revenue	445,5	499,6	558,7	585,3
Total expenditure	**513,8**	**526,8**	**550,5**	**579,9**
Current expenditure	204,4	210,7	219,8	232,1
Interest expense	75,1	78,8	83,5	86,4
Transfer payments	209,8	213,9	223,1	236,9
Maintenance	7,9	8,1	8,2	8,4
Capital outlays	16,6	15,4	15,9	16,1
Total balance	**-36,4**	**6,4**	**48,9**	**49,4**
as per cent of GDP	-2,1	0,3	2,6	2,5
improvement from last year	3,6	2,5	2,2	-0,1
Primary revenue	455,8	510,7	570,0	597,0
Primary expenditure	438,7	448,0	467,1	493,6
Primary balance	**17,1**	**62,7**	**102,9**	**103,4**
as per cent of GDP	1,0	3,4	5,4	5,2
improvement from last year	3,8	2,4	2,0	-0,2
Interest income	21,6	22,5	29,4	32,3
Interest expense	75,1	78,8	83,5	86,4
Interest balance	**-53,5**	**-56,3**	**-54,0**	**-54,0**
as per cent of GDP	-3,1	-3,1	-2,8	-2,7

As is stated above, developments in public finances are still somewhat uncertain, particularly over the long term; therefore, it is necessary to assess the need for adjustment regularly, in view of the above-described objectives concerning deficits and surpluses. The economic assumptions are under continuous reappraisal, and the medium-term fiscal plan needs to be updated at the same time to reflect changed assumptions. The results of the medium-term plan included here are based on the macroeconomic forecast published by Statistics Iceland in June 2010.

The table above shows the Treasury's estimated performance based on the Treasury accounting standard as used in the budget and the annual accounts, i.e. on a semi-accrual basis, and includes the measures necessary to allow the balance on the public finances to develop in line with the collaboration programme of the Government and the IMF. Figures are shown based on the price levels of each year. Presenting revenues and expenditures on an accrual basis allows for an assessment of Treasury performance based on revenues and expenditure obligations over the long term. This accounting basis allows for a more comprehensive view of Government activities, thus facilitating an better assessment of long-term impact and sustainability. The goals that have been set in collaboration with the IMF for Treasury performance and yearly improvement, however, are based on revenues and expenditures on a cash basis. This presentation emphasises the Treasury's cash flows, particularly its net financial balance, and therefore gives more consideration to present the current effects of public finances rather than to the long-term obligations that have been undertaken.

Section 3.3 discusses the revenue side of the plan in greater detail. It should be mentioned here, however, that the Treasury revenue estimate for the next four years is based on the outcome of year-2009 revenues, a revaluation of year-2010 performance, and projections for the coming years, based both on a number of appropriate assumptions, such as the Statistics Iceland macroeconomic forecast, and plans for changes in revenue collection and the tax system.

Section 3.4 discusses in greater detail the expenditure side, the assumptions on which it is based, the nominal expenditure framework for the next two years, and measures to reduce government spending.

Consolidation measures to be adopted in 2011 according to the budget proposal amount to an estimated 44 bi.kr., with around ¾ of the measures affecting the expenditure side and ¼ the revenues side. Sections 3.3 and 3.4 describe the principal measures aimed at improving fiscal performance on the revenue and expenditure sides during the period. If the outlook deteriorates from the assumptions in the plan, it will become necessary to respond with further consolidation measures in order to meet the fiscal performance targets.

The medium-term fiscal plan entails that the overall balance will become slightly positive in 2012 and firmly positive in 2013 and 2014, or by nearly 50 bi.kr. excluding potential interest expense due to the Icesave obligations. The overall balance is expected to yield a surplus amounting to 2.5% of GDP in 2013 and 2014.

According to the plan, the primary balance will be positive by about 17 bi.kr. in 2011 on an accrual basis, or the equivalent of 1% of GDP. The outcome is less favourable on a cash basis, however, as the balance is estimated at 6.2 bi.kr., or 0.4% of GDP. As mentioned previously, the outcome on a cash basis is the criterion on which the IMF programme is based. It is estimated that the primary balance will be positive by 5.4% of GDP in 2013 on an accrual basis and by 5.0% on a cash basis, in line with the final goals of the programme. The medium-term plan envisages a considerable increase in revenues for the years 2012–2014, in which GDP growth, including increased private consumption, will play a significant role. It is projected that, during the period, the Treasury's primary revenues as a share of GDP will rise by 3.3% over and above the estimate in the budget bill for 2011 and will amount to 29.8% in 2014. It is worth noting that the Treasury's primary revenues in 1998–2007 – that is, the last 10 years before the collapse – averaged 32.6% of GDP. It is estimated that primary expenditures will contract by 0.9% of GDP over the period 2011–2014. This is due primarily to a projected 40% reduction in unemployment-related expenses during the period, as well as the firm resolve that other expenditures will be tightly controlled.

The turnaround in the Treasury's primary performance over the period 2009–2013 is about 12%; that is, a 6.7% deficit in 2009 becomes a 5.4% surplus by 2013, which is in line with the revised objectives of the economic collaboration programme of the Government and the IMF. In view of the position in mid-2009, when the primary balance was headed for a 9% deficit and the current Government began implementing fiscal measures, the improvement by 2013 will be 14.4%.

During the period from 2009 to 2013, it is assumed that, due to improved economic conditions and changes in tax laws, revenues will increase from 24.7% of GDP, the estimate at mid-year 2009, to 29.9% of GDP in 2012, in line with Government objectives. The increase in primary revenues will then have generated 5.2% of the total change of 14.4%, so that the share of revenue changes in the fiscal consolidation will be about 36%. Just over 64% is achieved with reductions in primary expenditures, which, during this period, decline by 9.2% of GDP, or from 33.7% as of mid-2009 to 24.5% in 2013.

