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Selected chapters only.

Meld. St. 1

(2022–2023)

Report to the Storting (white paper)

The National Budget 2023

3 Economic policy

We live in challenging times, with an ongoing war in Ukraine, an energy crisis in Europe and high price growth. As a small, open economy, Norway is influenced by the developments in the global economy. At the same time, economic policy will affect the domestic business cycle. Fiscal, monetary and labour policy, as well as the tripartite collaboration on wage development, influence the development in prices, wages, employment and level of economic activity.

The main purpose of the Government's budget proposal for 2023 is to contribute to rein in the high price growth, provide safety around people's private economy and jobs, and level out social and geographic differences. The budget for 2023 is a budget for safe economic navigation in an uneasy period of time.

3.1 Fiscal policy

In the aftermath of the pandemic, the Norwegian economy has entered a sharp upturn; see Chapter 2. The labour market is tight, wage growth seems to be increasing, and inflation has risen to the highest level in many decades. There is now a need for tighter economic policy. Fiscal and monetary policy must act together. The Government is proposing a budget with reduced spending from the fund. Going forward, growth is expected to be lower, but the degree and the swiftness of the economic dampening are uncertain. In accordance with the fiscal guideline, spending from the fund given the Government's budget proposal is projected to be substantially below 3 per cent of the value of the Government Pension Fund Global (GPFG), as it should be when economic activity is high.

To reduce spending from the fund, the Government has had to make difficult priorities in the budget. Expenditures are increasing in many areas, including for the National Insurance scheme as well as for admission and integration of refugees. A lot of money is also spent on supporting household electricity bills as well as other measures related to high electricity prices. To make room for important priorities it has been necessary to cut expenditures in many areas. In addition, the Government is proposing to collect a larger share of the extra profit from production of hydropower to society through the budget. The Government is also proposing other tax increases.

The large demand for workers has increased job opportunities for many, and a lot of those who have been out of a job is thus experiencing a more solid economy. A safe labour income is the mainstay of the Norwegian welfare society. Still, many households experience reduced purchasing power, both due to high price growth on goods and services and increasing interest rates. Electricity prices have increased to very high levels, among other things due to the war in Ukraine. The Government wants to contribute to a more equal income distribution and reduce the social and geographic differences. Among other things, the Government proposes to prolong the measure to support household electricity bills and provide a net tax relief to groups with income below NOK 750 000.

Norway receives substantial revenues from the petroleum sector due to the high gas prices, which in their entirety are transferred to the Government Pension Fund Global (GPFG); see Box 3.1. At the same time, there is distress in the financial markets, and the fund had a negative return in the first six months this year. Future gas prices are very uncertain. The fund is financing almost 20 per cent of budget expenditures. When shaping fiscal policy, it must be taken into account that the market value of the fund is volatile, and that the fund as well as the projected future petroleum revenue could fall rapidly and substantially and remain at a lower level over time.

3.1.1 Fiscal policy stance in 2023

In a situation with high economic activity, spending from the fund should be reduced. Spending from the fund, measured by *the structural non-oil fiscal deficit*, is projected at NOK 316.8 billion 2023-prices given the budget proposal from the government; see Table 3.1.[1] This is NOK 18.3 billion lower than the projection for 2022 (measured in 2023-prices).

As a share of economic activity, spending from the fund will be reduced by 0.6 percentage points from 2022 to 2023, implying a negative *fiscal impulse*; see Chart 3.1 and Table 3.1. The lapse of temporary coronavirus related expenditures contributes to this reduction. For fiscal policy to be sustainable over time, spending on temporary emergency measures must be phased out when the crisis is over and not lead to a lasting increase in the level of expenditures.

The fiscal impulse is a rough and simple indication of the collective impact of the budget on the economy. Analyses of the economic effects of the budget using the macroeconomic

[1] To ensure better alignment between how revenues and expenditures in the structural budget balance are influenced by the high electricity prices, the Ministry of Finance has made a temporary adjustment to the calculation of the structural deficit; see Box 3.3.

models KVARTS and NORA, which take into account the automatic stabilisers and the fact that different budget items have different effects on the economy, indicate that the budget for 2023 is approximately neutral for economic activity next year; see Box 3.4.

When the level of economic activity is high, spending from the fund should be substantially below the long-term fiscal guideline, which is estimated to 3 per cent of the market value of the fund. Based on the Government's budget proposal for 2023 spending from the fund is projected to 2.5 per cent; see Chart 3.2 and Table 3.4. The budget proposal is based on a projected value of the fund at NOK 12 500 billion at the beginning of 2023. The projection is based on the market value of the fund after the first six months in 2022, projected with expected real return. The development of the value of the fund is uncertain, and to counter the risk of having to significantly tighten fiscal policy if there is a downturn in the value of the fund, spending from the fund should in normal times be well below 3 per cent. The percentage of money spent will vary with the value of the fund, which fluctuates a lot. The estimated risk in the fund indicates that the value of the fund in two out of three years can be expected to fluctuate by up to 10 per cent. If the value of the fund becomes 10 per cent lower than projected, the spending from the fund will be 2.8 per cent. If the value of the fund should fall by substantially more than this, the spending could be higher than the long-term guideline. A fall in the value of the fund at i.e. 25 per cent would result in spending at 3.4 per cent of the fund. For comparison, the return on the fund's investments during the global financial crisis in 2008 was close to -25 per cent (measured in foreign currency).

A projected spending of 2.5 per cent of the fund is somewhat lower than the level before the pandemic. Still, spending from the fund measured in terms of NOK and as a share of the mainland economy, has increased significantly in the last few years. In the period 2016-2019, spending from the fund on average accounted for 7.3 per cent of the mainland economy. For 2023 the projection is 8.8 per cent, or around NOK 66 billion (measured in 2023-prices) higher than the average from the period 2016-2019; see Chart 3.3.

The actual transfer from the Government Pension Fund Global to the fiscal budget, *the non-oil fiscal deficit*, is projected at NOK 257.0 billion in 2023; see Table 3.2. When the non-oil deficit is less than the structural deficit, it reflects that total tax revenue is expected to be above its trend level in 2023. In other words, the automatic stabilisers[2] are projected to have a contractionary effect on the economy.

The overall surplus in the fiscal budget and the Government Pension Fund is projected at NOK 1 415,0 billion in 2023 and corresponds to around 40 per cent of trend-GDP for mainland Norway; see Chart 3.4 and Table 3.2. The magnitude reflects high revenue from petroleum activity due to the high gas prices. Net provision to the Government Pension Fund Global, i.e. the net cash flow from petroleum activity adjusted for the transfers to the budget, is estimated at around NOK 1 127 billion in 2023. The estimate for 2022 is NOK 864 billion.

[2] Automatic stabilisers denote changes in the budget balance that are caused by high tax revenue in booms and low tax revenue in recessions, and that unemployment benefit payments are low in booms and high in recessions; see Box 3.1.

In contrast, the transfer from the fund to the fiscal budget in the period 2016-2021 was on average close to NOK 100 billion higher than the net cash flow from petroleum activity (measured in 2023-prices).

Expenditures in the fiscal budget increased considerably during the pandemic, which is reflected in the rise in expenditure within the public administration to 65.6 per cent of GDP for mainland Norway in 2020 and 62.3 per cent in 2021; see Chart 3.5. Given the Government's budget proposal the share will be 60.2 per cent in 2023. The fiscal budget's *underlying growth in expenditure* is projected at 1.3 per cent in 2023; see Chart 3.6 and Table 3.3.

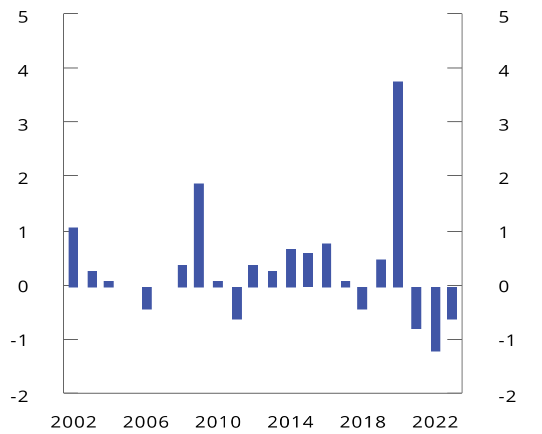

Chart 3.1 Structural non-oil fiscal deficit. Per cent of trend-GDP for mainland Norway. Percentage change from previous year (fiscal impulse)

Source: Ministry of Finance.

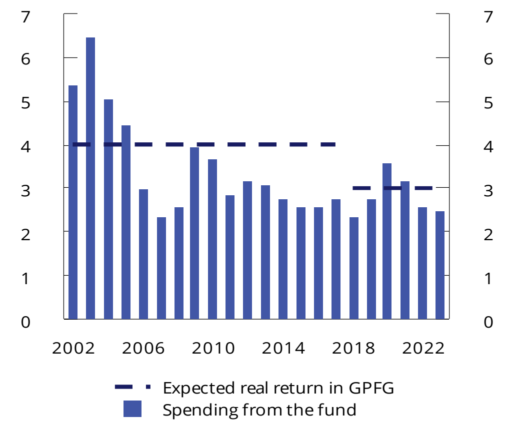

Chart 3.2 Structural non-oil fiscal deficit. Per cent of Government Pension Fund Global

Source: Ministry of Finance.

