

BÚSKAPARRÁÐIÐ

Á vári

2016

Búskaparfrágreiðing

- I. Konjunkturmeting
- II. Greiningar viðvirkjandi arbeiðsmarknaðinum
- III. Greiningar viðvirkjandi kommunum

Mars 2016

Economic report from the *Economic Council of the Faroe Islands*, Spring 2016, with Executive Summary in English: (I) Economic outlook and special analyses of (II) the labor market, and (III) the municipalities

Redegørelse fra det *Økonomiske Råd på Færøerne*, forår 2016: (I) Udsigterne for konjunkturudviklingen, og særlige analyser af (II) arbejdsmarkedet og (III) kommunerne

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English Summary

SHORT TERM ECONOMIC OUTLOOK AND ANALYSES OF THE LABOUR MARKET AND MUNICIPALITIES

Chapter I of the Report provides an evaluation of the short-term economic trends in the Faroes.

The trends in the Faroese economy over the last few years have been unusual. Thus, it has been difficult to generate accurate short-term analytical projections. This semi-annual review concludes that GDP growth in current year prices for 2015 and 2016 is somewhat higher than projected in the last report.

The report on the economic outlook is organized around elements of the demand side (expense side) of the country's Gross Domestic Product (GDP). Overall aggregate demand for goods and services is based on two factors: domestic demand for consumption and investment, and foreign demand for exports.

Statistics Faroe Islands and The Economic Council have jointly estimated *GDP economic growth in current prices for 2014-2017*. To facilitate the projections, an economic model was used, which was developed by the former Faroese National Bank (Landsbankin) and Statistics Faroe Islands and is currently maintained jointly by The Economic Council and Statistics Faroe Islands. The Table below captures the projected growth in GDP in current year prices for the period 2014-2017 and the driving forces behind this projected growth.

	2014	2015	2016	2017
Estimated GDP growth in current year prices:	5.8%	6.2%	5.3%	2.9%
Growth derived from:	Foreign demand	Mainly domestic demand	Domestic demand	Domestic demand

While consumption has been the most stable aspect of domestic demand, investment has been the most fluctuating. Public sector investment in the Faroes, as a part of overall domestic demand, has traditionally correlated positively with the business cycles. This cyclical pattern has always been detrimental for the economic development, and it would appear that the pattern is again being repeated, given that the investment plans for the central government and the municipalities are quite comprehensive for 2016 and 2017. There would appear to be the need for a coordinated re-evaluation of public investment plans.

For some time now, the Faroes has been experiencing a greater trade surplus than in the past. One reason for this is improved terms of trade in the foreign trade, derived from increased farmed salmon prices and lower oil prices. Also, an increase in quantities in the pelagic fisheries has influenced the result. Given these circumstances, the national fiscal accounts should show a very large surplus, which they do not.

The use of the revenue generated from the pre-taxing of pension savings disrupts the true picture of the government's financial sustainability. If the revenue from the pre-taxation of pension contributions was not used to finance actual public-benefit expenditures, then the result of the governmental accounts is around DKK 300 million worse than actually booked, and this should be the basis upon which to measure the overall balance and deficit/surplus of the national budget.

One is a short-term perspective, the other is a long-term economic outlook. As noted in previous reports from the Economic Council, changes to the country's demographic occur slowly year upon year. Therefore, there is a danger that if we focus only on the short-term instead of understanding the consequences of these demographic changes for the long-term fiscal sustainability and viability of the public accounts, it may be too late; already around 2035 we should anticipate a negative excess of births.

The initiatives undertaken by the central government up to now could be deemed logical and appropriate, but in the main they have not had any major impact on the country's fiscal sustainability. For example, the transfer of pension payments within the public accounts has no impact on the sustainability/vulnerability of the national accounts. In order to, for example, ensure greater sustainability, the pre-tax revenue from pension savings should 1) be used to reduce debt, 2) be set aside in trust for later use, or 3) the pension tax scheme itself should be revised to levy a tax at the time of actual pension distribution. We understand that work is underway on a new pension system and a new fisheries system, but new industrial policy initiatives could also be relevant in mitigating or resolving the problems of fiscal sustainability in the public accounts. Moreover, there is a need to coordinate all the reform endeavours being undertaken; for example, the new fisheries system could also have a considerable impact on the fiscal sustainability of the public accounts.