It is estimated that the interest balance will be negative by 53.5 bi.kr. in 2011. The interest balance is expected to deteriorate somewhat in 2012 but return to 2011 levels in 2013 and 2014. The plan implies that the revenue surplus in 2013 and 2014 will be used to reduce Treasury debt. The table on page 6 shows, however, that interest expense rises through 2014 in spite of lower debt. This is because interest rates, foreign rates in particular, are expected to rise. The table also shows that interest income will increase during the forecast horizon, as higher rates will also affect the Treasury's foreign-denominated deposits.

In 2009–2011, a wide range of measures are adopted in order to improve the Treasury operating balance, with greater emphasis on the expenditures side; that is, through reduction of expenditures both in real terms and as a share of GDP. In 2012–2014, improved Treasury performance is expected to stem primarily from increased revenues based on economic growth, although it will still be necessary to pursue firm restraint in spending.

Although the plan presented here represents a slight slowdown in the consolidation as compared with the report presented in 2009, the main objectives remain unchanged: that the primary balance will become positive in 2011 and that the overall balance returns a considerable surplus in 2013, which will suffice to begin reducing debt and covering interest expense due to the Icesave obligations.

3.3 Revenue projection and revenue generation measures

3.3.1 Assumptions, overall framework, and developments in revenues

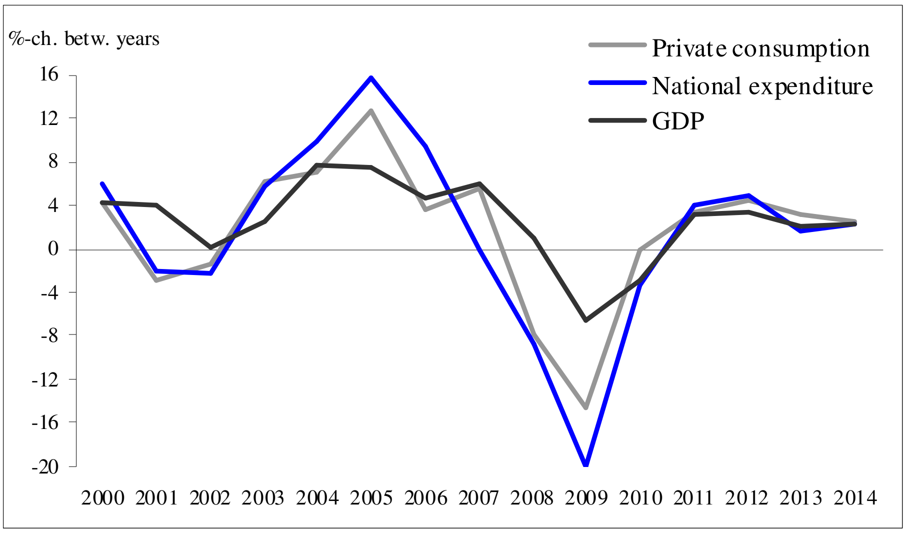
In 2010, the Icelandic economy is rising from the bottom of the recent economic recession. Unemployment will peak in the current year, reaching 9.1% according to forecasts, although there are indications that the jobless rate may become lower than this. Last year's unemployment forecasts, however, assumed that unemployment would average 11% in 2010. The reduced unemployment rate appears to be due to a post-crisis labour market adjustment, a smaller than expected contraction in GDP, and changes in the salary terms of employed persons. Part-time employment has risen, and wages have risen very modestly or even fallen because of curtailed overtime, less wage drift, and reductions in nominal wages. Wages as a proportion of gross factor income have fallen from 71.5% to 57.2% in two years and are now exceptionally low in a historical context. This is clearly revealed in reductions in real disposable income, which will contract by 8.3% this year according to Statistics Iceland forecasts but then rise by 3.7% next year, concurrent with a drop in unemployment.

The revenue projection in the 2011 budget is based on the macroeconomic forecast published by Statistics Iceland on 15 June 2010. The forecast assumes that a slow and gradual recovery will begin in the latter half of 2010. The components of GDP growth will respond at varying speeds, however, and will have varying impact on Treasury revenues. National expenditure, private consumption in particular, and the labour market outlook (wage developments and employment levels) are most significant in this regard. Private consumption is forecast to recover strongly in 2011, with a 3.4% increase in real terms. Investment is also forecast to rise by one-fourth. New revenue generation measures in 2011 are estimated to generate 11 bi.kr. in revenues, as is discussed in greater detail in Section 3.3.2. It is assumed that, after adjusting for these measures, the revaluation of the current year's budgetary revenue projection, and the macroeconomic forecast for 2011, Treasury revenues as a proportion of GDP will be close to 2009 and 2010 levels, or 25.9%, in 2011.

As has already been mentioned, the aim is to balance the public finances no later than 2013. The revenue projection included here contributes to the achievement of that objective and is aligned to the fiscal framework established by the Government for the next several years, including the restraint objectives on the expenditures side.

The Treasury revenue projection for 2012–2014 is based on the outcome of revenues according to year-2009 Treasury accounts, a revaluation of the year-2010 budget estimates, the revenue projection in the year-2011 budget proposal, and the Statistics Iceland macroeconomic forecast.

Economic growth 2000–2014



According to the Statistics Iceland forecast, private consumption will continue to grow in coming years, following a real increase of 3.4% in 2011. As such, private consumption is assumed to increase by 4.4% in 2012 and by 3% and 2.5% in 2013 and 2014, respectively. If the Statistics Iceland forecast materialises, unemployment will subside steadily to about 4.8% in 2014, with positive effects on households' disposable income. Inflation is projected to remain rather stable at about 2.5% throughout the forecast horizon. These developments will probably be reflected in coming years in rising tax revenues from both income and turnover taxes, which have taken a plunge since the crisis struck.