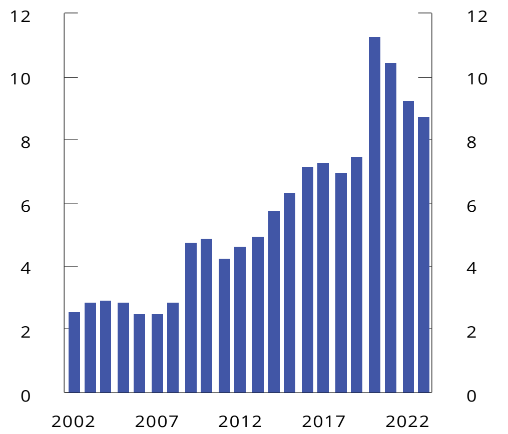

Chart 3.3 Structural non-oil fiscal deficit. Per cent of trend-GDP for mainland Norway

Source: Ministry of Finance.

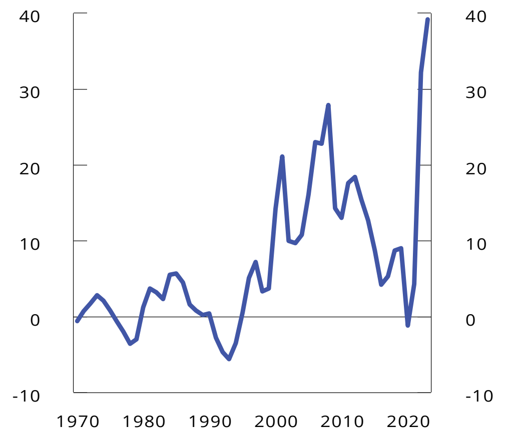

Chart 3.4 Combined surplus of fiscal budget and Government Pension Fund. Per cent of trend-GDP for mainland Norway

Source: Ministry of Finance.

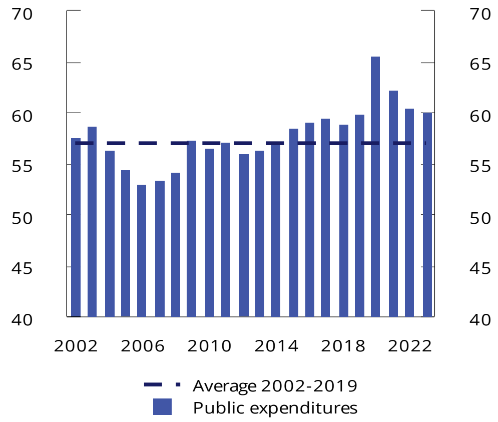

Chart 3.5 Expenditure in general government.[1] Per cent of GDP for mainland Norway

[1] General government comprises central government and local government.

Sources: Statistics Norway and Ministry of Finance.

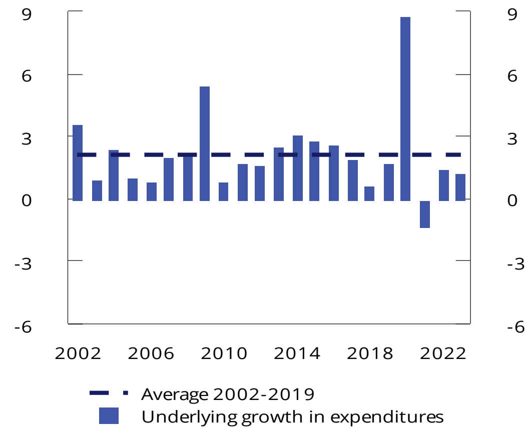

Chart 3.6 The fiscal budget's underlying growth in expenditure. Percentage change from previous year

Sources: Statistics Norway and Ministry of Finance.

Table 3.1 The structural non-oil fiscal balance.[1] NOK million

	2021	2022	2023
Non-oil fiscal deficit	368 968.6	304 445.5	257 048.5
+ Net interests and transfers from Norges Bank. Deviation from trend	2 979.0	2 717.8	11 750.3
+ Special accounting considerations[2]	-5 015.3	-37 711.6	-40 797.4
+ Taxes and unemployment benefits. Deviation from trend	-16 484.2	54 272.7	88 791.9
= Structural non-oil fiscal deficit	350 448.1	323 724.3	316 793.4
Measured in per cent of trend-GDP for mainland Norway	10.5	9.3	8.8
Percentage points change from previous year (fiscal impulse)[3]	-0.8	-1.2	-0.6
Memo:			
Income from investments in the Government Pension Fund. Estimated trend	261 277	286 066	310 408
Structural non-oil fiscal deficit, including income from investments	89 171	37 658	6 385
Measured in per cent of trend-BNP for mainland Norway	2.7	1.1	0.2

1 See Appendix 1 for a more detailed description of how the structural non-oil deficit is calculated.
2 Includes temporary adjustments for the governments extraordinary revenue above trend related to electricity prices; see Box 3.3 for more information.
3 Positive numbers indicate that the budget has an expansionary effect. The indicator does not take account of different revenue and expenditure items impacting economic activity differently.

Source: Ministry of Finance.

Table 3.2 Key figures in the fiscal budget and the Government Pension Fund. NOK billion

	2021	2022	2023
Total revenues	1 502.7	2 521.1	2 875.0
1 Revenues from the petroleum sector	312.2	1 195.5	1 412.6
1.1 Taxes and duties	91.8	580.2	854.9
1.2 Other petroleum revenue	220.4	615.3	557.7
2 Non-oil revenues	1 190.5	1 325.6	1 462.4
2.1 Taxes and duties from mainland Norway	1 099.5	1 219.8	1 355.6
2.2 Other revenues	91.0	105.9	106.8
Total expenditures	1 584.2	1 656.8	1 747.8
1 Expenditures in the petroleum sector	24.7	26.7	28.3
2 Non-oil expenditures	1 559.4	1 630.1	1 719.5
Budget surplus before transfer to the Government Pension Fund Global	-81.5	864.4	1 127.3
- Net cash flow from the petroleum sector	287.5	1 168.8	1 384.3
= Non-oil fiscal surplus	-369.0	-304.4	-257.0
+ Transfer from the Government Pension Fund Global	390.1	304.4	257.0
= Budget surplus	21.1	0.0	0.0
+ Net provision to the Government Pension Fund Global	-102.6	864.4	1 127.3
+ Interest income and dividends etc. in the Government Pension Fund[1]	223.7	252.8	287.8
= Combined surplus from fiscal budget and Government Pension Fund[1]	142.2	1 117.2	1 415.0
Memo:			
Interest income and dividends etc. from the Government Pension Fund Global	214.1	240.4	274.5
Market value of the Government Pension Fund Global[2]	10 907	12 340	12 500
Market value of the Government Pension Fund[2]	11 199	12 673	12 848
Commitments for old-age pensions in the National Insurance Scheme[2,3]	9 242	9 644	10 208

[1] Incl. Government Pension Fund Global and Government Pension Fund Norway. Does not include currency gains or losses.
[2] At the beginning of the year.
[3] The present value of existing accrued rights to future old-age pension payments under the National Insurance scheme.

Sources: Ministry of Finance and Statistics Norway.

Table 3.3 The fiscal budget's underlying expenditure.[1] Projections in NOK million and percentage change

		2022	2023
Total expenditure		1 656 789	1 747 772
-	Government petroleum activity	26 700	28 300
-	Unemployment benefits	13 420	9 138
-	Interest expenses	10 469	12 125
=	Expenditure other than for petroleum activities, unemployment benefits and interest expenses	1 606 201	1 698 210
-	Refugees in Norway financed through development aid framework	4 892	1 624
+	Correction for pension premiums etc. in hospitals	977	-3 275
+	One-off reduction in framework grant to municipal sector	12 066	0
=	Underlying expenditure	1 614 351	1 693 310
	Value change in per cent.	6.2	4.9
	Price change in per cent.	4.7	3.5
	Volume change in per cent	1.5	1.3

[1] The calculation of the underlying growth in expenditure excludes the fiscal budget's expenditure on government petroleum activity, unemployment benefits and interest expenses. In order to make the expenditures comparable over time, adjustments have been made for extraordinary changes and certain accounting considerations according to standard procedures.

Source: Ministry of Finance.

Table 3.4 The Government Pension Fund Global, 3 per cent real return and structural non-oil budget deficit. NOK billion and per cent

	Current prices			Fixed 2023 prices			Structural deficit	
	Government Pension Fund Global at the beginning of the year	3 per cent of fund capital	Structural non-oil fiscal deficit	3 per cent of fund capital	Structural non-oil fiscal deficit	Deviation from 3 per cent trajectory	Per cent of trend-GDP for mainland Norway	Per cent of fund capital
2001	386.6	-	17.6	-	37.1	-	1.4	4.5
2002	619.3	-	33.2	-	67.1	-	2.6	5.4
2003	604.6	-	39.4	-	76.6	-	2.9	6.5
2004	847.1	-	43.1	-	81.5	-	3.0	5.1
2005	1 011.5	-	45.2	-	82.8	-	2.9	4.5
2006	1 390.1	-	41.4	-	73.3	-	2.5	3.0
2007	1 782.8	-	43.0	-	72.7	-	2.5	2.4
2008	2 018.5	-	52.5	-	83.5	-	2.9	2.6
2009	2 279.6	-	91.6	-	140.5	-	4.8	4.0
2010	2 642.0	-	98.4	-	145.6	-	4.9	3.7
2011	3 080.9	-	90.3	-	129.0	-	4.3	2.9
2012	3 307.9	-	104.8	-	144.9	-	4.7	3.2
2013	3 824.5	-	118.1	-	158.0	-	5.0	3.1
2014	5 032.4	-	141.5	-	183.9	-	5.8	2.8
2015	6 430.6	-	164.6	-	209.0	-	6.4	2.6
2016	7 460.8	-	195.3	-	242.0	-	7.2	2.6
2017	7 509.9	-	207.8	-	252.3	-	7.3	2.8
2018	8 484.1	254.5	205.6	300.3	242.5	-57.7	7.0	2.4
2019	8 243.4	247.3	231.0	283.2	264.5	-18.7	7.5	2.8
2020	10 086.2	302.6	362.8	341.5	409.5	68.0	11.3	3.6
2021	10 907.1	327.2	350.4	354.6	379.7	25.2	10.5	3.2
2022	12 340.1	370.2	323.7	383.2	335.1	-48.1	9.3	2.6
2023	12 500.0	375.0	316.8	375.0	316.8	-58.2	8.8	2.5

Source: Ministry of Finance.

