

English translation of the Weekly Web Release



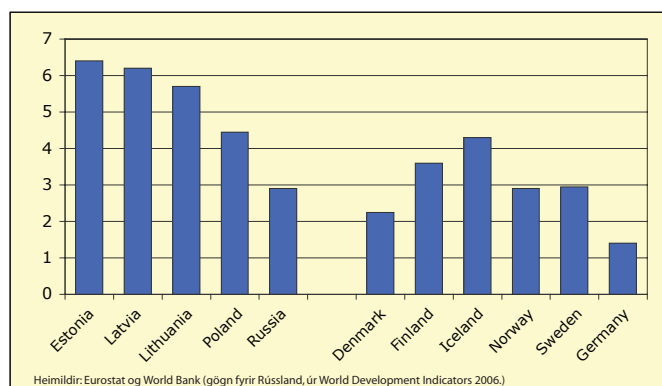
MINISTRY OF FINANCE IN ICELAND

May 18th 2006

The economic integration of the Nordic and Baltic countries

The recent addition of Baltic countries (Estonia, Latvia, Lithuania and Poland) to the European Union represents new opportunities and challenges for these countries and their Nordic neighbours. The geographic position of these countries moves the boundary of the EU to the east. Over the past decade, these countries have been preparing for EU membership by introducing extensive structural changes that have already begun to bear fruit. Following many decades of stagnation, these countries have embarked upon a market-driven integration that translates into increasing international trade, direct foreign investment and cross-border labour migration. A certain integration with the eastern neighbours is also discernible. At present, the GDP per capita in the Baltic countries is less than half of that of the Nordic countries. As economic growth has been considerably higher than in the Nordic countries in the past ten years, the level of income has begun to converge towards that of their Nordic neighbours.

Average annual growth of real GDP in the Nordic and Baltic countries 1995-2005



The ministers of finance in the Nordic and the three Baltic countries, in cooperation with the finance ministers of Poland, Russia and Germany, are seeking ways and means to accelerate economic development of the countries at the Baltic Sea with the aim of strengthening the foundations of economic growth for the future. For this purpose, a [report](#) has been issued that highlights the state and progress of economic affairs in the Baltic countries. The report deals with the integration of financial markets and competition in markets for goods and services. The report also discusses education and research.

In the report, proposals are presented regarding the economic integration of the Baltic countries which concentrate on the three areas, i.e. competition, finance and education.

Ten years of performance management

Ten years ago, the Government agreed to a new approach to managing government operations. The aim was twofold: One was to organise government organisation and operations in such a way that government could perform its duties towards the citizens in the most efficient, expedient and successful way possible. The other aim was to make government services to Icelandic companies more efficient in order to give them a competitive edge in international competition. To attain these aims, a method of performance management was introduced in order to facilitate the organisation of government projects and operations over the longer term, promote internal organisation and cooperation between ministries and government agencies, define their mutual duties and create increased flexibility of these agencies to meet changing circumstances.

During this time much progress has been achieved in government operations. The management of government agencies has improved. As an example, most government agencies now operate in accordance with a clear strategy based on detailed operational projections.

The progress achieved is closely monitored in terms of the goals established, efficiency has increased and the services to the public have improved.

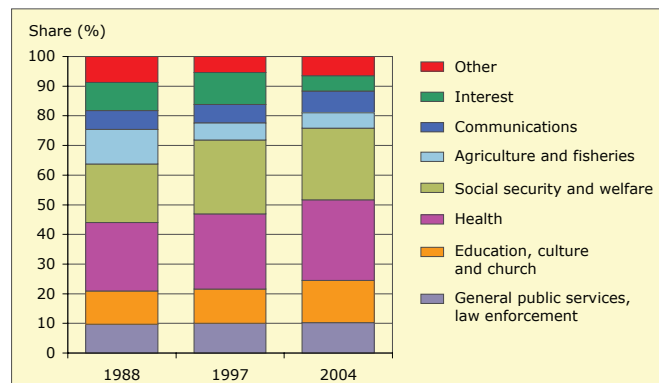
The Ministry of Finance has taken the initiative to implement various improvements in government services through amendments in laws and regulations pertaining to government operations as well as through general guidelines and encouragement. The Ministry has recommended that performance agreements be used to coordinate ministry policies and priorities above and beyond what is spelled out in laws and regulations.

The Ministry of Finance has selected one government agency every other year since performance management was introduced to recognise excellence. A comparison of agencies considered for this recognition shows their clear progress. Nevertheless, it is evident that performance management and other improvements in government operations is a long-term task that requires patience and will never be completed. There is always room for improvement, since expectations of the public concerning official services and the technology that can be used for this purpose is subject to constant change.

Treasury expenditure by category

The Ministry of Finance has prepared a summary of expenditure developments over the years 1988, 1997 and 2004 where Treasury expenditure is divided into 8 categories. Due to substantial accounting changes during this period the presentation required changes to ensure comparability over time. For example, interest rebates and child benefits are added to expenditure in 1988 and 1997. Expenditure on tax claims written off and pension commitments are excluded in order to make the figures. Expenditure on elementary schools is excluded as their financing and administration was transferred to the local government level in the autumn of 1996.

Treasury expenditure by category



The share of expenditure allocated to health, welfare and education has increased from 3.0 to 4.4 percentage points each over this 15-year period. In 1988, 54.1 per cent of Treasury expenditure went to these three categories, whereas by 2005 their share was up to 65.6 per cent. Included is the addition of a Parent Childbirth Leave Fund.

Expenditure on agriculture and fisheries declined by half, from 11.6 per cent to 5.2 per cent of the total. During the first half of the period, the Treasury ceased paying agricultural export subsidies and the reimbursement of the sales tax to fisheries exporters was abolished. These changes are the most important factors behind this decline. The second largest decline was in interest payments, from 9.5 per cent to 5.1 per cent, reflecting the improvement in Treasury finances in the latter half of the period. Spending on other categories showed little relative change.

Treasury revenue January-March		
	2004- 2005	2005- 2006
12 month changes (%)		
Total tax revenue	22.8	25.9
Taxes on income & profit	23.3	40.0
Taxes on property	51.4	-16.3
Taxes on goods & services	20.7	20.5
Social contributions	20.5	16.1
Total revenue	22.9	25.5

Treasury expenditure January-March		
	2004- 2005	2005- 2006
12 month changes (%)		
General public services	12.0	-2.0
Health	13.1	6.3
Social security & welfare	3.4	8.6
Economic affairs	5.2	-4.4
Education	11.5	13.9
Total expenditure	8.0	5.9

Treasury finances January-March		
Million krónur	2005	2006
Cash from operations	9 301	23 741
Net financial balance	15 511	21 286
Debt redemption	-11 404	-9 070
Gross borr. requirement	3 257	11 226
Net borrowing	1 094	1 532
Overall cash balance	4 351	12 758

Economic indicators		
	2004- 2005	2005- 2006
12 month changes (%)		
Inflation (May '06)	2.9	7.6
Core inflation (May '06)	3.4	6.4
Wage index (March '06)	6.5	8.6
Total turnover (Jan. - Dec. '05)	12.2	8.9
Retail turnover (Jan. - Dec. '05)	5.1	5.5
Unemployment rate (April '06)	2.1	1.1