DET KONGELIGE
FINANSDEPARTEMENT

Royal Ministry of Finance

The National Budget 2012

A summary

Contents: page

National Budget 2012

1 Introduction

The Norwegian mainland economy has been growing steadily since the summer of 2009, and labour market conditions have improved. The unemployment rate is down to 3¼ pct., which is clearly below the average of the last 20 years. Looking ahead, growth in the mainland economy is expected to be on a par with the historical average and unemployment to remain stable at the current level.

Fiscal policy is guided by the fiscal rule, stipulating a gradual phasing-in of oil revenues in the Norwegian economy in line with the expected real returns on the Government Pension Fund Global, estimated at 4 pct. The fiscal rule permits spending more than the expected return on the Fund in a cyclical downturn, while the use of oil revenues should lie below the expected return when capacity utilisation in the economy is high. This room for manoeuvre was used in 2009 to mitigate the effects of the financial crisis on production and employment. In 2011 the use of oil revenues will again be below the four percent path.

The Government Pension Fund Global is expected to grow for still some years. This provides a basis for a gradual increase in the use of oil revenues. In accordance with the fiscal rule, the Government is proposing to increase spending in 2012 in line with the underlying growth in the return on the Fund. The spending of petroleum revenues, as measured by the structural, non-oil budget deficit, is estimated at NOK 122.2 billion, which is NOK 2.4 billion below the expected real return on the Government Pension Fund Global. The increase in spending of petroleum revenues from 2011 to 2012 corresponds to ¼ pct. of mainland trend GDP. The overall impact of the fiscal budget on mainland GDP is estimated to be broadly neutral.

The Budget for 2012 prioritizes raising the quality of and increasing production of health care, schools and child care. Appropriations for transport projects and the police service will be significantly increased and necessary funds for addressing the consequences of the attacks on 22 July are proposed.

2 Economic outlook

The Norwegian mainland economy has grown for seven consecutive quarters, and activity is now higher than before the financial crisis. Throughout 2010 household consumption was the main source of growth, whereas in 2011 increased investments in housing and petroleum extraction have kept up growth in the mainland economy.

Low interest rates and strong income growth may lead to a further upswing in private consumption and housing investments. In addition, oil companies have ramped up their investment plans by a considerable amount for this and next year. On the other hand, slower growth abroad may curb activity in export-oriented businesses. Overall, the GDP for Mainland Norway is assumed to grow by 2.8 pct. in 2011 and 3.1 pct. in 2012, cf. table 2.1.

The *labour market* is performing well. Unemployment has remained at around 3¼ pct., slightly under the 2010 average of 3½ pct. Employment is assumed to continue to rise, by 1.2 pct. in 2011 and 1.5 pct. in 2012. Unemployment is projected to stay at around 3¼ pct. of the labour force in both years.

Norges Bank has kept its *key policy rate* unchanged at 2.25 pct. at its last three interest rate meetings. The actual rate is below the Bank's interest rate forecast from the monetary policy report in June. The September meeting also suggested that for some time to come the interest rate would be lower than announced.

Growth in *private consumption* has abated this year compared to the rates recorded in the last quarters of last year. Correspondingly, household spending has increased more slowly than income, pushing up the savings rate. The *savings rate* in the second quarter was 8¼ pct., more than double the historical level. The high savings rate might express a need for debt consolidation in the household sector. After several years of high borrowing, the gross debt of households is now more than twice their disposable income. This is high, both in a historical and international context. Increased international uncertainty may also lead Norwegian households to become more cautious.

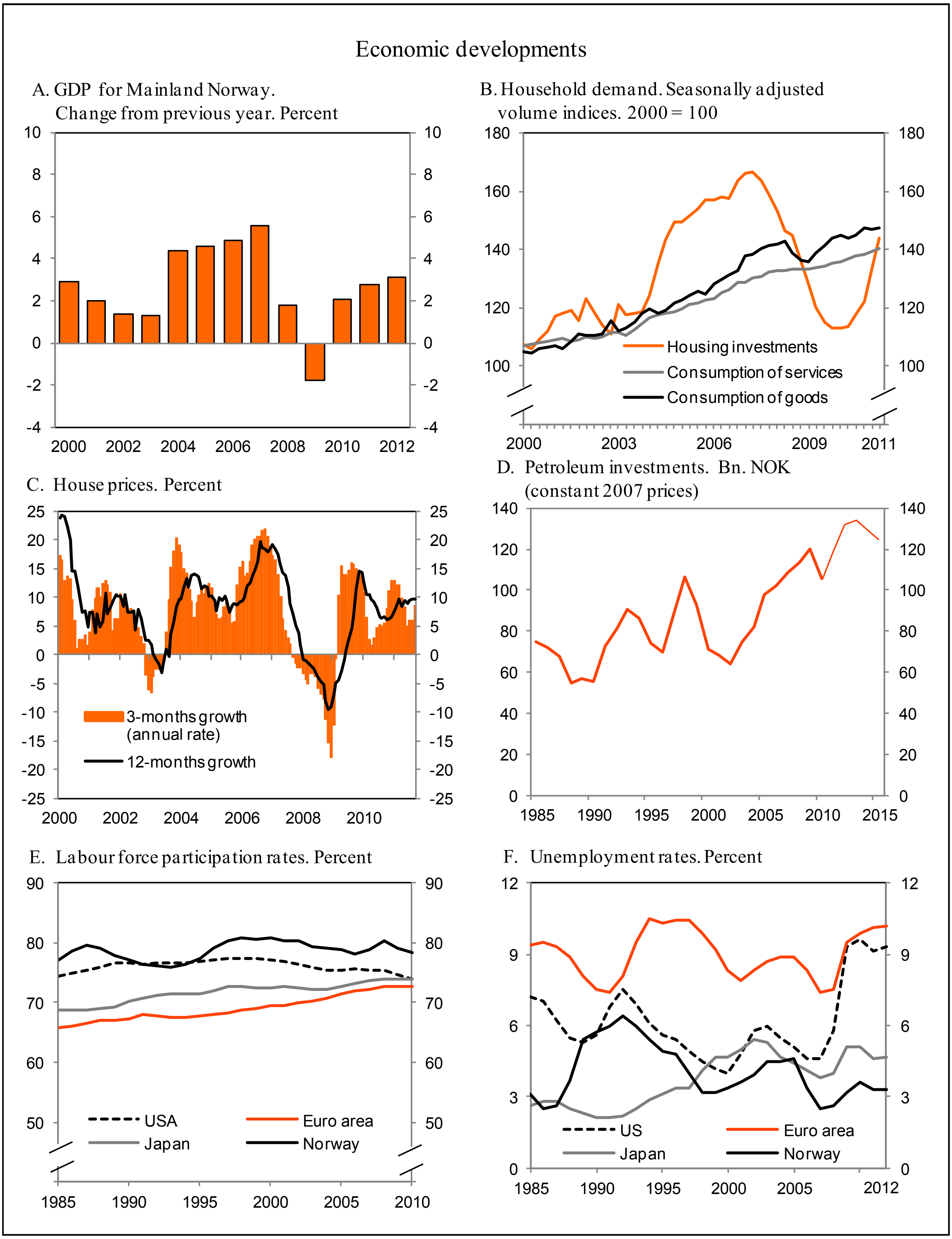

Figure 2.1 Economic developments

Sources: Statistics Norway, Norges eiendomsmeglerforbund, Econ Pöyry, the Ministry of Petroleum and Energy, OECD and the Ministry of Finance