The goal of Chapter II of this Report is to elucidate certain aspects of the Faroese labour market, which possibly could offer a basis upon which to estimate where or how employment in the Faroe Islands (*i.e.* the number of jobs and the manpower for those jobs) could increase and thereby potentially address and rectify the sustainability constraints inherent in the Faroese economy. The study is mostly based on analysis of data from the population census 11.11.2011, and data from the Faroese Tax Authority for the year 2014.

The Faroese labour market has, among others, these key concurrent characteristics: 1) a large portion of the resident manpower works for foreign employers abroad, while a relatively large number of foreigners work in the Faroes; 2) a part of the potential Faroese labour force is or has been studying abroad; and 3) the gender and age composition of the population is extremely disproportional. These same key characteristics are found in isolated regions in other Nordic countries, without, however, disrupting their financial sustainability. In the main, this last characteristic is addressed directly by the State and the most financially prosperous municipalities.

The Ministry of Industry, the North Atlantic Group of the Danish Parliament and *Jobmatch* have undertaken a number of initiatives to investigate or enhance the attractiveness of the Faroe Islands (*vis-à-vis* Denmark) as a place to live and work, especially for those currently living abroad. Although the attractiveness and allure of the Faroes is certainly a relative factor, by itself it is not enough. In truth, the attractiveness of the Faroes can be as great as the country can envision it. But if there continues to exist a limited number of jobs in the Faroes (whether for those resident in the Faroes or for those willing to move), then but little will be achieved. What more can be done to stimulate the job market? This question was not fully addressed in the report of the Ministry of Industry, *Fólkaflyting og fólkavøkstur* (Migration and Population Growth).

Another characteristic of the Faroese labour market is that part-time work is very common, especially among women, including women who desire to work full-time. Also, there is a significant gender bias in wages. More women than men are seeking higher education.

The Faroes is not lagging behind other Nordic countries with regard to the level of education found in the country. Relative to types of education, a rather large proportion of Faroese are educated in the so-called "transport services", which includes, among others, navigators and marine engineers. The choice of education paths (trade/technical, upper secondary, higher education) is to a certain extent impacted by business cycles and therefore the availability of both space in training programmes and work.

With regard to educational choices, for many pursuing higher education there is but little correspondence between the number of students and the number of comparable jobs that will become available over the coming ten years because of retirement. If there is no change in the current situation regarding in the Faroes relative to the availability of work for those with higher education (including recruitment habits), there will be no work in the Faroes for around 40% of those who are now seeking a university education. The situation varies relative to the type of education pursued. Reflecting this, statistics from STUDNA relative to students in higher education shows that only 50-60% of the students who completed their education abroad returned to the Faroe Islands to live. A study conducted in 2009 by the North Atlantic Group in the Danish Parliament on the first generation of those living abroad

between the ages of 20-45 and who were also either working or studying (2,502 people) indicated that around half of these individuals desired to return to the Faroes to live. This number (50%) corresponds well with the actual STUDNA data regarding those who return to the Faroes after completing their higher education abroad.

For the entire population (*i.e.* people registered by various education, industry and job-position), the average monthly wage is DKK 26,000. On average, 21% of the population will reach the retirement age of 67 by 2024.

For people with various types of *education*, the average wages clearly tracked their respective education. However, one major exception was the average wages for those with technical educations. On the other hand, those who were trained caregivers received proportionally lower wages. The percentage of workers who will reach retirement age (67) by 2024 is quite large for those with healthcare education and for people with only an elementary education.

For individuals in the various *business sectors*, the highest average income was found in the natural resources industries (including fishing) and ocean transport. The lowest average wages were in the business sectors "hotel and restaurant", "retail sales", and "childcare". Of those who will reach retirement age by 2024, the highest percentage is for those working in the industry sector "adult caregivers", and it is equally large in the sectors, *e.g.*, "elementary education", "hospitals" and "general services"; more than 4,600 people work in these four business sectors alone.

