

## Norges Bank Monetary Policy

### Research Report

## Background Information, Annual Address 2010

Staff Memo, No. 2/2010

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No. 2 | 2010

# Staff Memo

## Background information, annual address 2010

*Norges Bank Monetary Policy*

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## Potential for revenues from an increase in property taxation

The figures below are based on figures for 2007. The estimates may vary somewhat from year to year.

Property tax accounted for an average of 5.6 per cent of total tax revenues in OECD countries in 2007<sup>1</sup>, or 1.9 per cent of GDP. According to OECD estimates, revenues from property tax accounted for 2.8 per cent of total tax revenues in Norway in the same year. The figure overvalues property tax compared with other countries as the calculation for Norway includes wealth tax on dwellings. If wealth tax is deducted, revenues from property tax make up 1.4 per cent of total tax revenues, or 0.6 per cent of GDP.

Total tax revenues	NOK 993.4 bn	
Property tax	NOK 27.7 bn	2.8% of total tax revenues
-Wealth tax	NOK 13.3 bn	
= New estimate of property tax	NOK 14.4 bn	1.4% of total tax revenues

Source: OECD Revenue Statistics 1965-2008. Table 62, page 178 and Norges Bank

If the share of property tax in total tax revenues is increased to the average OECD level (i.e. 5.6 per cent), revenues from property taxation may rise to about NOK 57.6 billion. This is equivalent to NOK 43.2 billion in additional tax revenues.

Total tax revenues in Norway are higher than the average for the OECD countries measured as a share of GDP. The figure NOK 43.2 billion will therefore, as a percentage of GDP, entail a tax on property that is higher than the OECD average. It may therefore be reasonable to revise down the estimate somewhat. With a simple adjustment to take this into account, our estimates show that increased revenue from property tax may be NOK 35.4 billion.<sup>2</sup>

Total tax revenues as a share of GDP came to 35.8 per cent in OECD countries in 2007.<sup>3</sup> In Norway total tax revenues came to 43.6 per cent of GDP.

Total taxes	NOK 993.4 billion	
GDP	NOK 2 277 billion	43.6%

Source: OECD Revenue Statistics 1965-2008. Table 62, page 178 and National Budget for 2010, Table 3.2, page 208.

## **Alternative (I): Rate of tax on ordinary income can be reduced by 1 percentage point**

Revenues from taxes and social security contributions (mainland Norway) totalled NOK 268.5 billion in 2007.<sup>4</sup>

<sup>1</sup> OECD Revenue Statistics 1965-2008. Table 23, page 88

<sup>2</sup>  $43.2 \times (35.8/43.6) = \text{NOK } 35.4 \text{ bn}$

<sup>3</sup> OECD Revenue Statistics 1965-2008. Table 1, page 75

<sup>4</sup> Statistics Norway ([http://www.ssb.no/offinnut\\_en/tab-04-en.html](http://www.ssb.no/offinnut_en/tab-04-en.html))

NOK 268.5 billion / 28% (income tax rate) = NOK 9.6 billion, i.e. it costs about NOK 10 billion to reduce the rate of tax on ordinary income in mainland Norway by one percentage point, given that a reduction in tax on ordinary income from oil activities is matched by a corresponding increase in special taxes on petroleum exploration.

### **Alternative (II): Increase the basic tax allowance**

Increasing the basic tax allowance on wage income by NOK 1000 costs NOK 590 million.<sup>5</sup>

The cost may decrease in the event of higher increases.

### **Alternative (III): Remove surtax**

Removing surtax entails a loss of revenues of NOK 16.8 billion in 2007.<sup>6</sup>

### **Alternative (IV): Remove wealth tax**

Removing wealth tax entails a loss of revenues of NOK 11.8 billion in 2007.<sup>7</sup>

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<sup>5</sup> See for example the Ministry of Finance's response to question 51 from the Standing Committee on Finance and Economic Affairs, Conservative Party committee fraction, of 20 October 2009.

<sup>6</sup> Statistics Norway. Key figures from the tax assessment ([http://www.ssb.no/english/subjects/05/01/skattoppgjor\\_en/tab-2009-10-27-01-en.html](http://www.ssb.no/english/subjects/05/01/skattoppgjor_en/tab-2009-10-27-01-en.html)). Figure based on figures in "State wealth tax, surtax".