3.1.2 Fiscal policy going forward

The fiscal guideline states that over time spending from the fund must be in line with the expected real return from the Government Pension Fund Global, estimated at 3 per cent. At the same time, fiscal policy shall contribute to a stable development in the Norwegian economy, both in the short and long term.

Chart 3.7 shows the accumulated development in the market value of the fund up until the first six months of 2022, broken down by the cash flow from the petroleum activity, withdrawal from the fund, return (net of management fees) and changes in the exchange rate. The value of the fund is now around 3.5 times the size of the annual GDP of the mainland economy. Spending from the fund is projected to cover around 18 per cent of expenditures in the budget for 2023, which is still higher than the years before the coronavirus pandemic; see Chart 3.8

The size of the fund and its increasing importance in financing the welfare state makes us more susceptible than before to lasting falls in the value of the fund. Fiscal policy must be implemented in a way that ensures foreseeable reductions in the fund's market value will not necessitate large cuts in the budget expenditures or an increase of taxes, particularly not in a situation with a recession in the real economy. To counteract the risk of having to substantially tighten fiscal policy and thus reinforce the fluctuations in the economy if there is a large decline in share prices, spending from the fund should in normal times be well below 3 per cent.

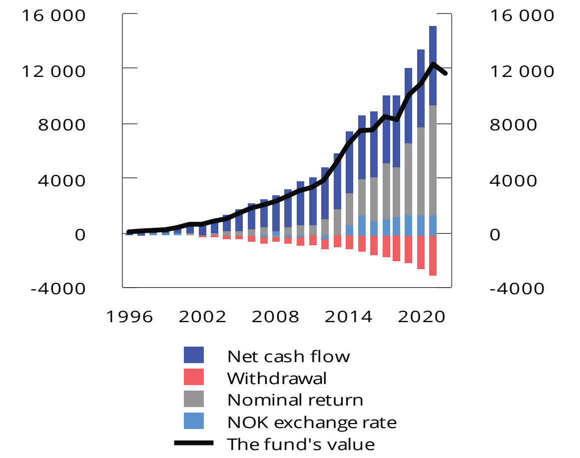

Chart 3.7 Market value of Government Pension Fund Global.[1] NOK billion

[1] Market value per first six months for 2022. Return is net of management fees.

Sources: Norges Bank Investment Management and Ministry of Finance.

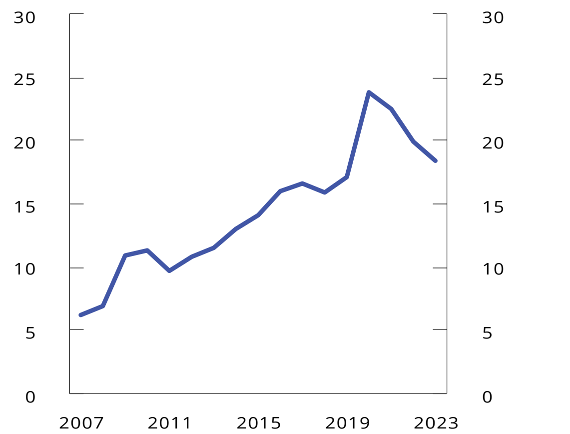

Chart 3.8 Spending from the fund as a share of expenditures in the fiscal budget.[1] Per cent

[1] Non-oil expenditures.

Source: Ministry of Finance.

The Ministry of Finance presents analyses of the sustainability of public finances in the white papers on long-term perspectives on the Norwegian economy, which are published about every four years. The most recent report on long-term perspectives was published in February 2021. The analyses of sustainability of public finances are based on economic projections.[3]

The calculations in the white paper on Long-term Perspectives on the Norwegian Economy 2021 illustrated that the revenues in the budget are expected to grow less in the period towards 2030. The projections indicated both that petroleum revenues will gradually decrease, and that growth in employment and productivity will be lower than the previous decade. At the same time, an increasing share of elderly people will imply an increase in expenditures for pensions, health, and care. Given spending from the fund in accordance with the fiscal guideline, the calculations in the 2021-report show that the fiscal space for manoeuvre will be reduced from NOK 21 billion a year on average for the period 2011-2019 to NOK 4 billion from 2023 until 2030. The calculated fiscal space for manoeuvre through to 2030 is about the same size as the growth in expenditures that is projected to follow from increased costs in municipalities and hospitals due to demographic changes.

Looking further ahead than 2030, the challenges of increased expenditures due to an ageing population will rise. In the white paper on Long-term Perspectives on the Norwegian Economy 2021, calculations for the fiscal gap through to 2060 were shown. The long-term fiscal gap expresses which adaptions in terms of reduced expenditures or increased taxes that will be necessary to fund public expenditures for a given amount of spending from the fund in accordance with the fiscal guideline. The projections in the *basic scenario* in the 2021-report show a fiscal gap of 5.6 per cent of mainland GDP in 2060. This corresponds to an average fiscal gap of a bit less than NOK 5 billion per year.[4]

The report on long-term perspectives from 2021 illustrates how important high employment is for sustainability of public finances. Reducing the number of people on benefits and sick leave, increasing employment among immigrants, getting more part-time workers into full-time work, having elderly work longer and getting youth through the education system and into work will be of particular significance. A more efficient public sector will also increase the fiscal space for manoeuvre.

Political goals, which among other things are expressed in declarations of intent, reports to the Storting (white papers), and plural notes in the Storting, place significant guidance on future

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[3] The calculations in the report differ in the medium and long term. In the medium term, until 2030, the projections for the fiscal space for manoeuvre is closely tied to how the yearly budgets are made. The long-term projections towards 2060 are based on the general equilibrium model DEMEC.

[4] The calculations in the white paper on long-term perspectives from 2021 were based on the fiscal policy arrangement for 2021 at the adoption of the budget in December 2020. Further, the technical calculations were based on a market value of the fund of NOK 10 400 billion at the beginning of 2022. In the Supplementary text no. 1 in the *Statement for 2022*, submitted by the *Advisory council for fiscal analysis* in March 2022, it was shown that if the market value of the fund at the beginning of 2022 had been projected at NOK 12 250 billion (in line with projections from the National budget for 2022), the fiscal gap in 2060 would have been projected at 4.5 per cent. If the value of the fund had been NOK 9 250 billion, the fiscal gap in 2060 would have been projected at 6.2 per cent. The calculations were done by the Ministry of Finance for the advisory council.

budgets. Follow-up of the long-term plan for the defence industry is one example of a highly prioritised area with political bindings. In addition, unforeseen events could result in high expenditures. The global financial crisis (2009), the oil price fall (2014), the coronavirus pandemic (2020) and the war in Ukraine are examples of such events.

The sustainability of public finances also depends on the development of the value of the fund and the cash flow from the petroleum industry. The value of the fund has developed more favourably than assumed in the report on long-term perspectives from 2021, which would have affected an updated projection of the long-term need for coverage. However, uncertainty about the future value of the fund is very high, both due to high uncertainty about the development of international financial markets and due to significant uncertainty about the future cash flow. Russia's cut in the gas supply to Europe contributes to the currently very high gas prices. Net cash flow from petroleum activity is projected to a bit less than NOK 1 200 billion and NOK 1 400 billion in 2022 and 2023, respectively. How gas prices will develop, will be of decisive importance for the cash flow and the value of the fund going forward. Box 3.5 discusses how different trajectories for the gas prices will affect the 3-per cent trajectory and the fiscal space for manoeuvre going forward.

3.1.3 Updated figures for fiscal policy in 2022

Spending from the fund in 2022 is now projected to NOK 323,7 billion, as measured by *the structural non-oil fiscal deficit.* This is NOK 43.1 billion lower than projected for 2021, measured in 2022 prices, but around the same level as the projection in the balanced budget for 2022 (NOK 322.4 billion); see Table 3.5.

There have been significant changes to the projection for spending from the fund since the balanced budget for 2022. In the revised budget for 2022, spending from the fund was projected to NOK 352.2 billion. The significant increase was, among other things, due to adopted extraordinary measures of around NOK 60 billion for temporary coronavirus measures, the electricity subsidy scheme for households, and admission of refugees from Ukraine. Around half of these extraordinary expenditures was funded in the revised budget. The coverage of expenditure was, among other things, done by reducing the framework grant for municipalities. The reason was that the municipality sector will have temporary high tax revenues in 2022 due to extraordinary high share dividends towards the end of last year. Changes in projections for structural taxes and so forth also reduced the projected spending from the fund.

After the revised budget, the projection for the structural fiscal deficit is reduced by NOK 28.5 billion. The reduction is mainly due to the ministry having added a temporary correction to the calculation of the structural fiscal balance due to extraordinary revenues related to electricity prices; see Box 3.3. A higher projection for the electricity subsidy scheme for households works in the opposite direction and, seen separately, increases spending from the fund.

The fiscal impulse, which measures the change in spending from the fund from one year to the next as a share of trend-GDP for mainland Norway, is projected to -1.2 per cent in 2022. The fiscal impulse must be viewed in light of most of the coronavirus measures being liquidated.