In preparing the revenue projection through 2014, it was also assumed that changes in the tax code will remain in effect throughout the horizon; that is, that temporary measures will be either extended or replaced with equivalent revenue generation measures. Besides temporary tax provisions, this applies also to the social security tax which is assumed to remain unchanged throughout the period. Furthermore, it is assumed that the principal nominal taxes and fees will be changed annually in line with the general price level.

The increase in tax revenues will be based on progress in economic affairs. As noted above, the macroeconomic forecast assumes GDP growth in coming years. Among other things, it is expected that wages as a share of factor income will rise and that private consumption as a share of GDP will rise as well. Both trends will affect Treasury revenues, irrespective of changes in taxation rules. It is clear, however, that the authorities' plans are dependent on economic developments. If the economic turnaround is not as strong as the authorities hope for, it will prove necessary to change projections to accord with that reality. In that case, it could become necessary to implement further streamlining measures in government operations if revenue sources do not recover in the wake of growing economic activity.

The mixed approach of expenditure cuts and revenue generation measures that the Government has pursued in order to achieve fiscal balance is subject to continuous review and will be adjusted in accordance with the progress made on both fronts. As such, attempts are being made to minimise both the impairment to the economy caused by cutbacks in public consumption and the negative effects that may accompany revenue generation measures.

Even though the Government's aim is to bring in increased revenues on the basis of growing economic activity, it will also be necessary to implement additional revenue generation measures during the period if the goal of achieving a positive overall balance in 2013 is to be reached. The following table shows the main variables for the period 2011–2014, based on the above-specified assumptions.

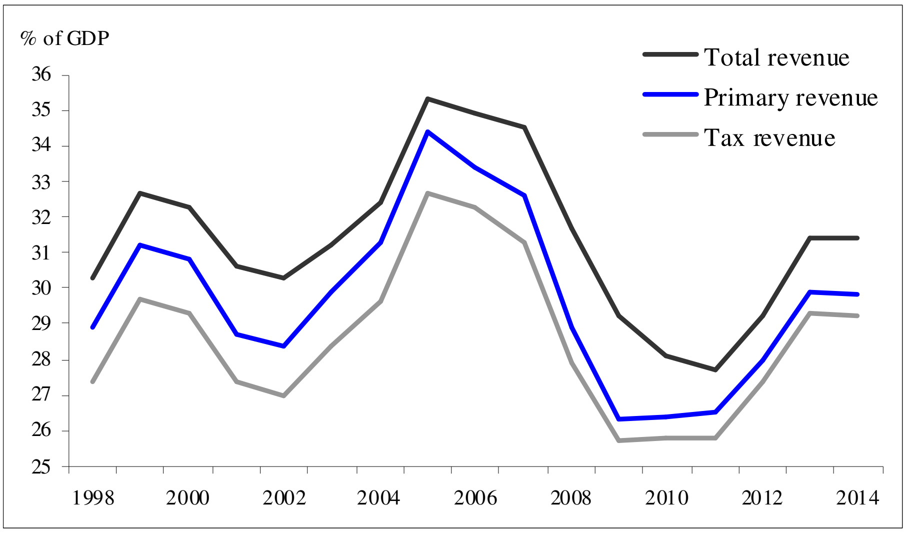
Total revenue, primary revenue, tax revenue

Accruals basis, ISK billion	2011	2012	2013	2014
Total revenue, frame	477,4	553,4	599,7	629,6
of which: Tax revenue	444,1	499,6	558,7	585,3
- - primary revenue	455,8	510,7	570,1	597,1
Tax revenue as % of GDP	*25,9*	*27,4*	*29,3*	*29,2*
Primary revenue as % of GDP	*26,5*	*28,0*	*29,9*	*29,8*

As is stated above, the revenue projection is based in part on the macroeconomic forecast published by Statistics Iceland in June.

Deviations from that forecast could change the scenario presented here as regards developments in Treasury revenues through 2014. Contractual wage agreements in the private and public sectors will be a major determinant of economic developments in the medium term, and the results of wage negotiations will also prove decisive in determining whether the revenue forecast here materialises.

Treasury revenue 1998-2014 (excluding irregular income)



3.3.2 Revenue generation measures during the consolidation period

The role of the revenues side in the consolidation process has entailed implementing a number of new revenue generation measures at a time when the economy has been in a deep recession. In many instances, the Treasury's tax bases have sustained heavier blows than the economy at large, and developments in revenues have been shaped by the interplay of a weaker tax base and the resistance provided by fiscal policy through tax system changes designed to achieve the intended objectives of the fiscal consolidation plan.

The first tax changes were implemented at year-end 2008. Further changes were made in May and June 2009, in support of fiscal objectives. These included both permanent and temporary measures, as a result of which the 2009 budgetary targets were reached with room to spare. The year 2010 will carry most of the weight of new revenue generation measures, which nonetheless proved smaller in scope than was expected during the preparation of the 2010 budget.

An important supplement to the revenue generation measures benefiting the Treasury and the municipalities as well is the authorisation for limited Pillar III pension savings payouts to persons under the age of 60, i.e. private pensions stored in individual accounts. This measure alone has yielded considerable revenues for the central and local governments in 2009 and 2010. It should be noted, however, that this is not a new source of revenue but rather an acceleration of income tax payments and local tax payments that would otherwise have been remitted later.