Table 2.1 Key figures for the Norwegian Economy. Percentage change from previous year [1]

	NOK billion[2] 2010	2010	2011	2012
Private consumption	1 073.2	3.7	2.7	4.0
Public consumption	558.3	2.2	2.4	1.5
Gross fixed investments	506.5	-7.4	9.3	5.6
Petroleum extraction and pipeline	124.2	-12.4	12.5	11.0
Mainland industries	195.6	-1.2	5.2	3.9
Housing	79.8	-2.2	24.0	10.0
Public sector	81.2	-8.0	2.5	-2.3
Demand from mainland Norway[3]............	1 988.1	2.0	3.7	3.3
Exports..	1 046.9	-1.7	0.4	1.0
Crude oil and natural gas	480.5	-7.4	-1.9	-2.2
Traditional goods	302.5	4.9	1.3	2.4
Imports	714.6	9.0	6.5	4.3
Traditional goods..................................	441.9	8.3	5.7	4.7
Gross domestic product	2 496.2	0.3	1.7	2.4
Of which: Mainland Norway	1 937.5	2.1	2.8	3.1
Other key figures:				
Employment, persons		-0.2	1.2	1.5
Unemployment rate. LFS (level)..............		3.6	3.3	3.3
Annual wage...		3.7	4.0	4.0
Consumer price index (CPI)		2.5	1.5	1.6
CPI adjusted for tax changes and excluding energy products (CPI-ATE)		1.4	1.1	1.8
Oil price. NOK per barrel[4]........................		484	588	575
Current account balance (pct. of GDP).....		12.4	14.0	11.5
Three-months money market interest rate[5]..		2.5	2.8	2.6
Trade weighted index (TWI)		95.7	93.8	93.9
Household savings. pct. of disposable income		7.6	8.6	9.3

1 Calculated in constant 2007 prices unless otherwise noted.
2 Preliminary national account data in current prices.
3 Excluding changes in inventories.
4 Current prices.
5 Technical assumption based on forward rates in September.
Sources: Statistics Norway and the Ministry of Finance

Coupled with good income growth and low interest rates, the high savings rate provides a reason to expect that consumer spending will rebound going forward. This is supported by consumer sentiment indices, suggesting an optimistic view on the economy. Private consumption is forecasted to rise by 2¾ pct. in 2011 and 4 pct. in 2012. This implies that the savings rate will stay high also in 2012.

Since the housing market turned at the end of 2008, *housing prices* have increased by an average of ¾ pct. per month. In real terms, prices are now more than 4 pct. higher than during the previous peak in June 2007, cf. Figure 2.1C.

The rise in housing prices has triggered a pronounced increase in *housing starts*. It is estimated that housing starts will rise to 28 500 new homes in 2011, up from just over 21 000 in 2010. *Housing investments* will rise accordingly.

Investments in mainland industries now appear to be rising again. These investments swing widely over economic cycles. We forecast a moderate further rise in investments in mainland companies this and next year. However, it cannot be ruled out that increased international turmoil may lead Norwegian companies to postpone investments to a greater degree than assumed.

Petroleum investments have grown sharply since 2002 and reached in 2010 a level of about 6½ pct. of mainland GDP. After falling somewhat last year, the reports from the oil companies indicate a sharp increase in investments this and next year.

After rebounding since the summer of 2009, *exports of traditional goods* again fell markedly toward the end of last year and into 2011. Even though exports rose sharply in the second quarter of this year, the overall level in the first half was barely higher than the average for last year. The poor global performance and lower demand signals from the export markets could indicate that growth will remain fairly moderate going forward.

Imports of traditional goods spiked in 2010 after growing slowly in 2008 and 2009. Growth continued in 2011, and in the first half of this year the volume of traditional imports of goods was nearly 6 pct. higher than the average for last year. Still, on an annual basis, the growth in imports is estimated to decline somewhat in 2011 and 2012 compared to 2010.

Rapidly increasing demand from Asian growth economies has pushed up the price of oil and other major Norwegian export products. At the same time imports have been turning in the direction of cheaper consumer goods from the same countries. This has contributed to a marked improvement in *Norway's terms of trade*. In the period 2003-2008 the terms of trade improved by 7½ pct. on average each year. After a sharp decrease in the wake of the financial crisis in 2009, the terms of trade improved by almost 6¾ pct. in 2010. While soaring oil prices contributed the most, other products such as metals and refined oil products also experienced price increases. The prices on these goods has continued to rise in 2011, and it is assumed that the terms of trade will improve by a further 8¾ pct. this year.

The favourable development in the terms of trade has helped maintain the profitability of Norwegian export companies despite Norway's particularly high *cost level*. For several years wage growth in Norway has been high in an international context. Last year hourly wage costs in manufacturing were more than 50 pct. higher in Norway than in the EU, trade-weighted and calculated in common currency. The high cost level makes many export companies vulnerable to lower product prices, continued high wage growth and a strong krone. Measured by the *trade-weighted exchange rate index (TWI)* the krone strengthened by 4¼ pct. in 2010, a development that has continued this year. At end-September the krone was about 2¼ pct. stronger than the average level last year.

High income from the petroleum sector has contributed to considerable surpluses in the *current account balance* for several years. The surplus was over NOK 300 billion last year, or more than 12 pct. of GDP. A further increase is expected this year, to nearly NOK 380 billion, mainly due to higher oil prices.

Consumer price growth adjusted for tax changes and excluding energy products (CPI-ATE) has remained low so far this year. A decline in prices for imported consumer goods has kept inflation down, while the price rise for Norwegian goods and services has been moderate. Prices on Norwegian goods and services are expected to edge upward, in line with increased capacity utilization in the economy. The rise in the CPI-ATE is estimated to be 1¾ pct. from 2011 to 2012 and around 1½ pct. for the CPI.