The spending from the fund in 2022 is now projected to 2.6 per cent of the capital in the Government Pension Fund Global at the start of the year. The *non-oil fiscal deficit* is projected to NOK 304.4 billion.

The estimate of *the government's net cash flow* from petroleum activity in 2022 is revised upwards with NOK 236 billion since the revised budget, to NOK 1 169 billion. The upward revision is mainly due to higher projections for the price of gas. *The overall surplus in the fiscal budget and the Government Pension Fund,* which include interest and dividend receipts from the Government Pension Fund Global and the Government Pension Fund Norway and the cash flow from petroleum activity, is projected to NOK 1 117 billion in 2022. This corresponds to just above 30 per cent of GDP for mainland Norway. At the same time, the Government Pension Fund Global had a negative return, of -14.4 per cent (equivalent to NOK -1 680 billion), in the first six months of 2022 due to the decline in international financial markets.

Table 3.5 Key figures in the budget for 2022. Projections at different times.[1] NOK billion

	Balanced 2022	Change	Revised 2022	Change	National 2023[2]
Non-oil fiscal deficit	300.1	3.3	303.4	1.1	304.4
Structural non-oil fiscal deficit	322.4	29.8	352.2	-28.5	323.7
Per cent of trend-GDP mainland Norway	9.5	0.9	10.3	-1.0	9.3
Per cent of capital in Government Pension Fund Global	2.6	0.2	2.9	-0.2	2.6
Fiscal impulse (percentage units)[3]	-2.6	2.2	-0.5	-0.7	-1.2
Real, underlying growth in expenditures (per cent)	-3.2	4.0	0.8	0.6	1.5
Overall surplus in the fiscal budget and the Pension Fund Global[4]	211.2	663.6	874.8	242.4	1 117.2

[1] Balanced budget 2022 adopted in autumn 2021 (Balanced 2022), adopted Revised national budget for 2022 following deliberation 2022 by the Storting in June 2022 (Revised 2022) and National budget for 2023 (National 2023).
[2] The projections include updated estimates for the measure to support household electricity bills, cf. Prop. 30 (2021-2022).
[3] Change in structural non-oil fiscal deficit measured as a share of trend-GDP for mainland Norway. A positive figure indicates an expansionary budget. The indicator does not take into account that different revenue and expenditure items may have different impact on economic activity.
[4] Incl. Government Pension Fund Global and Government Pension Fund Norway.

Source: Ministry of Finance.

3.1.4 The fiscal set-up for the municipal sector – *not translated*

3.1.5 Development in public sector finances

The general government surplus is measured in the national accounts through net lending. For Norway, net lending in general government[5] is projected at around NOK 1 494 billion in 2023. This corresponds to 26.1 per cent of GDP; see Table 3.9. The significant increase in net lending from 2021 is due to the high petroleum revenues. For 2022, net lending in the general government is projected to around NOK 1 272 billion.

Table 3.9 Net lending in general government.[1] NOK million and per cent of GDP

	2021	2022	2023
A. Central government's net financial investments, accrued value ..	396 788	1 343 565	1 550 968
Fiscal budget surplus and surplus in Government Pension Fund	142 209	1 117 156	1 415 003
Non-oil fiscal deficit	-368 969	-304 445	-257 048
Net cash flow from petroleum activity	287 513	1 168 801	1 384 301
Interest income and dividends etc. in the Government Pension Fund	223 665	252 800	287 750
Surplus in other government and social security accounts	4 427	-2 393	-1 321
Differences in definitions between central government accounts and national accounts	250 152	228 803	137 287
B. Municipal net financial investments, accrued value	8 071	-72 003	-56 753
Municipal sector surplus, accounted value	-10 176	-45 072	-59 379
C. Public administration net financial investments (A+B)	404 859	1 271 563	1 494 215
As share of GDP	9.8	22.7	26.1

1 Includes the central government administration's accrued, but not accounted, taxes, partly linked to petroleum activity. A correction has also been made for capital deposits in commercial operations, including government petroleum activity, being counted as financial investments in the national accounts.

Sources: Statistics Norway and the Ministry of Finance.

The development of the general government surplus is highly affected by the revenues from petroleum activity and interest and dividend receipts in the Government Pension Fund. Excluding these revenues, the government has in recent years been recording a substantial deficit. In line with the Government Pension Fund Act, this deficit is being covered by a transfer from the Government Pension Fund Global to the fiscal budget. The local government has also had negative net lending (net borrowing) in recent years.

A frequently used indicator for the fiscal balance in European countries is net lending/borrowing expressed as a percentage of GDP. The public sector budgets of the OECD countries and the countries in the euro area have on average been in deficit. According to OECD projections, member countries will collectively end up with net borrowing in general government equivalent to 3.8 per cent of GDP in 2023; see Chart 3.13.

5 The collective of central government and local government, including the Government Pension Fund.

Norway’s tax level is higher than the average of the OECD countries but has historically been lower than many other Nordic countries measured as a proportion of the country’s GDP; see Chart 3.14. In 2022 and 2023, accrued tax revenue from extraction of petroleum increased significantly. The proportion of tax revenues will vary somewhat between countries, partly depending on the extent to which public pension and benefit payments are subject to taxation, as well as how large the share of public pensions savings is.

From 2019 to 2021, public expenditure as a proportion of mainland GDP rose from around 60 per cent to 62.3 per cent. This is a result of in part increases in public expenditure and in part reduced economic output in the mainland economy, both of which must be seen in connection with the coronavirus pandemic. Lower growth in expenditure relative to growth in GDP result in an expected drop in public expenditure expressed as a proportion of GDP to 60.2 per cent of mainland GDP in 2023; see Chart 3.15.

Public expenditure consists of consumption expenditure, gross fixed capital formation and capital transfers. The level of consumption expenditure in Norway as a proportion of the mainland economy has been higher than in other European countries in the last few years, see Chart 3.16, and follows the development in public expenditures.

Gross capital fixed formation within the general government, i.e. public sector expenditure for construction of roads, railways and public buildings, has also increased. The level of public sector gross fixed capital formation has for many years been higher in Norway than in many other industrialised countries. The difference has increased since 2013, as many countries have reduced their investments in physical capital to strengthen their public sector budgets. Chart 3.17 compares gross fixed capital formation within the public sector as a proportion of mainland GDP and the corresponding proportions in Sweden and Denmark.

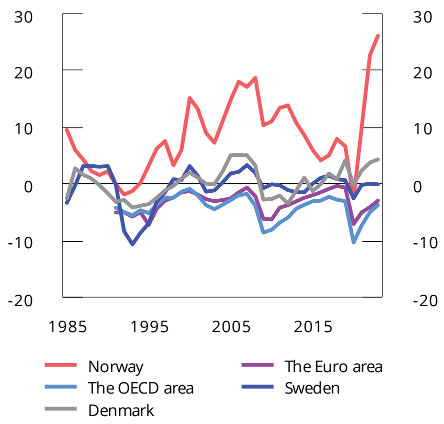

Chart 3.13 General government net lending. Per cent of GDP

Sources: OECD and Ministry of Finance.

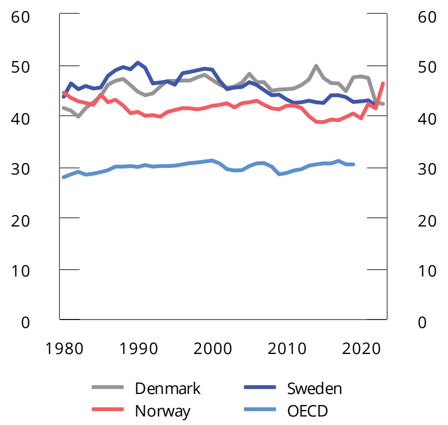

Chart 3.14 Public tax revenue. Per cent of GDP

Sources: OECD and ministries of finance in Sweden, Denmark and Norway.

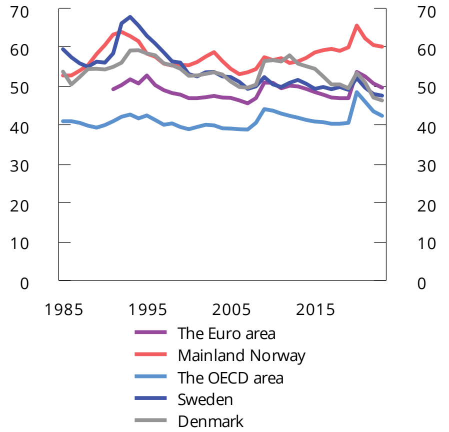

Chart 3.15 Public expenditure. Per cent of GDP

Sources: OECD and Ministry of Finance.

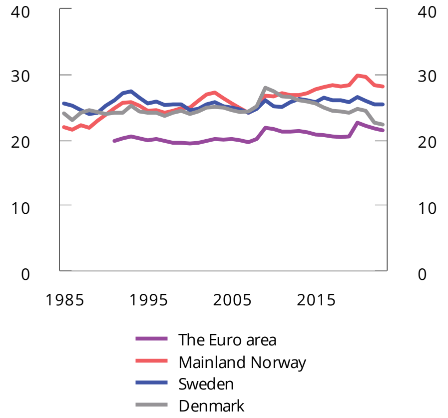

Chart 3.16 Consumption expenditure. Per cent of GDP

Sources: OECD and Ministry of Finance.

Developments in public sector net financial liabilities depend both on the current surplus or deficit and on changes in the market value of the portfolio of outstanding receivables and debt, such as shares and bonds. Including the capital in the Government Pension Fund and capital deposits in government commercial operations, public sector net financial liabilities are projected at around NOK 16 160 billion at the end of 2023, or 282.7 per cent of GDP; see Chart 3.18. Most of this is in the form of capital in the Government Pension Fund.