Effects of revenue generation measures, 2009–2011

Accruals basis, ISK billion	2009	2010	2011
Increased PIT	10,8	14,7	21,9
Increased SSC	6,0	24,4	25,5
Fixed fees in ISK, tariff increase	6,5	12,0	12,8
Standard VAT rate increase	-	4,0	4,3
New tax on wealthy individuals, incr. estate tax	-	3,5	6,2
New environmental and carbon taxes	-	4,7	6,7
Other taxes	0,4	4,6	4,6
Total without private pension	**23,7**	**67,9**	**82,0**
PIT on new allowance for use of private pension	5,3	4,8	3,9
Total with private pension	**29,0**	**72,7**	**85,9**

The discussion below describes in broad terms the revenue-generating measures that have already been adopted and those planned for 2011. Further discussion of individual measures, their impact on revenues, and overall developments in revenues can be found in the report on Part A revenues, in the second volume of the budget proposal. Revenue generating measures adopted from December 2008 until the present can be divided into the following categories:

- Income tax increases
- Social security tax increases
- Increases in various excise taxes; fee increases
- Increase in upper-bracket value-added tax
- Adoption of a net wealth tax
- Adoption of new environment and natural resource taxes
- Pillar III private pension savings withdrawals

Income tax increases. When the individual income tax was raised by 1.35 percentage points at the beginning of 2009, the personal deduction was simultaneously raised by 24%, which raised the tax-free threshold significantly. In mid-2009, high-income taxes were imposed on individuals' earned income and financial income over a specified threshold. These two taxes were temporary and were replaced at the end of the year. The rules concerning payment periods and due dates for financial income taxes in the tax withholding system were changed, calling for quarterly remittances instead of annual, which generated 10 bi.kr. in 2009 instead of 2010. The year-2010 budgetary bill introduced plans to merge all individual income into a single tax base, but the idea was later abandoned. Instead, the tax on financial income was raised at the beginning of 2010 and a tax-free threshold adopted for interest income, and a three-bracket income tax system replaced the single income tax bracket. The personal deduction was raised by 24,000 kr. per year, but CPI indexation of it was discontinued. The income tax on businesses was raised to the same level as the financial income tax. The temporary high-income tax imposed in 2009 yielded the intended results, or 11 bi.kr. on an accrual basis and nearly 10 bi.kr. on a cash basis. The changes in the tax system introduced at the beginning of 2010 have increased Treasury revenues significantly, but nonetheless, the increase was somewhat less than had been estimated in the first half of the year. A given amount of uncertainty is usually associated with the collection of a multi-bracket tax in a withholding-based system, and it can be assumed that a larger share than before will be collected retroactively, after tax assessment notices are sent out.

Payroll tax increases. The measure that generated the most significant revenue increase in 2009 (apart from the time-shift in collection of financial income tax) was the 1.65 percentage point social security tax increase imposed in mid-2009. The payroll tax was then raised by a further 1.66 percentage points at the beginning of 2010. These increases were based in part on the Unemployment Fund's growing financial need as this portion of the tax is earmarked to the fund. The social security tax increase is estimated to generate revenues in the amount of 24 bi.kr. in 2010.

Increases in various excise taxes, fee increases. So-called nominal taxes have been raised as much as three times since December 2008.

These are excise taxes that were determined as a specified nominal amount per unit volume: excise taxes on petrol, diesel fuel, alcoholic beverages, and tobacco; a per-kilometre charge, and the motor vehicle weight tax. Some of these taxes had not been raised for a long time; thus, it is not inappropriate that some of the first measures should entail bringing them into line with their previous real value. For example, the alcoholic beverage tax on beer was set at 58.7 kr./cl according to the original legislation on alcoholic beverage taxes, passed in September 1995, and it remained unchanged until December 2008, although the general price level rose by over 90% during the interim. After three increases, the alcoholic beverage tax in all categories is still much lower in real terms than it has been for a long period of time. The nominal taxes have been raised by various amounts, and the per-kilometre charge has been reduced to a level below that in 2008. At the beginning of 2010, an increase in the króna amounts of a number of fees provided for in the Treasury Special Revenues Act took effect, with the tax on court cases weighing heaviest. The combined revenue generation effect of these increases is estimated at 6 bi.kr. in 2009 and about 12 bi.kr. in 2010. Also worth mentioning is the increase in the excise tax on foods with a high sugar content, which took effect in the autumn of 2009.

Increase in upper-bracket value-added tax. Changes in the value-added tax system were under scrutiny in the fall of 2009, including broadening the tax base and increasing the number of tax brackets to three. Upon consideration of a number of factors, including the estimated inflationary effects and the expense associated with implementing a more complex tax system, it was decided only to raise the upper VAT bracket from 24.5% to 25.5%. Additional revenues due to this increase were estimated at 4 bi.kr. This general VAT bracket is now the highest in Europe, while the lower bracket (7%) is low in an international context.

Adoption of wealth tax. At the beginning of 2010, a wealth tax on individuals' net assets was introduced. In recent years, substantial monetary assets have accumulated in the hands of a small group of people, but the returns on those assets have been taxed at a very low rate. The wealth tax is imposed on net assets in excess of 90 million kr. for individuals, and 120 million kr. for couples. The tax rate is 1.25%, and the tax is imposed temporarily, until 2012. The wealth tax yielded 3.8 bi.kr. in 2010, which is slightly more than previously estimated.

Adoption of new environment and natural resource taxes. The budget proposal for 2010 introduced ideas concerning new environment and natural resource taxes. New legislation was passed at the end of 2009, but it was narrower in scope than the budget proposal. A carbon tax on liquid fuels was adopted, as were natural resource taxes (energy taxes) on electricity and hot water. The carbon tax is determined with reference to the price of emissions allowances according to the EU Emission Trading System (EU ETS). For example, it is set at 2.90 kr. per litre of diesel fuel and 2.60 kr. per litre of petrol. The electricity tax is set at 0.12 per kilowatt hour, and the hot water tax is 2% of the wholesale price. The estimated revenue generation effect of the new legislation is about 4.5 bi.kr. per year. The Act will expire at year-end 2012.

Pillar III private pension savings withdrawals. The final measure mentioned here is the temporary authorisation for withdrawal of individuals' Pillar III private pension savings, which helps individuals to mitigate the contraction in their disposable income. The authorisation to withdraw up to 1 million kr. was granted as of March 2009, and withdrawal of an additional 1.5 kr. was authorised as of the beginning of 2010. As of end-August 2010, individuals had applied for withdrawal of a total of 41 bi.kr., or about 2.6% of GDP. Income tax is paid on these withdrawals, and it is estimated that the revenues thus generated totalled about 3.6 bi.kr. on a cash basis in 2009 and will exceed 5 bi.kr. in 2010.