<sup>7</sup> Statistics Norway. Key figures from the tax assessment ([http://www.ssb.no/english/subjects/05/01/skattoppgjor\\_en/tab-2009-10-27-01-en.html](http://www.ssb.no/english/subjects/05/01/skattoppgjor_en/tab-2009-10-27-01-en.html)). Sum of county wealth tax (NOK 7 829) + state wealth tax (NOK 3 941).

## **Distortions in capital taxation**

To illustrate these distortions, we apply the simplified assumption that the benefit of home ownership can be valued at 4 per cent of the market value of the dwelling. The mortgage rate is assumed to be 4 per cent and the return on equity investment is assumed to be 4 per cent, which is also assumed to be the protection rate before tax. Under these assumptions, assessed income tax is the same for equity investment and bank saving as for loan repayment. Equity investment provides an illustration of the treatment of business investment. The distortion between housing investment and business investment may be smaller than between housing investment and equity investment.

### Non-wealth tax payers, 4% return before tax:

Return after tax:

Housing investment: 4 % (no tax)

Loan repayment:  $(0.04*0.72)*100=2.88$  % (interest costs saved after tax)

Investment in business (equities):  $(0.04*0.72)*100=2.88$  %

### Wealth tax payers, 4% return before tax:

Return after tax:

Housing investment:  $(0.04-0.11*0.25)*100=3.73$ % (tax basis for wealth tax is assumed to be 25% of market value, wealth tax =1.1%)

Loan repayment:  $(0.04-0.011-(0.04*0.28))*100=1.78$  % (wealth tax increases when the loan is repaid)

Investment in business (equities):  $(0.04-0.011-(0.04*0.28))*100=1.78$  %

## Return to the fiscal rule

According to the fiscal policy guidelines, petroleum revenues should be phased in gradually into the economy, approximately in pace with the expected real return on the Government Pension Fund Global, which is estimated at 4 per cent. Capacity utilisation in the Norwegian economy is projected to return to a normal level in the course of 2011. Our understanding of the fiscal rule is that the government budget for 2013 should be in balance with petroleum revenue spending at 4 per cent of the size of the fund, i.e. NOK120 billion.<sup>8</sup>

According to Ministry of Finance estimates, the annual structural non-oil deficit will be NOK 148.5 billion (in 2010 NOK) in the period 2010-2013. A return to the fiscal rule in 2013 implies fiscal tightening of NOK 28 billion in 2010 NOK over three years. We assume therefore that the deficit is tightened by an annual NOK 9.3 billion. It follows that the structural non-oil deficit will then decrease to  $(148.5 - 9.3) =$  NOK 139 billion in 2011,  $(139 - 9.3) =$  NOK 130 billion in 2012, and  $(130 - 9.3) =$  NOK 120 billion in 2013.

In order to compare with the tightening of the structural non-oil deficit in the period 1994-96, estimates have been based on tightening with a similar effect in 2011-13, measured as a share of mainland GDP.<sup>9</sup> The structural non-oil deficit would then decrease to around NOK 58 billion in 2013. See table below.

	Structural non-oil deficit. Constant 2010 prices <sup>10</sup>	Tightening of structural non-oil deficit 1994-96 <sup>11</sup>	Tightening as a percentage of mainland GDP 2011-13 <sup>12</sup>	Tightening 2011-13
2011	148.5	-2.1%	NOK 40 bn	$(148.5 - 40)$ =NOK 108 bn
2012	148.5	-1.5%	NOK 30 bn	$(108 - 30)$ =NOK 78 bn
2013	148.5	-1.0%	NOK 20 bn	$(78 - 20)$ =NOK 58 bn

<sup>8</sup> Source: National Budget for 2010. Table 3.6 (page 62)

<sup>9</sup> Mainland GDP for 2010 is based on Ministry of Finance estimates (NB 2010, Table 3.2). Norges Bank's growth estimates have been used for 2011-12

<sup>10</sup> Source: National Budget for 2010. Table 3.6 (page 62)

<sup>11</sup> Source: National Budget for 2010. Chart 3.1 c (page 55)

<sup>12</sup> Source: National Budget for 2010. Table 3.2 (page 208)