Very few OECD-countries have positive net financial liabilities within their public administration. For the OECD-countries as a whole, the public administration is projected to have negative net financial liabilities, i.e. net debt, equivalent to almost 75 per cent of GDP in 2023. This net debt rose sharply in 2020 and 2021 as a result of high public sector deficits during the pandemic.

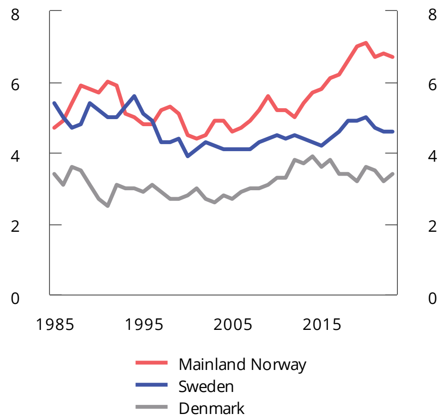

Chart 3.17 Public gross fixed capital formation. Per cent of GDP

Sources: OECD and Ministry of Finance.

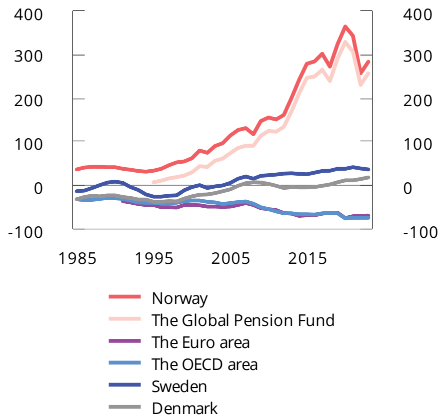

Chart 3.18 Public net financial liabilities. Per cent of GDP

Sources: OECD and Ministry of Finance.

Box 3.1 The fiscal framework

Like most other countries, Norway has a fiscal policy framework which imposes requirements on the fiscal balance. The framework in Norway is in addition customized to the special situation we have, with substantial, temporary petroleum revenues and substantial income from a fund.

One purpose of the fiscal framework is to transform a temporary income stream from extraction of petroleum resources into a lasting source of income. This is done by allocating the cash flow from petroleum activity to the Government Pension Fund Global (GPFG), and over time only spending the expected real return from the fund over the fiscal budget.

How the petroleum wealth is saved in GPFG and phased into the economy, is authorized by the Government Pension Fund Act. The act ensures that the government's net cash flow from petroleum activity in its entirety is transferred from the fiscal budget to GPFP, and that the money in the fund only can be transferred to the fiscal budget following resolution by the parliament (the Storting). The return on the fund is recognised as income directly in the fund.

The transfer from the fund corresponds to the non-oil fiscal deficit, which is authorized by the Storting during deliberation of the fiscal budget; see Chart 3.19.

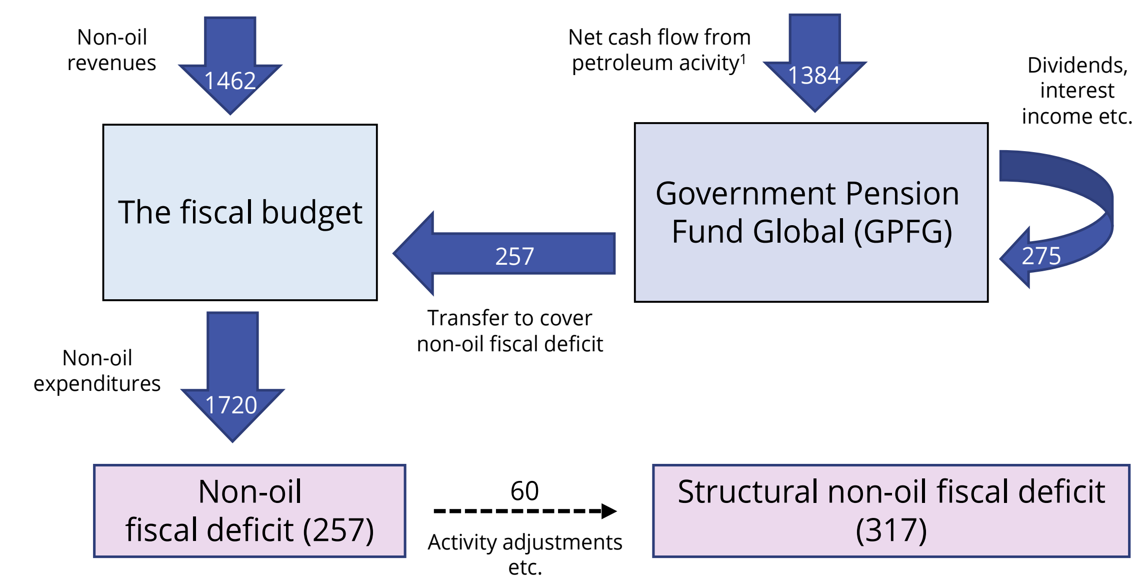

Chart 3.19 Cash flows between the fiscal budget and GPFG. Figures from the National budget for 2023. NOK billion

[1] The government's revenue from petroleum activity enters into the fiscal budget before the net cash flow from petroleum activity is transferred to GFPG, but this is simplified in the chart.

Source: Ministry of Finance.

Box 3.1 continues

The fiscal rule has since 2001 provided a guideline for spending from the fund:

- Spending from the fund shall over time follow the expected real return of the Government Pension Fund Global.
- Strong emphasis shall be put on smoothing out fluctuations in the economy to ensure sound capacity utilisation and low unemployment.

The expected real return is estimated to 3 per cent. The fiscal guideline facilitates the maintenance of the real value of the fund, to the benefit of present and future generations.

The fiscal policy framework contributes to shelter the fiscal budget from short-term fluctuations in petroleum revenues and provide fiscal space to counter economic setbacks.

Considerations and trade-offs when spending money from the fund

The fiscal guideline stipulates that the money in the fund shall be used in a manner that provides a sound distribution between generations, and that facilitates a stable development in the Norwegian economy. When assessing spending from the fund, these considerations must be weighed against one another.

On the one hand, spending from the fund today must be weighed against the necessity that the wealth should also be used in the future. Even if this is often called generational distribution of the wealth, it does also mean that present generations shall have means to use in the future. A spending that preserves the real value of the fund, will balance the trade-off between use of funds today and in the future. A well-balanced distribution of the funds between generations also contributes to stability in the economy in the long run.

On the other hand, to ensure strong emphasis on a stable economic development from one year to the next, the economic cycle must be heavily weighted when considering spending from the fund. Ensuring a stable development also means that significantly large changes in spending from the fund must be distributed over several years to avoid an abrupt contraction that could cause instability in the economy.

The trade-offs have become more demanding over the years as the fund has grown in importance for the budget and the economy.

The structural non-oil deficit and automatic stabilisers

The fiscal guideline and «spending from the fund» are related to the structural non-oil fiscal deficit[1], which is the non-oil fiscal deficit adjusted for economic fluctuations and other more temporary fluctuations in certain revenue and expenditure items, so-called activity adjustment; see Appendix 1 for a closer description (the Appendix is only available in Norwegian).

In a boom, tax revenues are usually high and expenditures for unemployment benefits are low, while it is opposite in a recession. This means that fiscal policy automatically works expansionary in recessions and contractionary in booms, implying that fiscal policy contributes to stabilising the economic development. Such effects of fiscal policy are called automatic stabilisers and can be substantial. The structural fiscal deficit is adjusted for such cyclical fluctuations. By relating spending from the fund to the structural deficit, it is ensured that the automatic stabilisers in the budget get working.

Box 3.1 continues

Spending from the fund is part of a holistic budgetary process

According to the Government Pension Fund Act the funds can only be applied in terms of an amount transferred to the fiscal budget following a resolution by the Storting. This ensures openness about the use of the money in the fund by making sure that they take part in and are made visible in the fiscal budget and fiscal accounts. The money in the fund is thus part of a holistic budgetary process and is not earmarked for special purposes. This stops the fund from being an alternative source of finance for expenditures that do not make it in the ordinary budgetary process. The Government Pension Fund Act also stipulates that provided there is money in the fund, any deficit in the fiscal budget must be covered by transfers from the fund, rather than through borrowing.

[1] The structural non-oil fiscal deficit is called «spending from the fund» or «spending of oil money». The terms are used interchangeably with the same meaning, and reflect that the fund at the starting point is oil revenues that have not been spent, but deposited into the fund for spending in the future.

Box 3.2 The government's extraordinary revenues from high electricity prices

Electricity prices in parts of Southern Norway have increased significantly since last fall and in the second quarter this year they were at the highest ever since Statistics Norway began making measurements in 1998; see Chart 3.20. Forward prices indicate that electricity prices in Southern Norway will be high also next year. The high electricity prices are caused by extraordinary circumstances in the European power market due to the war in Ukraine, a stronger attachment to the European power market in southern parts of the country as well as influx development and internal grid limitations in Norway and the Nordics, among other things. An important cause of the high power prices in Europe, is the high prices on gas and coal.

