

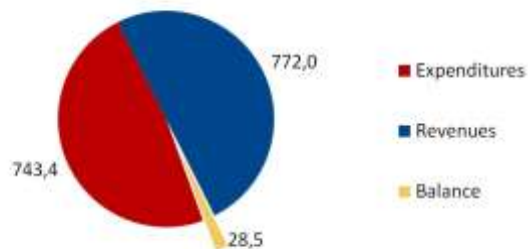


December 6 2016

NATIONAL BUDGET PROPOSAL 2017

- Treasury operates without deficit for fourth consecutive year
- Treasury debt ratio on the decline
- Social security allocations increased
- Increased funding for healthcare

Overall Treasury performance*



*Figures according to new government finance statistics (GFS)

The fiscal budget proposal for 2017 has been presented before Parliament, in accordance with the fiscal strategy and fiscal plan over a horizon of five years, both of which were approved in August and are based on a new organic budget law. The budget proposal for 2017 is based on the foundations that have been laid with the past three years' balanced budgets. The Treasury's performance has improved year by year since automatic debt accumulation was halted with the 2014 National Budget, and the 2017 budget proposal is the fourth in a row based on Treasury operations without a deficit.

The bill assumes an overall surplus of ISK 28.4 bn. This is virtually unchanged Treasury performance from the 2017–2021 fiscal plan presented last spring, or 1% of GDP.

The primary surplus is substantial, at ISK 90.9 bn.

The bill is based on the 2017-2021 fiscal strategy, approved by Parliament in August, but also takes account of the following:

- The financial impact deriving from new or amended legislation passed by Parliament;
- The Government's decisions on several new issues on which positions had to be taken during the period between the presentation of the fiscal plan in the spring and the Parliamentary elections;
- Other projected expenditure changes that the Treasury is obliged to finance, other things being equal.



Emphasis on healthcare, education, and law enforcement

In the National Budget for 2016, increased Treasury contributions have been used to strengthen and improve social welfare system services, where expenditures have grown by 5% during the year. At constant prices, primary expenditure is 7% higher in 2016 than in 2006. The fiscal plan allowed scope for special spending for operations and transfers in the amount of ISK 14 bn. Healthcare, education, and law enforcement have been given special priority.

Major expenditures according to the 2017 fiscal budget proposal

- Total nominal contributions to law enforcement increase from ISK 11.8 bn in 2015 to ISK 13.7 bn in 2017.
- Amendments to the Social Security Act, merging old-age pensioners' benefits categories into a single basic pension, and others — ISK 11.1 bn.
- Increased contributions to healthcare, including contributions to strengthen hospital and healthcare centre operations, nearly ISK 4 bn, plus ISK 1.5 bn in connection with a new framework agreement for nursing home operations — ISK 7.3 bn.
- Increased employer contributions to the A- division of the Pension Fund for State Employees (LSR), from 11.5% to 15.1%, as of the beginning of 2017 — ISK 4.5 bn.
- Increased expenditure for education and culture, such as strengthening university and upper secondary schools on an accrual basis and providing a contribution to the upper secondary school for the arts so as to strengthen music education — ISK 2.5 bn.
- A new framework agreement concerning the general working conditions in agriculture — ISK 1.1 bn.
- A new housing benefits system, which will take effect at the beginning of 2017 – the total scope of the system will be ISK 6.5 bn, and the increase in contributions will amount to ISK 785,000 according to the bill — ISK 0.8 bn.
- Regional development and promotion plans for regional Iceland — ISK 0.5 bn.
- The amounts and income thresholds for child benefits and the asset thresholds for mortgage interest allowances are raised, so that contributions remain unchanged between 2016 and 2017.

In addition to this, it is assumed that the scope for spending will increase in 2018-2021, by about ISK 7 bn per year. The total scope for the period 2017-2021 is ISK 42 bn.

In addition, there are new and increased investment and development projects in the 2017 budget proposal, in line with the scope for investment in the fiscal plan. Among them are the following:

- Contributions for the construction of three new nursing homes in 2016-2018 — ISK 1.2 bn.
- Construction of a new Westman Islands ferry — ISK 1.1 bn (total cost ISK 4.4 bn over three years).
- Increased contributions for general road construction — ISK 1 bn.

