

Stability Pact

of the Icelandic Federation of Labour (ASÍ), the Confederation of University Graduates (BHM), the Federation of State and Municipal Employees (BSRB), the Icelandic Teachers' Association (KÍ), the Confederation of Icelandic Bank and Finance Employees (SFF), the Confederation of Icelandic Employers (SA), the Government of Iceland and the National Association of Local Authorities

This Stability Pact has been concluded in an extremely difficult economic and employment environment, which has dealt a severe blow to Icelandic households and businesses. Under such circumstances, the parties to this pact have jointly agreed on actions for the nation to work its way out of these difficulties.

The aim of the Stability Pact is to promote economic recovery. Upon commencing the negotiations, the contracting parties agreed on specific benchmarks: by the end of 2010 inflation will not be higher than 2.5%; the deficit in public finances will not exceed 10.5% of GDP; the exchange rate will have stabilised and the ISK strengthened, to move closer to the real equilibrium exchange rate. The difference between domestic and Eurozone interest rates will be less than 4 percentage points. This will create the conditions for increased investment by both domestic and foreign parties, stronger growth, boosting employment and laying the foundation for improved living standards in the future.

The parties also agree that it is important to support Icelandic households, safeguard the foundation of the welfare system, protect the educational system and preserve jobs, both in the public and private sector, to the greatest extent possible.

In tandem with the conclusion of this pact, the social partners have joined forces to remove labour market uncertainty, by concluding collective bargaining agreements valid until the end of November 2010, which emphasise improving the situation of the lowest income groups.

To achieve the above objectives, the parties to this Stability Pact have agreed on the following:

1. Collective bargaining agreements

- In tandem with the conclusion of this pact, private sector workers' and employers' associations have reached agreement on extending the existing wage contracts until the end of November 2010.
- Contracting parties in the public sectors will conclude collective bargaining agreements as soon as possible based on this Stability Pact.
- Public sector workers' associations will conclude their wage agreements on the premise that no legislation or administrative action will be forthcoming which would directly affect the contents of such agreements or overturn the foundations upon which they are based. This shall not, however, prevent the passing of legislation calling for changes to collective bargaining agreements, provided such changes are subsequently negotiated by the contracting parties.

2. Proposed action plan for fiscal restraint

The government has presented to the contracting parties the state's fiscal action framework for 2009-13. It is important to balance the national budget as soon as at all possible, preferably even earlier than planned in the Economic Recovery Programme agreed by the government and the IMF.

The following actions in 2009-11 have been agreed upon:

- In view of the fact that state revenue sources are contracting sharply, it is important that the share of increased income in these actions be kept within limits. Taxes will comprise a decreasing portion of the rectification measures once this year concludes and comprise a maximum of 45% of the amount of such measures during the period 2009-11.

- The budget for 2010 will conform to the framework set out and, to the extent this is possible, a final and specific outline of the 2011 budget will be presented in tandem, together with the changes to legislation required. Active consultation on the drafting of these budgets will continue during the summer and autumn months.

- If the objectives of this Pact concerning a more rapid recovery of the economy and industry, with substantially lower unemployment than that currently forecast, are achieved, the resources which this makes available will be applied to further protect the welfare system and reduce reductions to social benefits and tax increases. Should the reconstruction efforts take more time than currently anticipated, the parties to this Pact agree that this will call for a revision of restraint measures, including the distribution of the state's income and expenditure by economic category.

3. Improving the situation of borrowers and indebted households

It is important to improve the situation of highly indebted households. To this end, the government will expedite the work of a ministerial committee examining their situation. Emphasis will be placed, for instance, on ensuring that the remedies which have already been made available are serving their intended purpose. Furthermore, proposals will be drafted, in consultation with the social partners, for additional remedies as necessary. Special attention shall be paid to recent first-time housing buyers.

Furthermore, proposals will be drafted, in consultation with the social partners, as to how the position of borrowers can be reinforced in the financial market.

4. Work projects to encourage increased employment

The government will pave the way for major projects already scheduled in macroeconomic plans, such as those linked to aluminium smelters in Helgúvík and Straumsvík. Preparatory work for planned medium-size industrial projects, such as server farms and silicon chip production, will be accelerated. Every effort will be made to ensure no obstacles on the side of the authorities will stand in the way of such projects after 1 November 2009.

Concerted effort will be made to move forward on plans for other major industrial investment in order that decisions may be taken as soon as possible on their eventual implementation.

The government will enlist the co-operation of pension funds to finance major projects, cf. the Memorandum on construction projects of 16/06/2009, etc., with special financing. Negotiations between the government and pension funds shall be aimed at reaching a conclusion by 1 September 2009. The involvement of pension funds in such projects shall not preclude the participation of other investors or financiers, either domestic or foreign.

Local authorities and other public agencies shall ensure that deadlines for planning and all granting of permits are adhered to and new investment facilitated wherever possible.