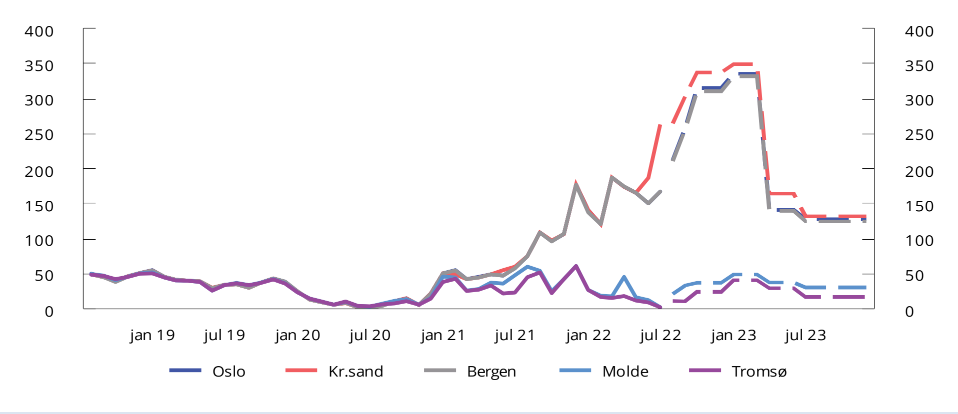

Chart 3.20 Spot prices in different price areas, August 2018-July 2022. Forward prices as of 1 August 2022.[1] Øre/kWh.[2]

[1] The calculations in the National budget for 2023 are based on forward prices as of 1 August 2022. In the chart the quarterly forward prices are spread evenly across the months of each quarter.
[2] An øre is a currency unit amounting to 1/100 NOK.
Sources: Nord Pool and Ministry of Finance.

Box 3.2 continues

The government receives significant extraordinary revenues due to the high electricity prices. The government's extraordinary electricity revenues mainly consist of resource rent on hydropower and dividend income from Statkraft. Through Statkraft the government owns around 35 per cent of the production capacity for hydropower. In addition, Statkraft owns shares in several power companies. The revenue in the municipal sector is also affected by electricity prices, particularly through the value of licensed power for municipalities affected by construction of power companies and through dividends from power plants owned by municipalities. The property tax base may also be affected in the long term. Municipalities and counties collectively own around 45 per cent of production capacity for hydropower.

Table 3.10 shows projections for the government's extraordinary revenues beyond a historic average (2010-2021) that largely is due to the electricity prices. The projections are based on forward prices as of 1 August 2022. The date is chosen considering the government's budgetary process. The figures are uncertain.

Resource rent is projected at around NOK 46 billion and NOK 37 billion higher (accrued) in 2022 and 2023, respectively, than an historic average, provided unchanged tax rules. The government proposes to increase the effective resource rent on hydropower from 37 to 45 per cent as of the income year 2022 plus some other changes. The government further proposes to introduce a high price contribution on power production of 23 per cent of prices above 70 øre per kWh, which also increases the government's revenues related to electricity. In addition, a proposal to introduce resource rent on wind power on land as of 2023 will be sent on consultation. See explanations of the proposals in Prop. 1 LS (2022-2023) Proposition to the Storting (bill and draft resolution) For the Fiscal Year 2023 *Taxes 2023*. Dividends from Statkraft is estimated to be NOK 5.4 billion higher in 2022 than average for previous years. Dividends accruing in 2022 are paid out in 2023. Projections for 2023 have not been made. The table also includes revenues from value added tax on the part of the electricity price that the government compensates through the measure to support household electricity bills.

Other government revenues are also likely to be affected by the high electricity prices. Increased profits at power companies will result in increased tax revenues for the government. At the same time, the government will likely receive reduced tax revenues from other sectors due to the high electricity prices, and from companies that are losing income due to high electricity prices leading to lower consumption of other goods and services.[1] The Ministry does not have enough information to make an estimate of any extraordinary revenues from the corporate tax, collectively, caused by high electricity prices.

The projection in Table 3.10 does not include increased revenues from value added tax beyond what's connected to the measure to support household electricity bills. As long as total sales of goods and services is not affected by the electricity prices, increased revenue from value added tax on consumption of electricity mainly corresponds to lower value added tax revenue from other goods and services.

The tax on electricity is a tax based on quantum and is not directly affected by prices. If electricity prices lead to lower consumption of electricity, revenues from the tax will be reduced. The Ministry has not projected the size of this effect. From January 2022 the tax on electricity was reduced by the equivalent of NOK 2.9 billion per year.

Box 3.2 continues

The government has introduced extensive support measures for different groups, of which the measure to support household electricity bills is the largest, and approximately constitute an estimated NOK 35 billion and NOK 45 billion in 2022 and 2023, respectively. Other measures include increased housing allowance, grants to the agriculture and greenhouse sector, grants to volunteers organisations and increased support for students. Collectively, the measures are estimated to around NOK 42 billion and NOK 50 billion in 2022 and 2023, respectively. The government also has significant extra electricity expenditures due to the high electricity prices, estimated at around NOK 3-5 billion per year this year and the next.

Table 3.10 Projections for the government's accrued revenues due to electricity prices above an historic average for the period 2010-2021. Measured in billion NOK in 2023-prices.

	Average 2010-2021	2021	2022	2023
Resource rent on hydropower[2]......................	8.3	11.6	57.1	46.1
Dividends from Statkraft[3]............................	6.1	5.0	5.7	-
Value added tax from measure to support household electricity bills[4]...........................			7.2	8.9
High price contribution on power production			9.2	16.0
Resource rent on hydropower on land[5]..........				2.0
Sum...	14.3	16.6	79.2	73.0[6]

[1] Projections of the government's revenues deducted average revenues for the period 2010-2021. The municipal sector also receives increased revenues due to higher electricity prices, such as licensed power (for municipalities affected by construction of power companies) and dividends (for municipalities that own power plants).
[2]The figures for 2021 are projections based on average spot prices in the five price regions in 2021, while the figures for 2022 are based on historical prices and forward prices as of 1 August 2022. Resource rent is rearranged as a cash flow tax from 2021. Proceeds is thus not directly comparable over time. Revenues are booked the next year. The projections include the government's proposal to increase the resource rent rate from 2022 as well as expanded contract exception and inclusion of guarantees of origin from 2023. See explanations of the proposals in Prop. 1 LS (2022-2023) *Taxes 2023*. In the table, the projections for proceeds are recalculated to 2023-prices based on the expenditure deflator in the fiscal budget.
[3]Dividend income is accounted for in the year financial year, not the year they are paid out. There are also other conditions beyond power prices that affects the size of dividends from Statkraft. Projections from 2023 is not available.
[4]20 per cent of the measure to support household electricity bills is compensation for paid value added tax and this corresponds to increased revenues from value added tax.
[5]Accrued gross resource rent revenues are projected to around NOK 2.5 billion in 2023. Of this it is proposed that half is distributed to the municipal sector through a production tax, natural resource tax and extra grant. The production tax and natural resource tax will be deducted in the determined resource rent, which reduces the accrued proceeds in 2023 to around NOK 2 billion. The extra grant is projected to around NOK 700 million and is paid in 2024. See explanations in Prop. 1 LS (2022-2023) *Taxes 2023* paragraph 5.4.
[5]Dividends from Statkraft comes in addition to this.

Source: Ministry of Finance.

Box 3.3 Adjustments to the structural non-oil fiscal deficit

To help households deal with very high electricity prices the government has introduced several support measures. The expenditures are handled in the ordinary way in the budget and, seen in isolation, contribute to increase the structural non-oil fiscal deficit (spending from the fund).

Tax revenues also increase due to high electricity prices, particularly through increased income from resource rent on hydropower, ref. Box 3.2. When calculating the structural non-oil fiscal deficit, tax revenues are normally trended, thus temporary high and low tax levels are disregarded. This implies that the governments revenues and expenses related to the electricity price will be treated differently when calculating spending from the fund.

To ensure better alignment between how the high electricity prices affect the revenue and expenditure side of the structural fiscal balance, the Ministry of Finance has temporarily adjusted the calculation of the structural balance. The adjustment is a measure of the government's extraordinary revenues above trend due to electricity prices, and seen in isolation, it contributes to pull down spending from the fund with an estimated NOK 40.4 billion in 2022 and NOK 34.9 billion in 2023; See Chart 3.21.[1] Without the adjustments, spending from the fund in 2022 and 2023 would have been calculated to 3.0 and 2.8 per cent of GPFG, respectively. As a share of trend-GDP for mainland Norway, spending from the fund would have been 10.5 and 9.7 per cent in the same years. The fiscal impulse in 2023 would have been -0.8 percentage units. The adjustment explains a lot of the reduction in spending from the fund this year compared to the revised budget.

Discretionary tax changes and higher future prices on electricity also contribute to lifting the calculated trend for tax revenues and thus reduce the projected spending from the fund.

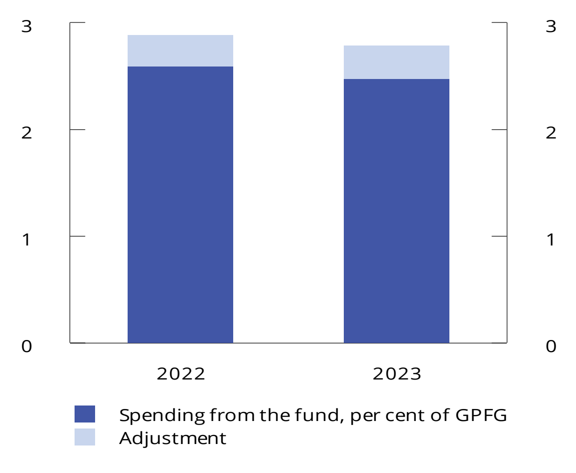

Chart 3.21 Projections for spending from the fund as a share of Government Pension Fund Global (GPFG) with and without adjustment in 2022 and 2023

[1]The adjustment is calculated based on expected revenue from resource rent on hydropower producers (provided unchanged tax rules) beyond a calculated trend revenue as well as the value added tax on the share of electricity price that the government compensates for through the measure to support household electricity bills (corresponding to 20 per cent of the projection for expenditures for the measure to support household electricity bills).
Source: Ministry of Finance.