On the basis of this year's wage settlement and the economic outlook the *average wage growth* is estimated at 4 pct. both this year and the next.

3 Economic policy

3.1 The fiscal policy guidelines

The Norwegian fiscal policy guidelines, introduced in 2001, plan for a smooth, gradual increase in expenditure of petroleum revenues to a level that can be sustained over time. The rule states that the use of petroleum revenues, as measured by the structural non-oil budget deficit, should over time be in line with the expected real return on the Government Pension Fund Global (GPFG), estimated at 4 pct., cf. box 3.1. At the same time, the spending of petroleum revenues for a particular year must be adjusted to current economic conditions.

The fiscal rule provides flexibility for using fiscal policy to stabilise the economy over the business cycle. The Government made ample use of this flexibility in 2009, when the use of petroleum revenues was increased rapidly to a level above the four percent path in order to mitigate the effects of the global recession on the Norwegian economy. The Government has been committed to return to the four percent path. In 2011 the use of petroleum revenues has again been brought below the four percent path. The reduction in the use of petroleum revenues is partly explained by an upward revision of

Box 3.1 The fiscal policy guidelines

The fiscal policy guidelines, introduced in 2001, ensure a predictable and prudent phasing-in of petroleum income into the mainland economy. Specifically;

- Petroleum revenues shall be gradually phased into the economy, in line with expected real return on the Government Pension Fund Global, estimated at 4 pct. a year.
- Fluctuations in economic activity shall be dampened in order to ensure high capacity utilization and low unemployment.

The fiscal guidelines take due account of uncertainty and aim at a gradual increase in the spending of oil revenues up to a sustainable level.

- Spending the expected real return on the fund reflects a cautious attitude to the uncertainty of the size of the total petroleum wealth and to the risks of overheating the economy. As wealth is gradually transformed from petroleum in the ground to financial assets, spending will increase.
- An important point with respect to stabilization is that the guidelines allow automatic stabilizers to work fully. This is ensured by letting the guidelines target the structural, not the actual, non-oil deficit. It means that the term "spending of petroleum revenues" will not refer to the factual transfer from the fund to the budget, but rather to the estimated transfer had the economy been working on normal capacity.
- The guidelines do not require that spending should equal strictly 4 pct. of the fund each year. Rather, fiscal policy is expected to support monetary policy in stabilizing the economy.
- Deviations from the four percent path are also justified when there are large changes in the fund value. The consequences of large changes in the fund value may be taken over a few years.

Long-term and short-term stability has been the overriding concern in formulating the guidelines. A cautious and gradual increase in the spending of petroleum revenues will in itself have a stabilizing effect on the economy. Flexibility is necessary for the sake of ensuring high capacity utilization and low unemployment. The existence of credible guidelines may also contribute to stability by shaping expectations in the foreign exchange market. Further, the fund must invest abroad, thus providing for efficient re-exporting of huge and volatile capital inflows. This will also contribute to stabilizing the exchange rate.

structural taxes, reflecting higher than expected tax revenues during the recession.

We are now in a period when the capital of the GPFG is expected to grow. This allows for a gradual increase in spending of petroleum revenues. In the 2012 Budget, the Government proposes to increase the use of petroleum revenues in line with the average growth in expected return on the GPFG, cf. figure 3.1A.

Over the past decades, demographic changes in Norway have had relatively benign effects on public finances, with an increase in the working-age population and a small decline in the share of older persons in the population. This development has now changed, and the share of older persons in the population is set to rise rapidly in the years to come, cf. figure 3.3A. In 2012, an increase in pension payments accounts for a large part of expenditure growth in the State Budget. At the same time, the pace of growth of the GPFG will gradually slow in the years ahead. In the coming years, expenditures on pensions, health services and elderly care, will grow faster than the expected return on the fund, cf. figure 3.1C. The growth of these ageing-related expenditures will continue well after the expected peak in the return on the fund in the mid-2020s. This will present fiscal policy with demanding challenges in the decades to come.

3.2 Budgetary policy in 2011 and 2012

In the 2011 Budget, presented in October last year, the Government planned for an unchanged spending of petroleum revenues in real terms. This implied a structural non-oil deficit of NOK 128.1 billion in 2011, NOK 7.4 billion above the four percent path. New information on economic developments, including budget revenues and expenditures, led to a substantial reduction in the estimated structural deficit for 2011, cf. also The Revised National Budget 2011. The structural non -oil budget deficit for 2011 is now estimated at NOK 108.8 billion, NOK 14.5 billion below the four percent path. This revision is due to higher estimates for structural taxes and higher than expected dividends from companies in which the state has a direct ownership. In addition, the

