EXECUTIVE SUMMARY IN ENGLISH

Currently, the Faroese economy is in a recession with little economic growth, a deficit in the government accounts, and increasing government debt. Recently, however, several independent indicators suggest evidence of a slow upturn out of recession. The Faroese Economic Council anticipates a rise of GDP of some 3% in current prices in 2013 and essentially the same in 2014.

Successfully climbing out of the current recession is essential, but more is required to overcome structural unemployment and gain a few competitive businesses that might stimulate a resurgence of population by encouraging some overseas Faroese to return to their homeland. These are critical preconditions, but even more is required.

One urgent goal is grounded in the reality that the national treasury has operated at a deficit since 2008 and as a consequence, the debt burden has steadily increased. The latest financial accounts indicate that the thrust of the government to reduce the deficit did not reach its intended goal. The national deficit for 2012 was DKK 335 million; thus the deficit grew, as the deficit in 2011 was DKK 322 million. The requisite balancing of the financial budget in the short run could possibly be achieved through a surcharge on access to natural resources, larger fees levied for aquaculture licenses, and by eliminating or limiting tax asymmetries and deductions and support programs that discriminate between industry sectors and individual citizens throughout the country. Moreover, the Economic Council believes that the current economic policy over the long run will not be fiscally sustainable. (A discussion of "fiscal sustainability" can be found elsewhere in this report under section 1.9.)

The need for this requisite fiscal sustainability accelerates as challenges materialize while implementing strategies to accelerate productivity and economic growth, which, for example, are designed to guard against the loss of competent workers through accelerating emigration.

Without policy revisions, long-term, fiscal sustainability in the Faroe Islands might well never become a reality, especially given available data that indicates that the number of retired people will double over the next several decades (2030-40). This was well established as early as 2009 by a work group with the Ministry of Finance (Ministry of Finance 2009: Recommendation for a sustainable pension system for the Faroe Islands). The same is true for Greenland; the financial policy of Greenland is a long way from achieving long-term fiscal sustainability. On the other hand, the Danish fiscal policy is sustainable over the long term, as the Danes have incorporated into their economic policy planning a doubling of the number of elderly in the country.

Another obstacle to long-term fiscal sustainability is the low rate of retirement pension savings among the Faroese. The amount of retirement savings held by the Faroese at year-end 2011 was DKK 7.7 billion. This is considerably lower per capita that the amount of Danish (or Icelandic) retirement savings. Adjusting for population size, total Faroese retirement savings should be around DKK 29 billion in order to be comparable to the Danish rate of pension savings. If this DKK 29 billion were held instead by the Faroese in retirement pension plans, the greater portion of these funds would be held as tax-deferred assets, with taxes falling due just when there was a need for revenue to finance income transfers and other the growing expense of services provided to the elderly in the country.

In addition to impacting the country's fiscal sustainability, significant retirement savings is critical for many other economic reasons. If, for example, the Faroese held DKK 29 billion in retirement pension savings, some of these billions would have found their way into profitable investments within the Faroese business community. There would have been less need for foreign capital in the Faroes, for example, for the expansion of infrastructure or the development of green energy production in the Faroes. The immediate taxation of funds destined for pension savings accounts does not contribute to long-term fiscal sustainability, in fact just the opposite.

The timeframe of the new pension scheme that is scheduled to come into effect at the beginning of next year is much too short to allow for the accumulation of any sizeable sum before demographic changes become a reality. Such a system cannot, however, stand alone. Indeed, the longer the structural changes needed to create fiscal sustainability are delayed, the more difficult and the more radical the eventual clean up will be.

If the implementation of the recommended changes in elder housing and care proved troublesome in 2013, the problem will be even more intractable, dreaded and overwhelming in 20-25 years if nothing is done. In a forthcoming report, the Economic Council intends to present a detailed analysis of the fiscal sustainability of the Faroe Islands from the present day until 2040, and will discuss possible options and initiatives.

Since the year 2000, the Economic Council has time and again recommended in its reports that fishing days and quotas should be auctioned, such that the resource rent as much as possible goes to the country in proportion to the income derived, while at the same time deregulation of the fishing industry is carried out. A larger fee for aquaculture licenses has also been advocated. Both industry and the political system appear to have recognized that one way or the other a resource charge should be a part of a politically-evolved natural resources economic policy solution.

The Economic Council is of the opinion that the time is now come to set forth an economically-viable solution for the collection of a natural resources surcharge that is both practical and administratively feasible and that incorporates sufficient technical detail, including how such a payment system could be organized and the payment amount calculated and/or measured. Moreover, it must be determined how such a payment will be incorporated into the overall economy of the country. The profit derived by the natural resources industry has historically fluctuated significantly. Therefore, future fluctuations in the income gained from the exploitation of the natural resources of the country must also be factored into any economic rent calculations.

The Economic Council strongly recommends that steps are taken to revise double-taxation treaties with other countries with the intent to strengthen the revenue basis of the government. The requisite balancing of the financial budget in the short run could possibly be achieved through a surcharge on access to natural resources, larger fees levied for aquaculture licenses, and by eliminating or limiting tax asymmetries and deductions and support programs that create differences between industry sectors and individual citizens throughout the country.

In the main, the analysis of the Economic Council regarding the long-term trends within the Faroese economy suggests that we are in the midst of a major structural transformation wherein worksites will be closed down and new workplaces often will not be created in other sectors of the economy. At the same time, it is important to note that there is evidence that the average wages in the Faroes as a whole have been stagnant and deflationary over the last ten years – in other words, zero growth for a total of ten years. This implies a stagnant gross domestic product (GDP) in fixed prices these last ten years.

The Economic Council considers the troubling trend in Faroese population demographics to be a direct result of the shortage of competitive businesses. Recovery will not take place without growth in the economy and in local productivity. The challenges here are exceptionally great, because there is no guarantee that the workplaces that are shutdown as a result of increased productivity and efficiency in the Faroese export industry will be counterbalanced by the creation of new employment opportunities in other industries in the Faroes. Most outlying areas will loose employment options to the central metropolitan areas.

It is anticipated that there will be a deficit on the current account of the balance of payment for 2012. The deficit stems from a significant import of vessels and airplanes during 2012. On the other hand, an increasing export of wild-caught fish and farmed fish in recent years has significantly impacted the balance of payments and this, together with wages earned abroad, has helped offset the crisis in the bottom-fisheries catch within Faroese waters.