Box 3.4 Activity effects of fiscal policy in 2020–2023

The fiscal impulse, measured by the change in the structural non-oil fiscal deficit as a share of the mainland economy, is a frequently used indicator when assessing the fiscal stance. The indicator measures if spending from the fund, adjusted for cyclical factors as well as some other conditions that contributes to temporary increases or reductions in the deficit, grows faster or slower than the trend growth of the economy. Changes in the structural fiscal deficit says something about discretionary changes in fiscal policy, while the effects on the fiscal deficit of automatic stabilisers are exempted.

The cyclical adjustments, related to increasing unemployment benefits and decreasing tax revenues during recessions and opposite in booms, is a central part of the difference between the non-oil and the structural non-oil deficit. The size of the activity adjustments etc. has historically largely followed the business cycle, in Chart 3.22 measured by the development in unemployment compared to the average over the last 20 years (unemployment gap). A negative unemployment gap implies that the registered unemployment is lower than average and indicates high capacity utilisation and pressure in the economy. In 2022 and 2023 increased activity in the economy and other conditions pulling up tax revenues compared to the trend, contributes to reducing the non-oil fiscal deficit as a share of mainland-GDP.

When assessing the effect of fiscal policy on the activity level in the economy, the effects of automatic stabilisers in the budget should be accounted for. Furthermore the assessment is related to general governement developments, i.e. including the local government in addition to the central government. It must also be taken into consideration that changes in different public revenues and expenditures may have different effects on the activity level. Further, it should be taken into account that fiscal policy in one year may also effect the economy for several years ahead.

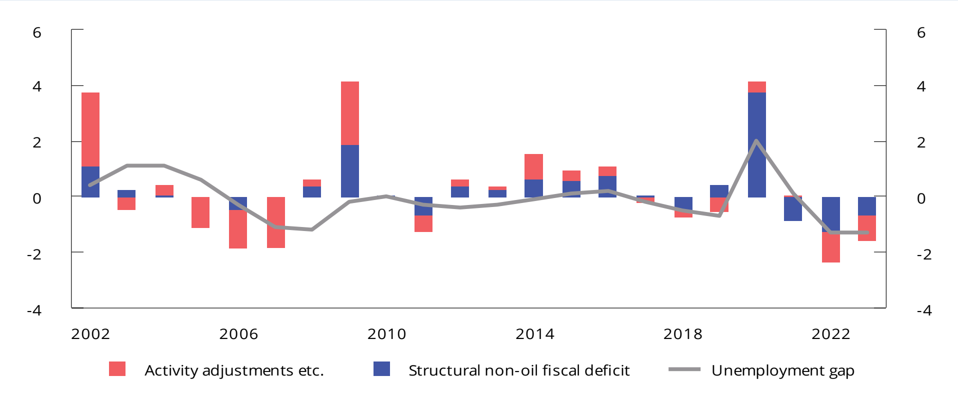

Chart 3.22 Unemployment gap[1], changes in the structural non-oil fiscal deficit and changes in activity adjustments etc.[2] Per cent and change from previous year in per cent of trend-GDP for mainland Norway

[1] Unemployment gap measured by difference between registered wholly unemployed 2002–2023 in per cent of the workforce (annual average) and average through the last 20 years (2002–2021). Projections for 2022 and 2023.
[2] To capture the temporary adjustment in calculation of the structural deficit to take into account the extraordinary high revenues due to electricity prices, the activity adjustments etc. also include special accounting considerations.
Sources: Nav, Statistics Norway and Ministry of Finance.

Box 3.4 continues

To asses the effect of fiscal policy on the economic activity, the Ministry of Finance's macro economic models KVART and NORA are used.[1] KVARTS, which is estimated on Norwegian data, is the ministry's forecasting model. NORA is a model for fiscal policy analysis which is calibrated, but not estimated. There is more inertia in KVARTS than in NORA, which make the first-year-effects of fiscal policy strongest in the latter, while the effects are larger over time in KVARTS.

The calculations of the effects on fiscal policy are based on the fiscal multipliers in the two models and say something about the effects of changes in public revenues and expenditures on mainland-GDP. These fiscal impulses reflects development of revenues and expenditures relative to trend growth in the economy. These impulses applied in the budget effects calculations must not be confused with what is normally called the fiscal impulse, see explanation above.

The fiscal impulses in 2023 is estimated to be approximately neutral on the activity level according to calculations of the effects on fiscal policy in KVARTS and NORA; see last column, second to last row in Table 3.11 and 3.12. Negative impulses from increased taxes are being neutralised by positive impulses on the expenditure side which have larger activity effects per krone in the budget.

Fiscal policy in previous years also has effect on the economy the next year. The calculations indicate that fiscal policy in the period 2020–2023 in total contribute to pull up the activity level in 2023 by 1.1 per cent according to KVARTS, while it is neutral according to NORA.

Lower total fiscal effect in 2023 in NORA compared to KVARTS is mainly due to different effects of the 2020-impulses, and in particular the significant increase in transfers this year. Households adjust faster to income changes in NORA than in KVARTS. At the same time, the effects of income changes on consumption further ahead is larger in KVARTS. In addition to large transfers to households and firms, the impulses from direct taxes contributed to the significant impulse in 2020.[3]

The estimated first-year-effect on mainland-GDP from the negative fiscal impulse in 2021 is estimated differently in the two models, with 0.1 per cent in KVARTS and -0.2 per cent in NORA. This is because strong growth in tax revenues this year has a more rapid impact in NORA. Both model calculations imply that fiscal policy in 2021 in isolation has a dampening effect on activity in 2023, of -0.6 and -0.7 per cent, respectively. Negative impulses are projected for fiscal policy in 2022 as well, but the 2022-budget contributes to increased activity according to both models this year (0.3 per cent) and the next year (0.2 per cent and 0.1 per cent in KVARTS and NORA, respectively.)

Neither the calculations in KVARTS nor NORA take into account that transfers to unemployed are mainly replacement for lost salary, and therefore to a lesser extent will be saved compared to how the household sector on average adjust to changes in income. If it is assumed that transfers to household (mainly unemployment benefits) result in an immediate increase in private consumption, the expansive effect is accelerated, and fiscal policy will have a faster impact on activity. Still, over the four years in total the fiscal policy effect is about the same as shown in the tables below.

Box 3.4 continues

Table 3.11 Budget effects on mainland-GDP according to KVARTS. Per cent

	Fiscal impulse [1]	Effects on mainland-GDP			
		2020	2021	2022	2023
2020	3.2	0.0	0.5	0.9	1.4
2021	-2.2		0.1	-0.2	-0.6
2022	-0.2			0.3	0.2
2023	-0.9				0.1
Total[2]	-0,2	0.0	0.6	1.0	1.1

Table 3.12 Budget effects on mainland-GDP according to NORA. Per cent

	Fiscal impulse [1]	Effects on mainland-GDP			
		2020	2021	2022	2023
2020	3.2	0.3	0.5	0.6	0.7
2021	-2.2		-0.2	-0.5	-0.7
2022	-0.2			0.3	0.1
2023	-0.9				0.0
Total[2]	-0.2	0.3	0.3	0.4	0.0

[1] The fiscal impulses in the table is different from the traditional «fiscal impulse» measured by changes in the structural non-oil deficit, among other things because the automatic stabilisers are included and because they are based on accrued figures for the central government (non-oil).
[2] Due to rounding off the sum of the single items above may differ from the sum presented in this row.

Source: Ministry of Finance.

[1] KVARTS is a macroeconomic model estimated on Norwegian data (mainly time series from quarterly national account statistics), see Appendix C in Bjertnæs, G., Brasch T. von, Cappelen, Å., Holmøy, E., Slettebø, O., Sletten, P. and Zhulanova, J. (2021) *Covid 19, tapt verdiskaping og finanspolitikkens rolle*. Statistisk sentralbyrå. Rapporter 2021/13. NORA is a dynamic stochastic general equilibrium model which is calibrated on Norwegian data with significant focus on analysing effects of fiscal policy, see *NORA - A Microfounded Model for Fiscal Policy Analysis in Norway,* available on regjeringen.no.
[2] The calculations of the effects on fiscal policy are based on accrued (primary) figures for the general government, i.e. local government as well as central government.
[3] The model relations used in the calculations are based on historical experiences. The calculations do not capture how extraordinary support measures may have affected bankruptcies and employment during and on the way out of the pandemic. Activity effects of the tax measure for the oil industry from June 2020 are not included in the calculations as well.

Box 3.5 Large uncertainties regarding the petroleum income and 3 per cent trajectory ahead

Russia’s warfare in Ukraine and halt in gas deliveries to harm European consumers have contributed to very high energy prices. The spot prices on natural gas have so far this year been at historically high levels. High gas prices imply Norway receives large revenues from its petroleum activity. The net cash flow, which is transferred to the Government Pension Fund Global, has never been higher and is estimated to be NOK 1 169 billion in 2022.

Given the assumptions made about the oil and gas prices in this white paper, see Section 2.5, the cash flow from the petroleum activity is projected to be very high also in 2023. The development in gas prices and the cash flow is highly uncertain. The development will depend on a range of circumstances, including the further development of the war in Ukraine, Russia’s decisions regarding the continued withholding of gas from Europe and Europe’s ability to substitute away from gas imports from Russia. The outlook can change vastly in a short amount of time, both in a positive and negative direction.