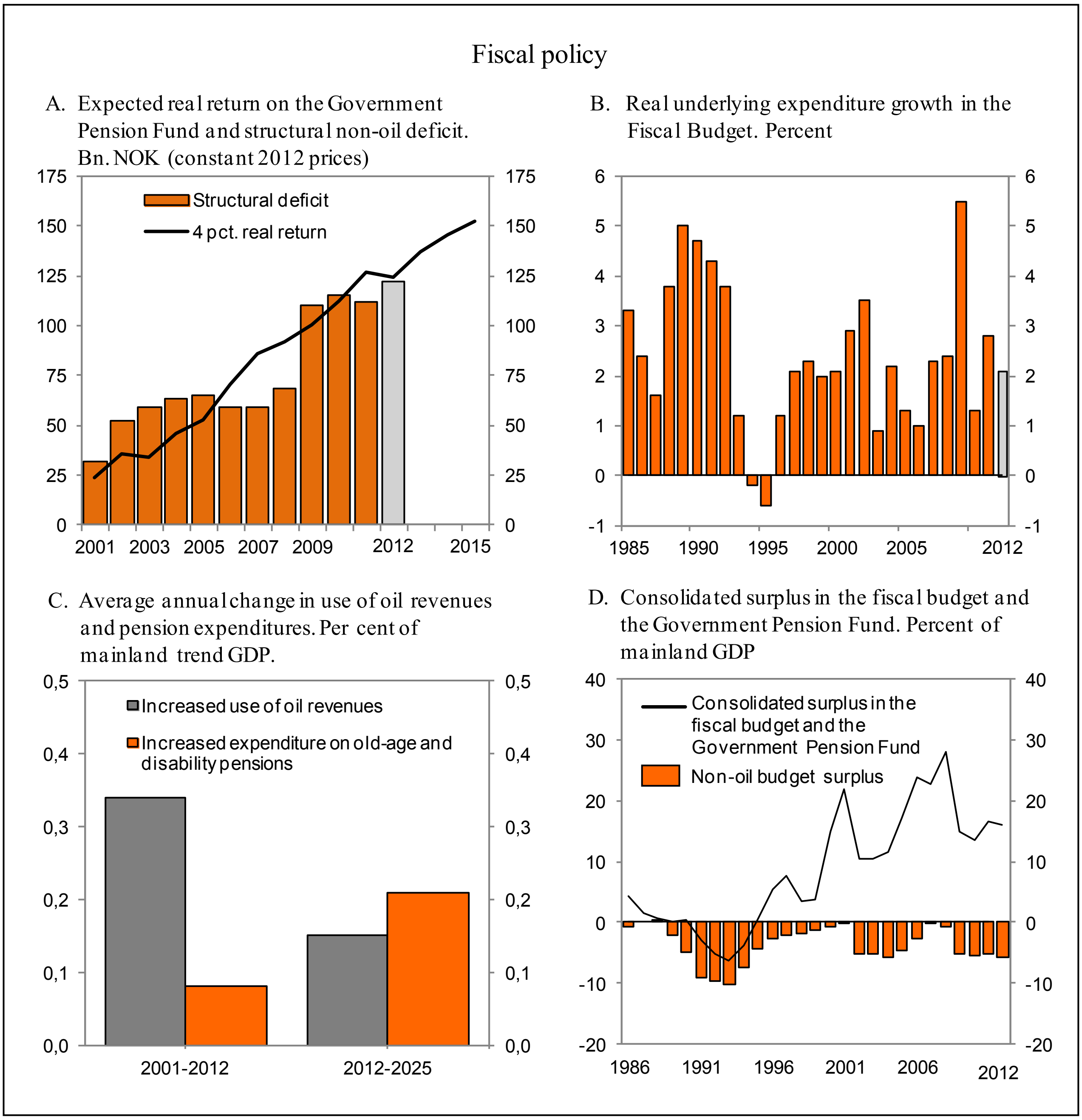

Figure 3.1 Fiscal policy

market value of the GPFG at the end of 2010, and thus the 4 pct. real return on the Fund in 2011, was somewhat higher than expected last autumn.

The proposed 2012 Budget implies an increase in spending of petroleum revenues in line with the average expected increase in the four percent path in the years ahead. Measured as a share of trend GDP for Mainland Norway, the structural non-oil budget deficit will increase by about ¼ percentage point from 2011 to 2012. Macroeconomic model simulations indicate that the overall impact of the Government's proposed budget on mainland GDP is broadly neutral. These calculations take into account that different budget items may affect the activity level of the Norwegian economy differently.

The main features of the proposed Budget for 2012 are as follows:

- The spending of petroleum revenues, as measured by the structural, non-oil budget deficit, is estimated at NOK 122.2 billion, which is NOK 2.4 billion below the expected real return on the GPFG.
- An increase in the structural non-oil deficit from 2011 to 2012 corresponding to ¼ pct. of mainland trend GDP. The overall impact of

Table 3.1 Key figures for the fiscal budget and the Government Pension Fund. Bn. NOK

	Accounts		Estimates	
	2009	2010	2011	2012
Total revenues	1 051.9	1 064.8	1 192.6	1 237.5
1 Revenues from petroleum activities	304.5	296.1	363.3	376.7
1.1 Taxes and excise duties	169.0	159.2	210.0	227.7
1.2 Other petroleum revenues	135.5	136.9	153.3	149.0
2 Revenues other than petroleum revenues	747.4	768.7	829.3	860.8
2.1 Taxes and excise duties from Mainland Norway	684.7	713.5	760.3	800.5
2.2 Other revenues	62.6	55.1	69.0	60.4
Total expenditures	868.7	892.9	957.4	1 006.1
1 Expenditures on petroleum activities	24.7	20.1	22.0	25.0
2 Expenditures other than petroleum activities	843.9	872.7	935.4	981.1
Fiscal budget surplus before transfers to the Government Pension Fund Global	183.2	171.9	235.2	231.4
- Net cash flow from petroleum activities	279.8	276.0	341.3	351.7
= Non-oil surplus	-96.6	-104.1	-106.1	-120.2
+ Transfers from the Government Pension Fund Global	107.2	109.4	106.1	120.2
= Fiscal budget surplus	10.7	5.3	0.0	0.0
+ Net allocation to the Government Pension Fund Global	172.6	166.6	235.2	231.4
+ Interest earnings and dividends to the Government Pension Fund	91.3	90.5	104.2	114.3
= Surplus, fiscal budget and Government Pension Fund	274.5	262.4	339.4	345.7
Memo:				
Market value of the Government Pension Fund Global[1]	2 642.0	3 080.9	3 115.0	3 542.8
Market value of the Government Pension Fund[1]	2 759.1	3 215.7	3 250.1	3 685.4
as percentage of GDP	118.4	128.8	120.2	131.1
National insurance scheme – old-age pension liabilities[1]	4 362	4 614	4 896	5 178

[1] At year-end

Source: Ministry of Finance.

the fiscal budget on mainland GDP is estimated to be broadly neutral.
- The real underlying growth in fiscal budget expenditures from 2011 to 2012 is estimated at 2.1 pct., cf. figure 3.1B.
- A non-oil fiscal budget deficit estimated at NOK 120.2 billion. The deficit is covered by a transfer from the GPFG.
- A central government net cash flow from petroleum activities of about NOK 352 billion.
- A consolidated surplus in the fiscal budget and the Government Pension Fund, including interest and dividends, of about NOK 346 billion, cf. figure 3.1D.
- An estimated market value of the Government Pension Fund of NOK 3 685 billion at the end of 2012, of which NOK 3 543 billion in the GPFG. The old age pension liability under the National Insurance Scheme, is estimated at NOK 5 178 billion at the end of 2012.
- An unchanged level of taxation.

3.3 The tax profile in 2012

Total accrued tax revenues in Norway will amount to about NOK 1 183 billion in 2011. Of this, about 88 pct. is paid to the central government, while local government (municipalities and counties) receives 12 pct.

The Norwegian tax system is characterised by a relatively high share of indirect taxes. Value-added tax (VAT), excise duties and custom duties represent about 30 pct. of the central government's tax revenue. Personal income tax and the tax on net wealth levied on individuals represent about 23 pct. Corporate tax, including employers' social security contributions, amounts to approximately 20 pct. Taxes levied on petroleum activities represent about 23 pct. of the central government's tax revenue.

The Government's objectives for its tax and fiscal policies are to ensure public revenue, contribute to a fair income distribution and a better environment, promote economic growth and employment in the entire country and improve the functioning of the economy. The Government has stated that the level of taxation should be kept stable to ensure a good economic foundation for maintaining the welfare system.

