

English translation of the Weekly Web Release



MINISTRY OF FINANCE IN ICELAND

June 29th 2006

Treasury finances January-May 2006

[Treasury revenue](#) amounted to 155 billion krónur in the first five months of this year, 19 billion more than in the corresponding period a year ago, an increase of 13.6 per cent. Adjusting for a shift in revenue between months, the increase is about 11 per cent. Tax revenue and social security contributions rose by close to 18 per cent in nominal terms and by 12 per cent in real terms. Other current revenue declined by 42 per cent, due to the fact that last year a large dividend payment from Iceland Telecom accrued to the Treasury.

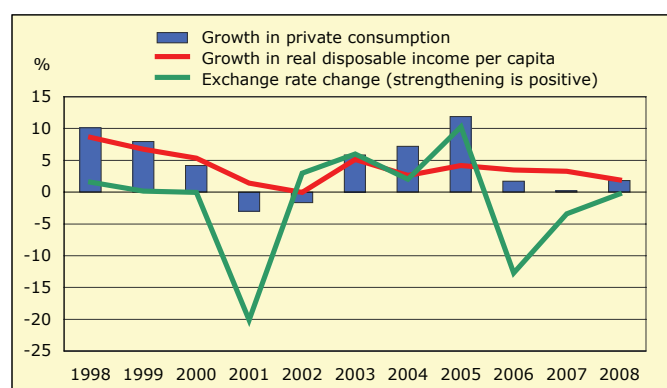
Taxes on income and profits amounted to 56 billion, increasing by 14 billion or 32 per cent. Revenue from personal income tax rose by 11 per cent and by 76 per cent from corporate income tax (after adjustment between months as noted above). Revenue from capital income tax rose by 43 per cent. Social security contributions rose by 15 per cent, compared to an 8.5 per cent increase in the wage index. Taxes on assets amounted to 4.7 billion, 25 per cent less than last year. Of this amount, the stamp tax yielded 3.5 billion, a decline of 15 per cent, partly due to a reduced rate of debt conversion.

Indirect taxes increased by 17 per cent in nominal terms and by 11.5 per cent when deflated by the consumer price index. Revenue from the value added tax rose by 18 per cent in nominal terms, equivalent to a 12 per cent increase in real terms. Amongst individual indirect tax revenue items, import charges on motor vehicles increased by 25 per cent in the first five months of this year. Gross borrowing amounted to only 11 billion in spite of 38 billion krónur in repayments. The difference comes out of liquid funds at hand.

Private consumption

In the Ministry's recent [economic forecast](#) the growth in private consumption was scaled down from the previous forecast. The exchange rate was expected to weaken this year and next more than previously. It is now predicted that private consumption will increase by 1.7 per cent this year (instead of 2.2 per cent) and by 0.2 per cent next year (instead of 0.5 per cent). Private consumption in the first quarter of 2006 increased by 12.6 per cent in volume terms from a year ago. At present, there are indications that the growth in private consumption is beginning to slow down. The forecast implies that private consumption will decline by 1.5 per cent in the next three quarters compared to last year.

Private consumptions and its main determinants



As has been noted on earlier occasions, private consumption in the present business cycle is somewhat different from the downturn in 2001-2002 when private consumption actually declined. In the forecast, it is expected that real disposable income per capita will increase by 3.5 per cent this year and 3.3 per cent next year. This

compares with the previous downturn, when real disposable income per capita rose considerably less. The exchange rate is assumed to decline less this year than in 2001. The exchange rate is very influential in determining consumer purchasing power. The policy interest rate is also higher than at the turn of the century and it is expected to increase further still. In the Ministry's spring forecast, it was estimated that net assets of households had increased faster in the present expansion than in the earlier one. The wealth effect is therefore stronger today than five years ago. In light of these circumstances, it is realistic to assume that private consumption will continue to increase this year and the next.

Environmental taxes in the Nordic countries

A [report on environmental taxation](#) was introduced at a recent meeting of Nordic finance ministers. This report deals for the first time with environmental taxes in the Baltic countries as well as in the five Nordic countries.