Relative to the different *occupations*, people in management and technical positions receive the highest average wage; this is also true for people in accounting and administrative positions. On the other hand, the lowest paid workers are those in occupations such as "cleaning", "caregivers", and "retail sales in stores". The percentage of those who will reach retirement age by 2024 is largest in the positions, *e.g.*, "cleaning" and "caregivers", and very low for such positions as, *e.g.* "retail sales in stores".

For individuals receiving only income from abroad, the average monthly wage (from abroad) is DKK 41,000, which is considerably greater than the average monthly wage for the entire population (DKK 26,000). Wages in this regard equates to taxable income.

With regard to foreign-earned income, the highest average wages are paid to individuals with nautical and technical *education*, but individuals with only elementary education also receive high wages. Based on *business sectors*, the highest wages are found in the petroleum industry, the fishing industry and ocean transport. For the various *types of occupation*, the highest wages are for technical jobs (including navigators and marine engineers) and engineers in general.

According to the updated February 2016 tax registry of the Faroese Tax Authority, foreign-based income was 9.2% of all taxable income in 2014. At the same time, while there was significant growth in foreign-based income all the way up to 2013, the wage payments from the Faroes to foreign nationals also grew, especially in 2014. The number of foreign nationals working in the Faroe Islands consequently has grown significantly since 2011.

To overcome the longer-term fiscal sustainability problem inherent in the public accounts, through increased GDP growth through employment, it is self-evident that this will require a large number of new sustainable jobs within a not too distant future. This, of course, provides an enormous challenge, but employment surges are not totally unknown in Faroese economic history (during the period 1989 to 2004, some 7,000 jobs were lost and created).

These analyses of business structure, education, industry and jobs suggest that there may be space for several additional businesses (and the associated jobs and educated employees) in the private tertiary business sector – businesses that potentially grow out of the primary and secondary business sectors. More research in this area is necessary to corroborate this conclusion.

Chapter III of the Report provides a short summary of the issues surrounding fiscal harmonization among the various municipalities, and offers several scenarios addressing these harmonization issues.

When the administration of elder care was placed with the municipalities on 1 January 2015, a guideline was issued to govern the financing of elder care in the municipalities. This financial guideline appeared to be a solution that took into partial consideration the expense items within elder care, and it also addressed the imbalances in the tax revenue base of the various municipalities.

At the same time this financial guideline was being implemented, a third governmental authority arose parallel with both the municipal and central government authorities – namely the eight service areas within elder care. Thus, it could be said that the Faroes went from a two-pronged to a three-pronged division of the Governmental sector. Including the Danish realm and social funds, the Faroes went from a four-pronged to a five-pronged division of the government sector.

The question arises whether or not such a situation is necessary in such a small country as the Faroes. With clearly defined burden and task responsibilities between the central government and the municipalities, and with fewer and larger municipalities, a three- or five-pronged segmentation seems unnecessary. With fewer and larger municipalities, a harmonization system could be implemented that would encompass all the expense items and all the revenue sources.

One possibility for harmonization among the municipalities is a block grant programme. Thus, according to this plan, the central government could finance harmonization and allocate additional funds to those municipalities that would otherwise be unable to adequately address or finance their respective elder care obligations, because of excessive expense or insufficient revenue, relative to a so-called “average” municipality.

Another possible method to address fiscal harmonization is an inter-municipal harmonization programme. According to this type of programme, the municipalities themselves would finance harmonization among the different municipalities. In such an inter-municipal harmonization programme, the municipalities that are financially better off (relative to elder care expenses and revenue base) would transfer funds to those municipalities that are financially at a disadvantage and less able to meet their respective elder care obligations.

The statistical data further reveals the vast differences between the municipalities relative to taxable income per resident, as well as the relative proportion of residents over 80 years of age, and the number of young people between the ages of 0 to 17.