The Government has strengthened the redistributive aspect of the tax system through more stringent taxes on dividends and gains on equity investments, a fairer net wealth tax and inheritance tax and higher minimum deductions in both of these taxes. In addition, the tax system more clearly promotes environmental concerns. By continuing the systemic changes in the tax reform within the confines of a stable tax level, the Government is ensuring a predictable tax system, making it attractive to invest and do business in Norway.

In April this year, the Minister of Finance submitted a White Paper on the evaluation of the 2006 tax reform; see Report no. 11 (2010-2011) to the Parliament. The evaluation depicts a very positive picture of the effects of the reform. The adaptation possibilities inherent in the old system have been largely eliminated. The amount paid in tax now depends far less on how labour income is earned or how businesses are organised. By coupling dividend tax with wealth tax, the most affluent pay considerably more tax than before. In addition, lower tax on labour has raised production by increasing labour supply. The administrative costs are moderate, and dividend tax does not appear to have had a negative effect on the supply of capital. The tax system appears more unified than before the reform.

At the same time, the evaluation shows that there is room for improvement, first and foremost to prevent tax avoidance and to simplify the rules. In the 2012 Budget, the Government follows up the evaluation by proposing some changes in the corporate taxation. For further details, see English summary of Chapter 1 of the bill and draft resolution on taxes, Prop. 1 LS (2011-2012).

3.4 The fiscal position of the general government

In addition to the fiscal budget and the Government Pension Fund, general government includes other central government and national insurance accounts and local government administration. General government net lending is the surplus concept of the national accounts and is computed in a way that makes possible meaningful comparisons of public sector figures in different countries. Since the mid-1990s huge oil revenues have contributed a substantial surplus to public finances in Norway, whereas the euro area and industrial countries as a group have generally posted deficits, cf. figure 3.2A. As is seen, from 2008 to 2009 general government net lending decreased by a substantial amount in both the euro area and in Norway. This must be viewed in the context of lower tax revenues in the wake of the global downturn, along with extensive fiscal policy measures to dampen the rise in unemployment. For Norway, the decline in the price of oil from the high level in 2008 also played a part.

For 2012 general government net lending in Norway is estimated at 11.5 pct. of GDP. This is about the same level as in 2009 and 2010, but is clearly lower than in 2006-2008. The general government surpluses can primarily be linked to developments in central government net lending, cf. table 3.2.

For Norway, gross government debt is estimated at 39 pct. of GDP at the end of 2011. The level of the gross debt must be viewed in light of the use of repurchase and reverse repurchase agreements (repos and reverse repos) in the management of the Government Pension Fund Global (GPFG). These transactions do not change the government's net financial position, but in line with international guidelines for national accounts repurchase agreements shall be treated as liabilities and reverse repurchase agreements shall be treated as assets. Outside the GPFG public gross debt at the end of 2011 has been estimated at about 26 pct. of GDP. This is 4 percentage points below the level at the end of 2010. The level is still about 8 percentage points higher than at the end of 2008, which can be primarily attributed to the crisis related scheme under which the banks may swap covered bonds for government securities. The State's net asset position is not affected by these swaps.

Public expenditure as a share of GDP is used as an indicator of the size of public sector. Measured as a share of mainland GDP, public expenditure in Norway is estimated to decline somewhat each year from 2009 to 2012, after rising significantly from 2008 to 2009. As with other OECD countries and countries in the euro area, the increase from 2008 must be viewed in light of cyclical developments and fiscal policy measures to dampen the effects of the global financial crisis. The level of public expenditure in 2012, measured as a share of mainland GDP, will stay at the average of the past 25 years, cf. figure 3.2B.

When public spending is measured as a share of mainland GDP, it appears to be relatively high in Norway compared with the level in other countries. Measured relative to total GDP, public spending is slightly lower than the average for the Euro area. This must be viewed in connection with the fact that petroleum revenues provide an extraordinary contribution to Norway's GDP, and a correspondingly low expenditure ratio. Today's

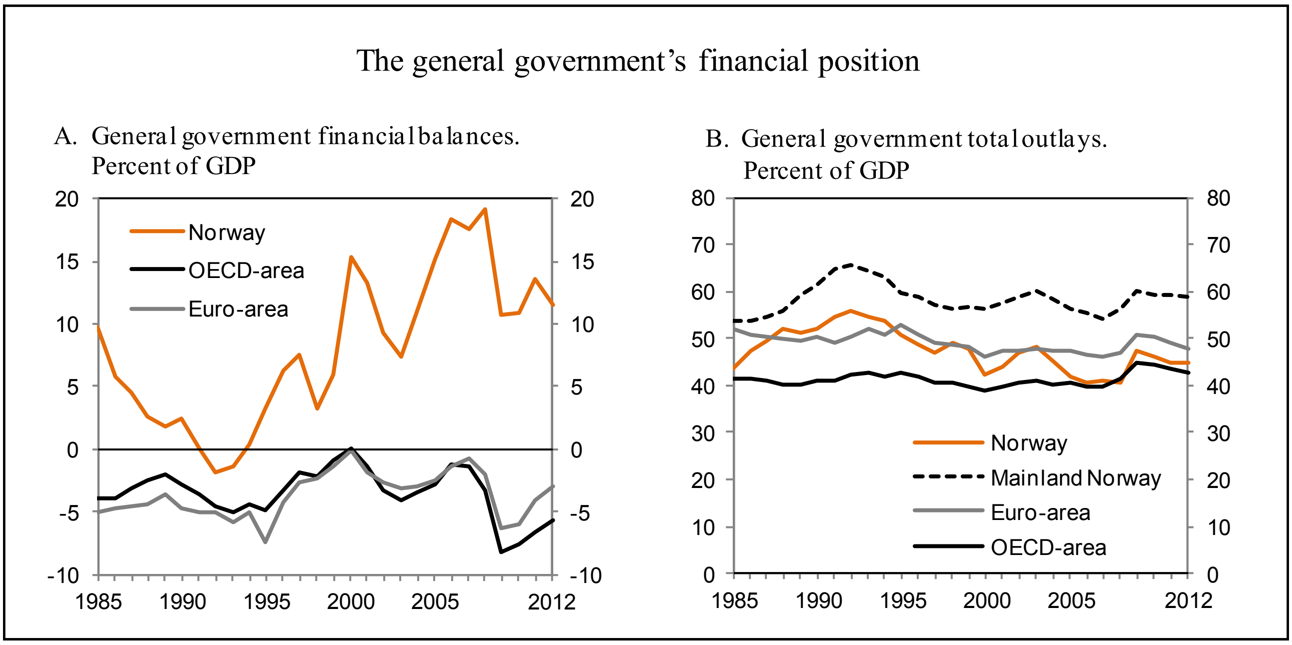

Figure 3.2 The general government's financial position
Sources: OECD, Statistics Norway and Ministry of Finance.

high oil revenues are based on the depletion of a non-renewable resource.