5. Reconstruction of banks

The state's ownership policy regarding the banks will allow for the possibility of foreign parties acquiring a majority holding in one or more of the new banks and, as the case may be, in other financial undertakings. This represents, in part, an attempt to ensure normal access to foreign credit for corporate and household customers. Restructuring of the banks' ownership will be concluded by 1 November 2009.

How the banks' foreign currency balance will be handled will be disclosed by 17 July 2009.

6. Industrial reconstruction and social responsibility

The authorities and social partners will formulate joint benchmarks to be followed in industrial reconstruction and the involvement of public parties in commercial activities and corporate ownership. These efforts will be based, for instance, on recognised domestic and foreign guidelines on corporate governance.

7. Restrictions on foreign currency transactions

Restrictions on foreign currency transactions will be removed in stages, in accordance with a scheduled plan by the government, with the aim of stabilising the ISK exchange rate. The plan will be made available by 1 August and aim at resolving problems due to capital outflow from Iceland. Efforts will be made to remove restrictions on new investment by 1 November 2009.

Possible measures to be attempted to address the situation include settling ISK claims of non-residents on the state or Central Bank with long-term instruments in EUR or other foreign currencies. An attempt will be made to invite pension funds to participate in transactions with non-residents holding ISK assets.

8. Specific concerns of municipalities

The central government and the Union of Local Authorities will increase their co-operation in economic affairs and the co-ordination of planning and accounting of public activities. Furthermore, central and local governments will co-operate more closely in implementing fiscal restraint and on developments in overall government fiscal balance. Outstanding amounts owed by the state for rent subsidies will be settled. In the cutbacks they implement, municipalities will emphasise preserving basic services and jobs as far as possible. While it is evident that in some cases individual municipalities will deem it necessary to increase income from services, every effort will be made to limit tariff increases.

The Union of Local Authorities and social partners will appoint a consulting group to discuss ways to safeguard basic services provided by municipalities and prioritisation in their activities.

9. Pension fund issues

Central and local governments and the social partners will jointly review pension matters and issues concerning pension funds. These questions will be examined from the ground up, without obligation, and a future vision for these issues discussed.

If no changes are made, the funds are obliged by law to review their financing and/or cut back members' entitlement. The parties agree to take measures to enable the postponement of such decisions for the moment, while a comprehensive review is carried out.

10. Lowering interest rates

The social partners trust that this Stability Pact will create the premises for a reduction in the policy rate of the Central Bank of Iceland to a single-digit figure by 1 November 2009 and that this and other interest rates of the bank will then continue to decrease. The parties also emphasise that, to stimulate the economy, strengthen industry and improve the situation of households, interest rates must decrease rapidly in coming months and an acceptable domestic-foreign interest rate differential be reached.

11. Co-operation on labour market surveillance and workplace identification

The social partners and authorities will establish effective co-operation on workplace surveillance and the introduction of workplace identification, as provided for in a protocol from ASÍ and SA of 17 February 2008. The objective of such joint efforts is in part to ensure that employees enjoy their contractual rights and to combat illegal employment and abuse of unemployment benefits. The government will do its part to ensure the necessary amendments to legislation on general workplace surveillance and workplace identification.

12. Implementation of the statement by the government of 17 February 2008 and related matters

The government will take action on the following:

- Legislation providing for a levy on industry earmarked for the Employment Retraining Fund will be adopted in 2009. The Fund will receive an allocation from the Treasury of ISK 150 million in 2010. Provided that co-operation continues on the basis of this Stability Pact, the state's contribution to the Fund will increase to ISK 250 million in 2011 and to ISK 350 million in 2012. A contribution to this Fund from pension funds will be provided for by law, to enable payments to begin on 1 July 2010. Legislation will be adopted by 1 July 2010 providing for the state to pay 0.13% of the Social Insurance Fee base to the Fund, commencing as of 1 July 2013, by which time the state's contribution will be fully payable. A consultation committee of the social partners and authorities will be established to assess on an on-going basis the success and the continuation of the project.
- The taxation of payments from illness and educational funds, payments from strike funds and additional related aspects will be reviewed having regard for the government's statement in February 2008.

- Contributions to adult education will be increased in accordance with the statement. An agreement will be concluded on the participation of public labour market associations in the system.

13. Proviso by the Confederation of Icelandic Employers concerning fisheries

The Confederation of Icelandic Employers maintains its proviso concerning extension of collective bargaining agreements, that work initiated by the government to review fisheries management will continue on the course towards reconciliation set when the committee was appointed to work on the matter.

14. Progress of the Stability Pact, etc.

All parties to this Stability Pact agree to work towards ensuring the success of the Pact and other urgent social projects in a formal consultative forum of the above-mentioned parties and the Farmers' Association of Iceland, under the leadership of the Prime Minister.

Reykjavík, 25 June 2009

**On behalf of the Government of Iceland
Authorities in Iceland**

On behalf of the Union of Local

**On behalf of the ASÍ negotiation committee
Graduates**

On behalf of the Confederation of University

**On behalf of the Federation of State and Municipal Employees
On behalf of the Icelandic Teachers' Association**

**On behalf of the Confederation of Icelandic Bank and Finance Employees
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