Economic and fiscal achievements 2014-2016

In recent years, the authorities' policy has been based on responsible management of public sector finances and a long-term approach, with an eye to prudent and sensible use of Icelanders' collective financial assets. With targeted measures, the authorities have managed to bring public sector finances into balance:

- The combined overall Treasury balance for 2014-2016 will be about ISK 96 bn (excluding stability contributions).
- Gross Treasury debt will fall from 60% of GDP in 2015 to 39% by year-end 2017. The ratio will be 29% by year-end 2021.
- Treasury interest expense will decline from ISK 79 bn in 2015 to ISK 69 bn in 2017, a reduction of ISK 10 bn per year in only two years.



In recent years, the premises have been created for tax reductions and for reforms designed to enhance the efficiency of the tax system. The aim has been to simplify the tax system, reduce exemptions, and increase equal treatment. In the recent past, the following measures have supported the increase in individuals' purchasing power and have benefited households:

- Individuals' income tax reduced in two stages between 2014 and 2017.
- Emphasis on lightening the tax burden of lower-income individuals and reducing the number of tax brackets.
- General excise taxes cancelled in 2015.
- All customs duties on specified foods cancelled in two stages in 2016 and 2017.
- Payroll tax reduced by 0.84% in the past two years.
- Value-added tax system changed to enhance efficacy and simplicity.

Prioritisation in favour of social security, healthcare, and education

In 2014 and 2015, there was moderate consolidation in primary expenditure growth. Special priority was given to increased funding for social security, healthcare, and education in the wake of strict consolidation on the expenditures side in 2009–2012. In the National Budget for 2016, increased Treasury contributions have been used to strengthen and improve social welfare system services, where expenditures have grown by 5% during the year. At constant prices, primary expenditure is 7% higher in 2016 than in 2006.

- Healthcare expenditures increased by ISK 38.5 bn in 2014-2016 — 16% real increase.
- Total expenditures for upper secondary education increased by 25% in 2013-2016.
- The fiscal budget proposal assumes that contributions to upper secondary schools will increase by 36% in real terms from 2013 through 2021 — this equals an increase of just over 70% per student during the period.
- Contributions to tertiary education increase by 37% in real terms per student-year in 2013–2021.
- Contributions to research and technology in competitive funds increased by over 60% in real terms during the period 2013–2016.
- The fiscal plan assumes that they will continue to increase by 5% in real terms during the period 2017–2021.
- Special emphasis on the elderly and the disabled – old-age pension income increases markedly under the new Social Security Act. The Act also entails a more flexible retirement age, promotes more active labour market participation, and simplifies and harmonises rights and rules in the social security system and the public pension system.
- Changes in social security and the tax-free income threshold for old-age pensioners increase Treasury expenditure by ISK 11 bn next year, an additional obligation that was not provided for in the fiscal plan.

Economic reconstruction well underway

Iceland's economic reconstruction following the collapse of the banking system in autumn 2008 is well advanced, and economic forecasts for the coming years are favourable. However, there are signs of



overheating in the economy, which demand disciplined economic policy and call for appropriate emphasis in overall management of public sector finances. As a result, there will still be a need for conservative policy concerning government expenditures, so as to increase the surplus and pay down debt.

With responsible economic policy and a balanced fiscal budget, it will continue to be possible to make progress towards improved living standards and further strengthening of social welfare, for the benefit of all Icelanders. This is the main substance of the fiscal budget proposal for 2017.

Fiscal budget proposal presented under unusual circumstances

The fiscal budget proposal for 2017 is presented under unusual circumstances. According to Article 42 of the Constitution, the budget proposal must be presented before Parliament when it convenes. Furthermore, according to Article 1 of the Act on Parliamentary Procedure, Parliament convenes on the second Tuesday in September. This spring, it was decided to hold early Parliamentary elections this autumn, and this was done on 29 October. Since then, no Government has been formed. The Minister of Finance and Economic Affairs presents the fiscal budget proposal on behalf of the Government, and according to the Constitution, no spending may be undertaken without budgetary authorisation. It is therefore essential that authorisations for the coming year be passed before the year-end.

The budget proposal and the new Act on Public Sector Finances

In August, Parliament approved, for the first time, a fiscal strategy and fiscal plan covering a five-year horizon, on the basis of the new Act on Public Sector Finances. The strategy and plan are Parliamentary resolutions that are provided for in the Act and are to be used as a basis for budget preparation. They reflect the Government's objectives and emphases concerning the economic policy impact of public sector finances, tax policy, and prioritisation of expenditures. In the fiscal plan, expenditures are classified by function, based on existing premises and economic forecasts.

In all major respects, the fiscal budget proposal for 2017 is based on the fiscal strategy and fiscal plan approved by Parliament.