Over time, revenues from oil and gas extraction will gradually decline and eventually stop completely. Public expenditure relative to total GDP therefore underestimates the financing burden in the long term. On the other hand, public expenditure as a share of mainland GDP overestimates the financing burden, before taking into account the ageing of the population. This is partly because of the funding contribution from the pension fund and partly because we disregard the possibility of alternative use of the resources now used in the petroleum industry.

Net debt in the local government sector has increased in the last ten years. At the end of 2010 net debt equalled just under 40 pct. of the sector's revenues. However, not all municipal loans are a burden on local government finances. Some loans are connected with chargeable services, where increased principal payments and interest expenses can be financed through higher municipal fees. This mainly applies to investments related to water, sewage and waste disposal. In addition, the central government covers interest expenses and some principal payments on loans for investments in schools, churches and nursing homes as well as transport projects in the counties.

Municipalities and counties must balance their operating budget and their current accounts. On the whole, the net operating result in the local government sector totalled 3.2 pct. of revenues last year. For 2006 to 2010 the net operating result in the sector averaged 2.9 pct. Municipalities that do not meet the balanced budget requirement must have the approval of the county governor in order to make lawful decisions about borrowing and long-term leases. These municipalities are reported to ROBEK, a register for governmental approval of financial obligations. The number of municipalities registered in ROBEK fell from a peak of almost 120 registered municipalities in the second half of 2004 to 42 in the second half of 2007. The number of registered municipalities has since remained at a relatively low level. No counties are currently registered in ROBEK.

3.5 Fiscal policy in the medium and long term

Over time, the leeway in budgetary policy is primarily determined by the growth of the tax bases of the mainland economy, by expenditure and revenue commitments from previous decisions and by the path of expected real returns on the capital in the GPFG.

Tax bases trend upward over time. For a given structure of the tax system this provides increasing tax revenues to the public sector. For the coming years, it is estimated that the underlying growth of the tax bases will strengthen the budget by around NOK 16 billion per year.

This is slightly higher than estimated in the 2011 Revised National Budget, which, among other things, must be viewed in connection with

Table 3.2 General government net lending. Mn. NOK

	2010	2011	2012
A. Central government net lending, accrued value	297 654	397 651	350 166
Consolidated surplus in fiscal budget and Government Pension Fund	262 433	339 365	345 743
Non-oil fiscal budget surplus	-104 070	-106 117	-120 247
Net cash flow from petroleum activities	275 957	341 282	351 691
Interest and dividends on the Government Pension Fund	90 546	104 200	114 300
Surplus in other government and public pension accounts	-2 840	519	538
Definitional discrepancies, central government accounts/national account[1)]	38 061	57 767	3 885
B. Local government net lending, accrued value	-28 524	-29 745	-27 031
Local government surplus, book value	-24 291	-23 269	-23 164
Difference between accrued and book values, taxes	-4 233	-6 475	-3 867
C. General government net lending (A+B)	269 130	367 907	323 136
Measured as percentage of GDP	10.8	13.6	11.5

1 Includes central government taxes accrued, but not booked, incl. taxes from the petroleum sector. Adjustments are made to address that capital contributed to state-run enterprises, including central government petroleum activities, are classified as net lending in the national accounts.
Sources: Statistics Norway and Ministry of Finance.

the fact that new population projections from Statistics Norway indicate slightly higher underlying growth in the work force and value added in the future than previously assumed.

Even without further expansion of the publicly funded welfare programmes, fiscal budget expenditure is set to increase substantially in the years to come. This is largely due to the interplay between National Insurance Scheme rules and a demographic shift towards an older population. Eventually, the need for health and care services will also increase sharply. Expenditure increases in the National Insurance Scheme are estimated, on average, at nearly NOK 11 billion 2012 kroner per year for 2013-2015. In comparison, expenditure rose by just under NOK 5 billion 2011 kroner on average per year from 2005 to 2010. In the longer term, the growth in expenditure on pensions, health and care services is estimated to be clearly stronger than the underlying growth in tax revenues.

Petroleum revenues are based on the depletion of a non-renewable natural resource and will eventually subside. This will lead to gradually slower growth in the GPFG, and thus also in the expected return on the Fund, cf. figure 3.3C. With the fiscal rule the use of oil revenues has increased from 1.8 pct. of the mainland trend GDP in 2001 to 5.6 pct. in 2012, i.e. by an average of just over 0.3 percentage point per year. Based on the estimates for the performance of the Fund capital in the years to come, the use of petroleum revenues may increase to a peak equal to 7½ pct. of mainland GDP around 2025, i.e. by just under 0.2 percentage point per year for the entire period as a whole.

Expenditure on old-age and disability pension in the National Insurance Scheme is estimated to increase from 9¾ pct. of mainland GDP in 2012 to 12½ pct. in 2025. This is equal to an average of 0.2 percentage point per year. This is far greater than from 2001 to 2012 and is more than the estimated scope for annual petroleum revenue spending until 2025. Reforms that slow spending growth or increase revenues - for example, by facilitating more work - will thus be important for creating room for action to solve other tasks.

Population projections from Statistics Norway show a persistent increase in the share of the elderly in the population, from just over 20 per 100 persons of working age now to just above 40 per 100 persons in 2060, cf. figure 3.3A. At the same time Figure 3.3B shows how public welfare programmes are primarily financed by the working age population, while children, youth and elderly are net recipients of publicly funded benefits. Calculations of generational accounts couple net expenditure statistics for the different groups with detailed population projections from Statistics Norway. The calculations show that today's public budgets must be correspondingly bolstered by 9 pct. of mainland GDP if future generations will not have to face a heavier tax burden.