Statutory amendments have also been passed in order to assist taxpayers. These include an increase in the reimbursement percentage for value-added tax on maintenance and renovation of residential property and new tax deductions for individuals engaged in residential housing construction or investment in new business ventures related to innovation or pioneering firms. Furthermore, such new business ventures have been allowed a special deduction from their tax base for research expense related to further innovation.

The discussion above summarises the tax system changes made in order to generate further revenues in 2009 and 2010. Ahead is the third year of the fiscal consolidation programme. It is intended that special measures on the revenues side will generate 11 bi.kr. in new revenues in 2011, or nearly one-fourth of the year's consolidation. This represents a much smaller step in revenue generation than in the past two years, with the goal of making as small an impact as possible on households' disposable income. No changes will be made in taxes on earned income or in value-added taxes. The focus is on taxes on capital and assets, particularly in those areas where the current tax system is more lenient than is customary in neighbouring countries. The following discussion outlines the changes proposed for 2011. Most of them are in line with the ideas presented in the interim report submitted by the work group appointed by the Minister of Finance to examine the entire tax system. The table on page 19 shows the amounts that the measures are estimated to generate according to the revenue projection for 2011.

It is proposed that taxes on individuals' financial income and legal entities' profits will be raised from 18% to 20%. They will still be somewhat lower than is common in the other Nordic countries and the euro area. Because Iceland's inheritance tax is also low in comparison with that in most neighbouring countries, it is proposed to raise the tax from 5% to 10% in 2011. It is also planned that a larger step be taken in taxation of assets through the temporary wealth tax. It is assumed that this tax will generate 1.5 bi.kr. in additional revenues through an increase in the tax rate, which is now 1.25%, and/or a reduction in the tax-free threshold, which is now 90 million (net) for individuals and 120 million for couples. It is also assumed that a special excise tax will be levied on alcoholic beverages and tobacco sold in the Duty-Free Store at Leifur Eiríksson International Airport in 2011. Also under consideration are internal changes in alcoholic beverage taxation, based on the strength of the beverage concerned, and a tobacco tax. When the carbon tax was imposed in 2010, it was only levied at 50% of the full fee based on the price of EU ETS emission allowances; thus, it is planned to raise the percentage to 75% next year. In preparation is a radical change in the rules on motor vehicle taxes and excise taxes on motor vehicles, so that these taxes will be determined based on carbon emissions levels. It is expected that such changes will generate some additional revenue. Finally, the idea of imposing a special tax on banking operations has been under consideration, with reference to new legislation of this type in a few neighbouring countries. The above-specified measures are estimated to yield the Treasury over 8 bi.kr. in revenues. This does not include the new authorisation for Pillar III private pension savings withdrawals. It is assumed that the income tax on such elective withdrawal could generate another 3 bi.kr., in addition to the revenue generation effect of previous pension withdrawal authorisations.

Special revenue generation measures 2011

Accruals basis, ISK billion	ISK billion
Capital income tax	1,5
Corporate income tax	0,5
Estate tax	1,0
Net wealth tax	1,5
Alcohol and Tobacco levies	1,3
Carbon tax	1,0
Annual car weight tax	0,2
Bank levy	1,0
Total without private pension	**8,0**
PIT on allowance for use of private pension	3,0
Total with private pension	**11,0**

As is stated in Section 3.3.1, it will probably be necessary to adopt some measures to generate additional revenues in the years after 2011; however, the scope of such measures will be determined by economic developments.

3.4 Expenditure projection and cost-restraint measures

3.4.1 Assumptions, overall framework, and developments in expenditures

The medium-term plan presents developments in the main categories of government expenditure according to their economic breakdown into current operating costs, interest expense, transfer payments, maintenance, and capital costs. It is based in part on demographic assumptions and on an assessment of changes in the ministries' expenditure obligations during the period, with a review of, for example, allocations to temporary projects, foreseeable weaknesses, and a revaluation of the main calculated and systemic expenditure categories. It should be noted that, at this point, the presentation of neither the plan nor the budge proposal includes the transfer of the affairs of the disabled from the State to the municipalities that is under consideration. Developments in total expenditures and expenditures according to the economic breakdown in the medium-term plan are shown in the table on page 6.

The medium-term plan assumes that, beginning in 2012, public employees' salaries will rise by 2% and benefits for the elderly and the disabled and others will rise in line with the inflation forecast (see Section 8 on macroeconomic assumptions). Unemployment compensation is expected to develop in line with the forecasted rate of unemployment, and interest expense is calculated on the basis of the composition of debt and interest rate categories. The projection assumes that most other operating expenses, the revenues of agencies from sales of their services and goods, and other transfers to households, organizations and companies will rise in line with inflation. It is assumed that systemic growth will average about 4% per year in child benefits expenditures, and about 2% in mortgage interest rebates. No other real growth in ministerial functions is expected, except for demographic growth in retirement and disability pensions and in pharmaceuticals. In general, the expenditures side of the medium-term plan makes no allowance for increases in volume over the period – that is, increased number of government employees, students, etc. – which actually implies that any such increases occurring in specific functions will have to be offset by means of restraint measures or a contraction in expenditures for other projects. In line with the renovated fiscal framework, the plan is designed to generate 5 bi.kr. unallocated contingency fund annually, which can later be allocated towards deviations from price level assumptions and unforeseen but unavoidable obligations that may occur each year.