The Nordic countries have a 10-20-year experience with environmental taxation and have been at the forefront in the use of economic instruments in environmental management and an assessment of their effect. They possess an extensive experience in taxes on the release of carbon dioxide, and research indicates that such taxes have an intended impact. In some cases it is thought that environmental taxes have an indirect effect by calling attention to environmental problems arising from the use of certain substances. The Nordic countries have also acquired experience in concluding voluntary agreements with individual sectors.

One of the issues related to environmental taxes is that they may possibly affect the competitiveness of countries that impose them. This is not borne out by experience. In some cases the tax revenue is redistributed within the same sector, thus neutralising the competitive effect. A border adjustment of taxes is also common in the case of exports. The most important issue in this area is the allocation of emission quotas pursuant to the Kyoto Protocol. The most common form is to issue free quotas to energy-intensive industry. The argument against such an arrangement is that it would give polluting industry an advantage, thereby reducing the necessity of further cutting emissions. It is noted that those Nordic countries that belong to the European Union are presently engaged in a dispute with the EU Commission because it can not accept that sectors subject to emission quotas should be exempt from the tax and would thereby be considered as having received a state subsidy. These countries see this as a punishment for their earlier prudence.

A number of changes in environmental taxes have been implemented in recent years. Sweden has for instance transferred considerable taxation from incomes onto energy, communications and pollution. Estonia cut the personal income tax by 6 per cent in 2005 and imposed environmental taxes instead. Taxes have also been imposed on the emission of several greenhouse gases in Denmark and Norway that are not energy-related. Finland has increased its so-called energy tax by 5 per cent. Taxation of motor vehicles is being directed towards the emission of greenhouse gases, both as regards import duties, fuel and annual fees.

The experience of London of the taxation of traffic in the city centre has led to plans of introducing similar arrangements in the Nordic countries. A seven-month experiment with road charges is being introduced in Sweden.

Summer holidays

The Weekly Web Release will next appear on August 3rd.

Happy holidays!!

| Treasury revenue January-May | 2004-2005 | 2005-2006 |
|------------------------------|-----------|-----------|
| 12 month changes (%) | 2004 | 2005 |
| Total tax revenue | 19.5 | 20.2 |
| Taxes on income & profit | 17.5 | 32.4 |
| Taxes on property | 59.2 | -24.5 |
| Taxes on goods & services | 18.3 | 17.3 |
| Social contributions | 17.7 | 15.3 |
| Total revenue | 25.1 | 13.6 |

| Treasury expenditure January-May | 2004-2005 | 2005-2006 |
|----------------------------------|-----------|-----------|
| 12 month changes (%) | 2004 | 2005 |
| General public services | 170.7 | -23.6 |
| Health | 69.3 | 19.3 |
| Social security & welfare | 80.0 | -0.2 |
| Economic affairs | 40.5 | 0.4 |
| Education | 253.7 | 8.4 |
| Total expenditure | 94.6 | -0.3 |

| Treasury finances January-May | 2005 | 2006 |
|-------------------------------|---------|---------|
| Million krónur | | |
| Cash from operations | 11,566 | 28,281 |
| Net financial balance | 18,102 | 25,853 |
| Debt redemption | -29,994 | -38,104 |
| Gross borr. requirement | -13,442 | -13,901 |
| Net borrowing | 9,273 | 11,010 |
| Overall cash balance | -4,168 | -2,890 |

| Economic indicators | 2004-2005 | 2005-2006 |
|-------------------------------|-----------|-----------|
| 12 month changes (%) | 2004 | 2005 |
| Inflation (June) | 2.8 | 8.0 |
| Core inflation (June) | 3.5 | 7.0 |
| Wage index (May) | 6.6 | 8.7 |
| Total turnover (Jan. - Feb.) | 5.9 | 9.2 |
| Retail turnover (Jan. - Feb.) | 1.8 | 6.5 |
| Unemployment rate, sa (May) | 2.1 | 1.2 |