The generational accounts are based on relatively simple assumptions. As a result, price growth in public purchases is overestimated and calculations do not take the savings contained in

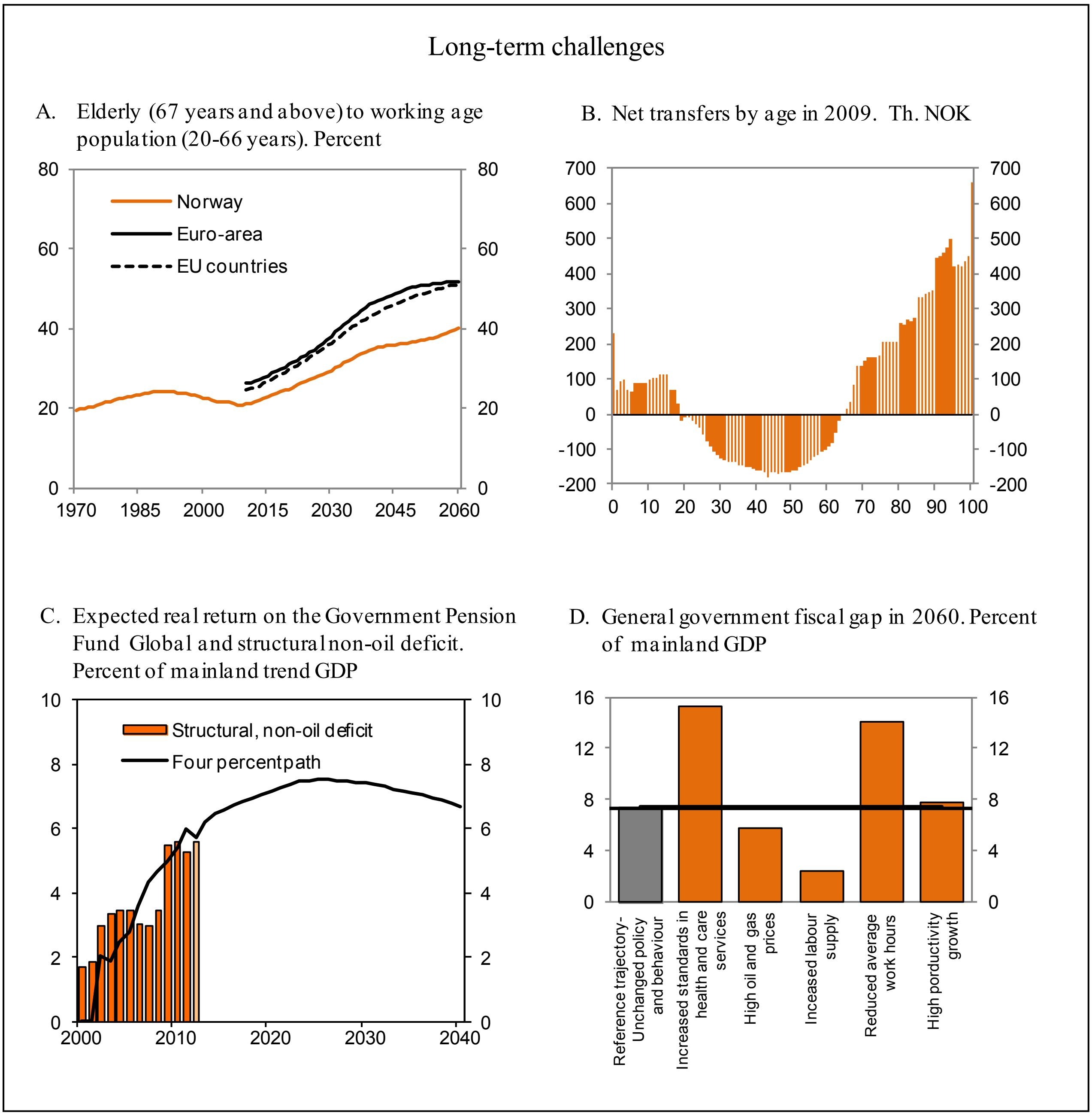

Figure 3.3 Long-term challenges
Sources: Statistics Norway and Ministry of Finance.

the pension reform into account. However, the conclusion that public budgets must be bolstered so that current welfare programmes can be continued is supported by more extensive model projections of public finances.

The more extensive model projections are based on assumptions including the continuation of current welfare programmes and current labour force participation among different demographic groups. It is also assumed that the spending of oil revenue follows the four percent path.

In the 2011 National Budget, the unmet funding gap in 2060 related to a continuation of the current welfare programmes was estimated at 7¼ pct. of GDP in the mainland economy. Since the 2011 National Budget the estimate for structural tax and excise duty revenues has been adjusted upward by an amount equal to 0.8 pct. of mainland GDP. By itself, this points in the direction of a corresponding downward adjustment of the long-term adjustment need. This is offset to some extent by the proposed increase in the use of oil revenues from 2011 to 2012. The estimates are uncertain and sensitive to changes in assumptions. The conclusion that

Table 3.3 Government Pension Fund Global, expected real return on GPFG and structural non-oil budget deficit. Bn. NOK and percent

	Current prices			Constant 2012 prices			Structural deficit	
	Government Pension Fund Global at the beginning of the year[1)]	Expected return (4 pct. on the Fund capital)	Structural, non-oil budget deficit	Expected return (4 pct. on the Fund capital)	Structural, non-oil budget deficit	Deviation from the 4 pct. trajectory	As pct. of Mainland Norway trend-GDP	As pct. of the Fund capital
2001	386.6	-	21.3	-	32.1	-	1.8	-
2002	619.3	24.8	36.4	35.8	52.5	16.7	3.0	5.9
2003	604.6	24.2	42.9	33.5	59.5	26.0	3.3	7.1
2004	847.1	33.9	47.2	45.6	63.5	17.9	3.4	5.6
2005	1 011.5	40.5	49.7	52.9	65.0	12.0	3.4	4.9
2006	1 390.1	55.6	46.6	70.3	58.9	-11.4	3.0	3.4
2007	1 782.8	71.3	48.5	86.3	58.7	-27.7	2.9	2.7
2008	2 018.5	80.7	60.0	92.3	68.6	-23.7	3.4	3.0
2009	2 279.6	91.2	100.2	100.5	110.4	10.0	5.4	4.4
2010	2 642.0	105.7	108.2	112.7	115.4	2.7	5.5	4.1
2011	3 080.9	123.2	108.8	127.2	112.3	-14.9	5.3	3.5
2012	3 115.0	124.6	122.2	124.6	122.2	-2.4	5.6	3.9
2013	3 542.8	141.7	-	137.3	-	-	-	-
2014	3 887.2	155.5	-	146.0	-	-	-	-
2015	4 190.9	167.6	-	152.4	-	-	-	-
2016	4 501.4	180.1	-	158.3	-	-	-	-
2017	4 824.2	193.0	-	164.1	-	-	-	-
2018	5 153.0	206.1	-	169.5	-	-	-	-
2019	5 500.3	220.0	-	175.0	-	-	-	-
2020	5 866.4	234.7	-	180.5	-	-	-	-

1 When projecting the Fund capital from 2013 and onward, it is technically assumed that annual withdrawal from the Fund equals 4 pct. of the capital at the beginning of the year.
Source: Ministry of Finance.

there will be increasing pressure on public finances is still resilient vis-à-vis a variety of reasonable outcomes in the underlying assumptions

Total labour effort is crucial for ensuring the sustainability of public welfare programmes. According to calculations a 10 pct. increase in the number of hours worked in 2060 compared with the benchmark nearly closes the estimated public sector financial gap in 2060. A high labour force participation rate provides a large tax base and boosts public revenues. At the same time expenditure on benefits can be cut if the number of people outside the labour force is reduced. In this context the pension reform is very important as it provides incentives for increasing labour supply.