The following table presents total Treasury expenditures through 2014 according to the plan. It also specifies certain irregular items that are not a part of core operations and may fluctuate considerably between years due to economic developments or retroactive assessment after reconciliation of annual accounts, and are therefore extremely difficult to predict and do not fall under any direct Government decision-making associated with budget preparation. An example of such an item can be found in the Treasury accounts for 2008, when an increase of 41.5 bi.kr. in the pension obligation for State employees was expensed, while in 2009 the same item amounted to 1.4 bi.kr. More specifically, the irregular items in question include expensed unfunded liabilities for the State employee's pension fund, financial income tax that is paid by the Treasury and also entered on the revenue side, write-offs of tax claims, government guarantees of debts, lost claims, unemployment benefits, the statutory contribution to the Municipal Equalization Fund based on State tax revenues, and interest expenses. The total expenditure frame for each year, which is to be used as a basis for budget preparation, is obtained by excluding these irregular items from the expenditures in the medium-term plan. In the medium-term plan, these items combined are estimated at 132.4 bi.kr. for 2011; however, as is noted above, the final figure is subject to considerable uncertainty. The total expenditure frame for 2011 will therefore be 381.4 bi.kr. excluding these irregular items.

Irregular items and total expenditure frame

ISK Billion	Proposal 2011	Estimate 2012	Estimate 2013	Estimate 2014
Total expenditure	513,8	526,8	550,5	579,9
Irregular items				
Pension fund liabilities	5,4	5,5	5,7	5,8
Capital gains tax	2,6	2,4	2,4	2,5
Tax write-offs	10,0	10,0	10,0	10,0
Unemployment	24,9	19,0	15,9	15,4
Municipal Equalisation Fund	11,2	12,9	14,1	14,8
State guarantees	3,1	3,1	3,1	3,1
Write-offs	0,1	0,1	0,1	0,1
Interest expense	75,1	78,8	83,5	86,4
Total irregular items	**132,4**	**131,9**	**134,7**	**138,0**
Expenditure frame	**381,4**	**395,0**	**415,9**	**441,9**

The medium-term plan entails that the total expenditure frames will be binding. This is considered an essential step towards strengthening the budgetary framework, as was stated in the previously mentioned 2009 report on the consolidation plan. The ministries' annual budget preparation will therefore take place on the basis of the frames presented here. Many parties that keep abreast of fiscal affairs in

Iceland, including international organizations, have considered this change in procedure to be a key move towards enhancing the credibility of the budget.

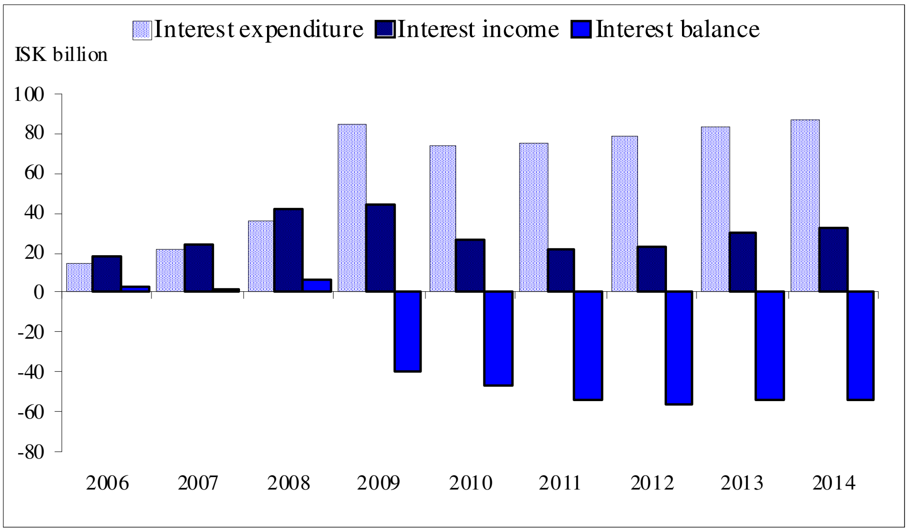
The expenditure framework for each year includes estimated changes in wages and salaries, exchange rate, and price level. The plan is based on the policy that for the first two years – 2011 and 2012 – the frame will be binding in nominal terms if deviations from price level assumptions are within 1.5%; otherwise, the expenditure categories concerned can be reviewed. As is already mentioned, the plan allows for the generations of a 5 bi.kr. contingency fund that may be allocated towards unforeseen price level deviations and obligations each year. In other respects, all decisions and deviations must be accommodated within the overall budget frame. Consequently, the overall frame may not be changed at later stages so that all decisions to increase expenditures in particular categories of government operations must be offset by an equal decrease in the spending of other categories. This policy implies that the guideline expenditure frames for 2013 and 2014 can be reviewed in the spring of 2013 during the preparation of the budget proposal for 2013, with an eye to wage and price assumptions and possible changes in circumstances.

In the medium-term plan – and therefore, in the budget proposal – it is projected that primary Government expenditure excluding the above-specified irregular items will total 381.4 bi.kr. but will increase by 1-2% of GDP in 2012 through 2014. Developments in primary expenditures are discussed in further detail in Section 3.2.5 in the second volume of the budget proposal.

3.4.2 Interest balance

The Treasury interest balance was positive in 2006 through 2008, as the accompanying chart shows. In 2009, however, after the economic collapse, it turned around sharply and was negative by 40 bi.kr. The interest balance is projected to remain negative by 47–56 bi.kr. through 2014.

Financing balance



As is described in Chapter 4 on Treasury debt management and credit procurement, this unfavourable interest balance is attributable to the enormous debt burden that the State had to shoulder in the wake of the bank collapse in the fall of 2008. Not only did the Treasury have to issue a bond at the end of 2008 amounting to 270 bi.kr. to the Central Bank in order to strengthen its equity position due to its losses on collateralised and overnight loans upon the failure of the banks, but had also to issue bonds for some 96 bi.kr. in excess of repayments on outstanding loans in order to fund the fiscal deficit in 2009. The Treasury also utilised part of the loan facilities from Iceland's partner countries in 2009 in order to expand the foreign exchange reserves. Furthermore, a special series of Treasury bonds was issued, in the amount of 190 bi.kr., in order to finance the capital injections provided to the commercial banks. It needs to be borne in mind, however, that the loans to expand the foreign exchange reserves and the capital contributions to the commercial banks are offset by monetary assets and share capital.