Chart 3.23 illustrates potential 3 per cent trajectories, given different assumptions on future cash flows and values of the fund. The chart shows the projection for the 3 per cent trajectory up to 2030 from the white paper on Long-term Perspectives on the Norwegian Economy 2021 (grey), in combination with a trajectory which is based on the projection for the net cash flow where the oil and gas prices are forecasted based on the forward prices and other market information (red), as well as a calculation where the projection is based on gas prices falling from 2023 to the average level during the period 2017–2021 (blue). The last alternative lies closely to what must be considered as the long-term cost of transporting LNG from the US to Europe, see further explanation in Section 2.5.

The development ahead is highly uncertain, and the chart shows that the development in gas prices will have vast implications for the fiscal space for manoeuvre in the medium term. The high price trajectory lies approximately 3.7 percentage points above the trajectory in the white paper on long-term perspectives in 2030 and 1.3 percentage points above the trajectory where the gas prices are reduced to more normal values. The distance down to the long-term perspectives trajectory must also be seen in connection with the starting point of the fund’s value in 2023 being considerably higher than what formed as the basis in the white paper on long-term perspectives, after a strong increase in the fund’s value the last years. There is great uncertainty regarding the development in international financial markets ahead and the fund’s value could fall considerably regardless of increased cash flow. This will also affect the withdrawal from the fund and the development in the 3 per cent trajectory.

We are facing an extraordinary situation with war in Europe, and it is too early to conclude that the petroleum income in the years ahead will change the fiscal space for manoeuvre in the medium and long term. Fiscal policy must account for the large uncertainty and be implemented in a way that ensures foreseeable reductions in the fund’s value will not necessitate large cuts in the budget expenditures or an increase in taxes.

Box 3.5 continues

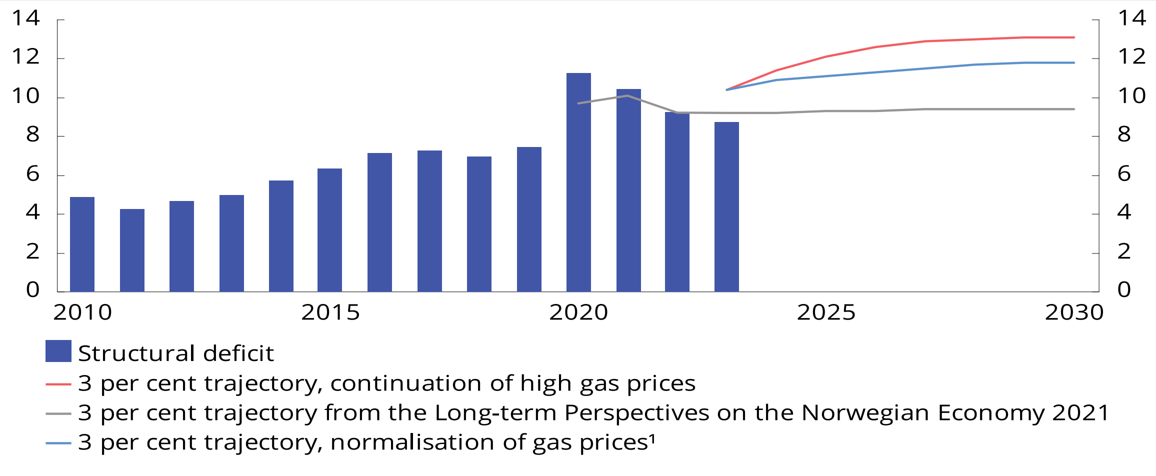

Chart 3.23 Structural deficit and 3 per cent trajectories based on different assumptions on gas prices. Per cent of trend-GDP for mainland Norway

[1] The calculation includes the assumption that gas prices fall to their average value in the previous five years from 2023.
Sources: The Ministry of Finance and the Ministry of Petroleum and Energy.

Box 3.6 Different ways to operationalize the long-term guideline for spending from the fund

The fiscal guideline says that spending from the fund over time shall follow the expected real return of GPFG, estimated to 3 per cent. In any single year spending from the fund shall be customized to the economic situation so that fiscal policy contributes to level out fluctuations in the economy to ensure sound capacity utilisation and low unemployment. Fluctuations in the value of the fund in any single year must also be smoothed over time. Spending from the fund in any single year thus deviates from the expected real return.

In the national budgets the last few years it has been shown that the spending in normal years, which will be most years, should be well below 3 per cent to ensure that the spending over time will be 3 per cent. To spend less than expected real return in normal times will give extra savings that can be consumed when there are large setbacks in the economy or if the value of the fund should decline.

Chart 3.24 illustrates how spending from the fund, measured by the structural non-oil fiscal deficit, has developed compared to the long-term guideline. In addition, the chart shows some different ways to operationalize the long-term guideline in the fiscal rule.

A possible different operationalization of a guideline for the spending of money in the fund can be based on the fund's cash flows, meaning dividend income from stock investments, nominal interest income from bond investments, and interest and dividend income from investments in unlisted property and infrastructure. In Chart 3.24 the fund's current income is shown.

Box 3.6 continues

The advisory council for fiscal analysis pointed out that one option to reduce uncertainty about expected real return of the fund and provide a more stable spending from the fund could be to calculate a sustainable level of the fund's cash flow, ref. Statement 2022.[1] For the equity portfolio the council thought that this could be based on the cash flow from the companies owned by the fund, i.e. the companies' dividends and share buybacks, and forecast the future real growth of the cash flows. Such a calculation is not included in Chart 3.24.

An alternative method to calculate a sustainable cash flow from the equity portfolio is to start with the profit of the companies. The companies' profit is a measure of the underlying value creation. If the spending of funds for stocks is based on the profit (after depreciation, interest costs and taxes) per share, the real value of the stock owners' capital stock (i.e., the ability to create profit) is maintained. For comparison, today's guideline for spending from the fund aims to maintain the real market value of the fund over time. In the long term, however, the development of the capital stock and the market value will follow each other.

The chart below displays a guideline where spending of the money from the equity portfolio is based on company profits, measured by the book equity multiplied with return on equity. The profits vary considerably from year to year and should be smoothed, as today's guideline is smoothed by having the spending over time follow the portfolio's expected real return. In the chart the profits are smoothed by calculating a five-year moving average for the return on equity. For bonds the spending from the fund is based on inflation adjusted coupon rates.

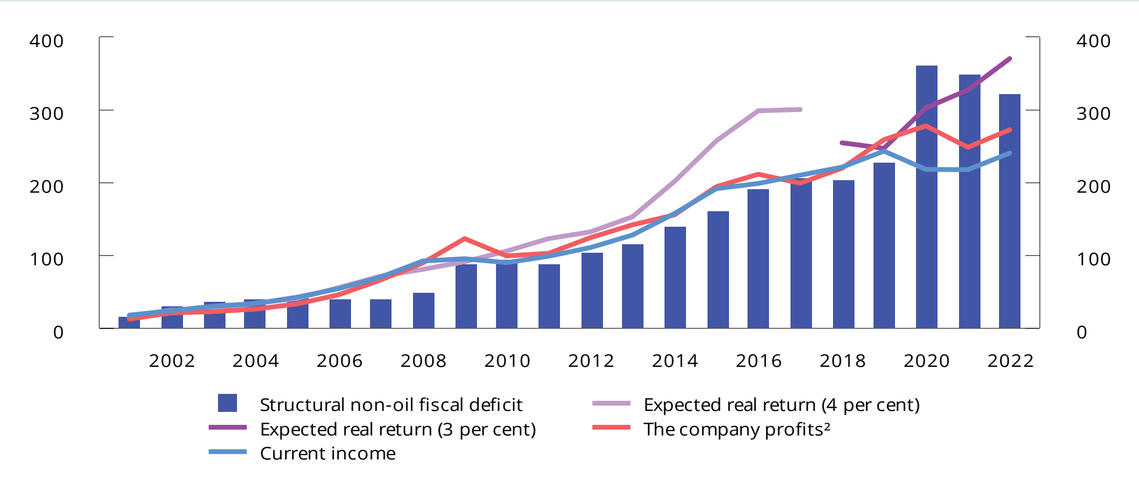

Chart 3.24 Structural non-oil fiscal deficit and different ways to operationalize the long-term guideline for the spending from the fund[1]

[1] In 2001 the estimate for expected real return was 4 per cent. As of the National budget for 2018, submitted in October 2017, the estimate was reduced to 3 per cent.

[2] The calculation of the long-term guideline based on smoothed profits uses the book value of equity at the start of the year multiplied with a moving average of the return on equity of five years deducted yearly average share dilution in the period. The book equity is calculated by dividing the market value of the relative pricing of equity (P/B). Both P/B and return on equity is from MSCI. For bonds the «spending» is determined by interest income deducted average inflation in the fund's lifespan, calculated to 1.8 per cent annually.

Sources: NBIM, FTSE and Ministry of Finance.

Box 3.6 continues

The long-term guideline for spending from the fund shall not be followed mechanically from year to year. When using the fiscal guideline it is necessary to apply a substantial degree of discretion to perform sound trade-offs between the considerations in the guideline.

The ministry is working continually with assessment of the sustainability of public finances, and this work is among other things reflected in budgetary documents and reports on long-term perspectives, as well as the ministry's working papers. It is important to have a broad and solid anchoring of the framework that fiscal policy shall be based on. The fiscal guideline for spending from the fund is a political management tool that shall anchor the considerations and trade-offs that are done when spending money from the fund over time.

In the ministry's assessment, today's operationalisation of the fiscal guideline provides a sound basis to ensure the goals of the fiscal guideline, herein a stable economic development in the short and long run. At the same time, the ministry will work further on analysing characteristics of different designs of guidelines for spending from the fund, to obtain a broader and more solid academic basis to assess the sustainability of government finances under the fiscal guideline.

[1] Source: Statement 2022 from the Advisory council for fiscal analysis, 3 February 2022.