In 2010, it is estimated that interest expense in excess of interest income will total 47.4 bi.kr., as opposed to the 58.9 bi.kr. assumed in the budget for the year. There are three main reasons for the decrease. First, the estimated interest expense on Treasury securities has declined because Treasury bond yields have been lower than previously estimated in spite of foreseeable sizeable bond issues. Second, less will be drawn on the loan facilities from Denmark, Sweden, Finland, and Poland than previously anticipated. Third, the bond that the Treasury issued to the Central Bank at year-end 2008 in order to strengthen the bank's capital position declined by 134 bi.kr. at year-end 2009 when the Central Bank purchased claims assumed by the Treasury at the previous year-end.

In 2011, it is estimated that the interest balance will be negative by nearly 53.5 bi.kr., some 6 bi.kr. more than the estimate for 2010. Interest expense will be about 1 bi.kr. higher, and interest income will be roughly 5 bi.kr. lower.

The main reason for the increase in interest expense in 2011 over and above the 2010 estimate is the increase in domestic Treasury bonds and loans from partner countries, the impact of which does not emerge in full until 2011, as the bulk of the borrowing took place in mid-2010. This is offset, however, by reduced interest expense on the recapitalisation of the banks because of a projected decrease in Central Bank interest rates compared to this year. That monetary easing will also affect interest income, which will decline both for this reason and because it is expected that some 20 bi.kr. of the Treasury deposits in the Central Bank will be utilised in 2011. Interest income on foreign loans that were taken by the Treasury in 2006 and 2008 to strengthen the foreign exchange reserves and are scheduled to mature in 2011 will decline as well. The Treasury bought back a portion of this debt in 2010.

As can be seen on the graph at the beginning of this section, the deficit in the interest balance increases steadily in comparison with current estimates, from 2009 until 2012, when it peaks at 56 bi.kr. and then begins to taper off. This is based on the assumption that plans to reduce Treasury debt gradually will be successful, concurrent with improved fiscal performance. On the other hand, it is assumed that interest rates will begin rising, which will cause a marginal increase in interest expense in spite of declining outstanding debt. It is estimated that roughly 70-80% of interest payments will be due to domestic obligations.

3.4.3 Restraint measures on the expenditures side

Treasury expenditures have already been reduced considerably, and the budget proposal provides for continued implementation of extensive measures to curtail operations in most areas of the government. The restraint measures have entailed abandoning various previously planned expenditures, preventing a range of expenditure increases that would otherwise have occurred, and – last but not least – implementing direct budget cuts, based both on general objectives for achieving targets in various governmental functions and on decisions concerning measures in specific projects and services, such as changes in benefits systems or plans for transport and communications development.

The consolidation process can be considered to have been commenced with the budget proposal for 2009, which was presented shortly before Iceland's banking system failed. No radical austerity measures were implemented in the 2009 budget upon its passage by Parliament, however, in the sense that a considerable share of the measures primarily involved abandoning or reducing allocations to the further build-up of various projects and services and to increased scope of operations provided for in the proposal. Including all of these, the 2009 budget allowed for cuts of 33.1 bi.kr. from the expenditures planned at the time the budget proposal was presented to Parliament. This entailed, among other things, reducing operating expenses by 3-5% from the figures in the 2009 bill. This reduction was implemented differently by the line ministries, but as an example, officials' salaries were cut by 5-15%, pursuant to a decision by the Employment Terms Council. Overall operating expenses declined by 13 bi.kr. In addition to this, a number of transfers were reduced in comparison with the proposal. Most significantly, plans for 1.2 bi.kr. in increased contributions to development aid were abandoned. Allocations to the Icelandic Student Loan Fund were cut by 1 bi.kr., as the fund's capital position made this feasible. Medical insurance expenditures were cut by 1 bi.kr. through reductions in various expense items, increased patient participation in payments, and changes in income means-testing. The contribution to the Rehabilitation Fund was reduced by 375 million kr. from previous plans, and allocations to parishes and religious organisations were reduced by 300 million kr. In all, transfer expenditures were reduced by 9 bi.kr. Capital outlays were cut by a total of 11 bi.kr., largely due to the deferral or abandonment of various road construction projects in the amount of 6 bi.kr. In addition, harbour and coastal flood protection projects amounting to 500 million kr. were deferred. The Coast Guard renegotiated project agreements concerning the construction of a new ship and aircraft, which were intended to defer costs in the amount of 2.3 bi.kr. to 2010. In addition to the above-specified cutbacks, decisions were made which prevented expenditure increases in the amount of 5.5-6.0 bi.kr. that would otherwise have occurred.

By mid-2009, it was clear that these measures would be far from sufficient to reach the year's fiscal targets. The new Government that had taken office following the spring Parliamentary elections decided to adopt without delay further consolidation measures in the latter half of that year. Those measures involved decisions to cut expenditures by a further 9.4 bi.kr. with various restraint and savings actions. Operating expenses were reduced in the latter half of 2009 with reduced allocations to administrative and supervisory institutions in the amount of 2% of the year's total turnover; furthermore, contributions to educational institutions and social welfare institutions were cut by 1.6% and 1%, respectively. In all, operating expenses were reduced by 1.8 bi.kr. in the supplementary budget for 2009. Transfer payments were cut by 3.1 in the supplementary budget. The most substantial measure was a reduction of 1.8 bi.kr. in pension insurance expenditures, which was achieved by increasing means-testing in the calculation of pension benefits, with the result that payments to higher-income pensioners were reduced the most. Maintenance and capital outlays were reduced still further, by about 4.4 bi.kr., including 3.5 bi.kr. for road construction.

It can be said that fiscal consolidation measures began to emerge with full force in 2010. Measures to contract Treasury expenditures for 2010 totalled 43.8 bi.kr., the equivalent of a 9.7% reduction from the 2009 budget, excluding interest expense and irregular items such as write-offs of tax claims and pension liabilities. Part of this was due to the full-year impact of measures implemented in the latter half of 2009; therefore, new measures were assessed at 36 bi.kr. In addition, through a decision to exercise the utmost restraint concerning wage and price rises in the 2010 budget, it was possible to avoid expenditures of 11 bi.kr., which could otherwise have been incurred due to increases in benefit payments and State employees' salaries based on then-current forecasts concerning developments in the CPI and a 3% wage hike. Therefore, it is assumed that the 2010 budget reduced or prevented expenditure increases in the amount of 55 bi.kr.

Operational restraint measures total about 14 bi.kr. in 2010. Measures to decrease operating expenses usually need a certain amount of lead time, and it can take a while before their effects emerge fully. For this reason, ministries and institutions already began initiating cost-cutting measures in 2009. In order to achieve such reductions in operating expenses, it has been necessary to reduce almost all of the expenditure items that are classified as operating expenses, including salaries, travel expense, outsourced services, etc. Targets in the 2010 budget include achieving a reduction of 10% in the operating costs of administrative and supervisory institutions, 7% of educational institutions engaged in teaching, and 5% of healthcare institutions and those providing services to the disabled. Measures to reduce transfer expenditures total 15.8 bi.kr. They entail changes in benefits systems, reductions in contributions to development aid, and reductions in miscellaneous subsidies and allocations. The most substantial measure consists in a reduction of 4.4 bi.kr. in pension insurance expenditures, which was achieved by increasing deductions depending on reference income so as to reduce payments to higher-income pensioners. Pension benefits to the lowest-income pensioners are not affected by these measures. The budget also provides for a decline in medical insurance expenditures by 3.6 bi.kr. as a result of changing the criteria for Treasury participation in the cost of pharmaceuticals and by reducing the scope of medical specialists' services. Expenditures related to the Parental Leave Fund were cut by 1.6 bi.kr. by lowering the ceiling on maximum payments and the ratio of payments depending on income prior to the childbirth leave. Measures to reduce maintenance and capital outlays in 2010 total 13.9 bi.kr. The largest cutback, 12.3 bi.kr., is in maintenance and new construction in the road system. With these restraint measures, central government investment will be about 1.4% of GDP in 2010, as opposed to an average of 1.9% in the period 2001-2007 before contributions rose sharply in 2008, primarily due to road system construction.

The following table shows the restraint measures in the 2010 budget, both in terms of economic breakdown and as a share of turnover in the 2009 budget, excluding irregular items and interest costs.

Restraint measures 2010, economic breakdown

Accruals basis, ISK billion	Cuts 2010	Expendit. 2009	Cuts in %
Current expenditure	-14,0	198,9	-7,0%
Transfers	-15,9	206,0	-7,7%
Maintenance and investment	-13,9	43,7	-31,8%
Total	**-43,8**	**448,6**	**-9,8%**

The 2011 budget proposal includes plans to reduce prospective expenditures by an additional 33 bi.kr. with new restraint measures. In order to achieve this contraction in expenditure, it has been decided to pursue an approach that is broadly composed of three courses of action. First, it is proposed that there will be no increases in the wages of government employees or in the reference amounts for the main benefit and subsidy systems, such as the social security system, unemployment benefits, child benefits, etc. It is estimated that this measure will prevent expenditures amounting to at least 5 bi.kr. in comparison with the assumptions of previous medium-term projections. Second, it has been decided to undertake certain specific expenditure cuts totalling 10 bi.kr., centring on a few heavy-expense items. Included in this amount is a reduction of 3 bi.kr. in allocations to road construction. It has also been decided to launch measures aimed at reducing expenditures in several large benefit and subsidy systems; that is, childbirth leave, child benefits, and mortgage interest rebates. Third, these special measures make it possible, however, to avoid direct cuts in social security system benefits for the elderly and the disabled; moreover, they make it possible to set general expenditure restraint targets for the ministries that provide for much more lenient cost-cutting requirements for medical insurance (3%) and social welfare, upper secondary schools, and law enforcement (5%) than for the operation of general service, administrative, and supervisory systems, as well as miscellaneous allocations and other general transfer expenditures (9%). It is estimated that these measures will reduce expenditures by 18 bi.kr. Therefore, in 2011, direct restraint measures will yield a reduction of budget turnover in the amount of 28 bi.kr., and a further 5 bi.kr. reduction in expenditures that would otherwise have been incurred. Section 3.2.3 in the second volume of the budget proposal discusses the restraint measures more fully. The following table shows the economic breakdown of the reductions in spending that these plans and prioritisation entail. Irregular items such as interest expense and pension obligations are excluded from the turnover figures.

Restraint measures 2011, economic breakdown

Accruals basis, ISK billion	Cuts 2010	Expendit. 2009	Cuts in %
Current expenditure	-12,7	204,8	-6,2%
Transfers	-11,4	211,5	-5,4%
Maintenance and investment	-3,9	27,7	-14,1%
Total	**-28,0**	**444,0**	**-6,3%**

It is expected that, in coming years, a considerable share of operational cost reduction will be achieved through reorganisation of the institutional system, transfer of functions, and merger of ministries and institutions, as well as a re-evaluation of the tasks being carried out. The objective is that such changes shall generate savings of at least 5-10%. Several institutions have already been merged, and it has been decided to merge some of the ministries. These plans are discussed in greater detail in Section 3.2.4 in the second volume of the budget proposal.