3.6 Monetary policy

The long-term objective of monetary policy is to provide the economy a nominal anchor. The 2001 monetary policy guidelines established flexible inflation targeting as the guide for interest rate setting by Norges Bank. Norges Bank's operational implementation of monetary policy shall be aimed at low and stable inflation, defined as an annual increase in consumer prices that remains close to 2.5 pct. over time. In the short and medium term, monetary policy shall weigh low and stable inflation against production and employment stability. Monetary policy shall also contribute to stable expectations concerning exchange rates. Fiscal and monetary policy must work together to contribute to the goal of stable development of the Norwegian economy.

To mitigate the effect of the financial crisis on the Norwegian economy, Norges Bank reduced its key policy rate from 5.75 pct. in October 2008 to 1.25 pct. in June 2009. With the prospect of an upturn in the economy and higher inflation, Norges Bank increased its key policy rate by 1 percentage point, to 2.25 pct., from October 2009 to May 2011. At the interest rate meeting in September the key policy rate was kept unchanged at 2.25 pct. In the press release after the meeting in September Norges Bank wrote: *"There is an unusually high level of uncertainty surrounding the key policy rate ahead. If price and cost inflation moves up and growth prospects improve, the key policy rate may be raised. If the Norwegian economy is exposed to new major shocks, with a further deterioration in the outlook for growth and inflation, the key policy rate may be reduced"*. Norges Bank will present the next monetary policy report and new interest rate forecasts on 19 October.

The krone has strengthened considerably since November last year. Measured by the trade -weighted exchange rate index (TWI), the krone is now 2¼ pct. stronger than the average level last year, and 4¼ pct. stronger than the average of the last five years.

3.7 Financial stability

Financial stability

There is a strong interdependence between the real economy and the financial system. Failure in the financial sector weakens production and employment, and lower activity in the real economy has negative consequences for the financial sector. In order to reduce risk in the financial sector, the promotion of a strong capital base, adequate liquidity and good conduct through public regulation and supervision is emphasised.

Uniform financial market regulation covers the whole financial sector and ensures consistent regulation of its various parts. As a main rule, equal risk should be regulated equally, regardless of the type of financial institution that bears the risk. This provides for sounder institutions, and prevents risk accumulation in the least regulated areas.

Norway also has one universal supervisory authority for the entire financial industry. This contributes to uniform supervision of banks and other financial institutions (across industries) and a better overall view of developments in the financial industry. It also provides a better foundation for assessing systemic risk in the financial sector.

Rules on consolidation promote the soundness of both financial groups and individual firms. Moreover, the Norwegian authorities have emphasized that rules shall be consistent over time, to avoid a situation where rules are eased in good times and tightened in bad times.

Norwegian banks and other financial institutions have emerged relatively unmarked from the international financial crisis. In the last couple of years they have strengthened their financial soundness somewhat and to some extent obtained more robust financing. Norwegian banks have limited direct exposure to government bonds from euro countries with high government debt. Nevertheless, severely reduced capital flows in the international capital markets must be expected to quickly weaken the availability of funding to Norwegian banks as well.

On 20 July 2011 the EU Commission presented its proposal for implementing the Basel III standards for banks in the EU zone, the so-called Capital Requirements Directive (CRDIV). The Commission has proposed that the new rules be phased in over a long period, and not take full effect until 1 January 2019. The proposal will now be debated by the EU Parliament and Council of Europe. The Commission's proposed regulation provides some national leeway to speed up the introduction of the EU's new common rules, higher risk weights for loans secured on residential and commercial properties, and stricter requirements for the equity share of such loans. How much scope for action this will leave Norwegian authorities will depend on how the EU laws are designed and the decision of the EEA Committee.

Norwegian authorities will continue to use the national scope for action to have a regulatory framework that contributes to sound banks. It may be relevant to assess Nordic cooperation on stricter capital requirements for large and systemically important banks that use internal methods for calculating capital requirements for housing loans. It may also be relevant to assess a more rapid joint implementation of Basel III than specified in the plans, e.g. stricter capital requirements and countercyclical capital buffers.

3.8 Employment policy

A key goal of the Government is to facilitate an inclusive labour market. Work provides individuals with economic independence and is important for preventing poverty, evening out social differences and achieving equality between men and women. Working life is also an arena for social inclusion.

Potential for increased supply of labour

Work force participation is high in Norway compared with most other countries. This is particularly due to high participation among women and the elderly in the labour force. On the other hand, participation measured in work hours is lower than the OECD-average. Part-time work is more common among women than men, and the share of part-time work is therefore high in Norway compared with many other OECD countries. The potential for further growth in the female force is now probably primarily related to an increase in average working hours.

In the decades to come favourable demographics of the past will be succeeded by an increase in the proportion of elderly. The elderly generally have a lower level of work force participation than the prime age groups in the labour market. The recently implemented old-age pension reform is important to stimulate work force participation.

The total disability propensity, measured as the number of disabled as a percentage of the population aged 18-66 years, has remained fairly stable at about 9.5 pct. in recent years. With a growing percentage of elderly in the workforce it is likely that this number will increase.

There is a considerable gap between immigrants and the general population's participation in the labour market. However, there are also large differences between different immigrant groups, depending on country of origin, reason for immigration, education and knowledge of Norwegian. Employment is highest among immigrants from Western countries, while immigrants from countries in Africa and Asia have the lowest employment levels. It is an important policy objective to include more immigrants in the labour market.

Employment and incomes policy

The Government pursues an active labour market policy emphasizing close follow-up, activation and use of *labour market programmes* to ease the transition to work. The Government proposes to continue the high level of measures in 2011 into 2012. In all, the proposal will fund around 71 200 programme places, consisting of around 17 000 places for unemployed persons and about 54 200 places for persons with impaired work capacity. Measures for persons with impaired work capacity are extended while measures for the unemployed are cut back.

From 2012 the Government will implement a job strategy to enable more persons with disabilities to find an ordinary job. The target group is mainly young people under the age of 30.

Long-term sick leave is often the first step on the path to disability pension. Through the Agreement on a More Inclusive Working Life (IA agreement), the Government and the social partners seek to facilitate return to work. The agreement aims to reduce sick leaves and the use of disability pensions, increase the retirement age and ensure the recruitment of disabled and other vulnerable groups to the labour market. On 1 July 2011 changes were implemented in the National Insurance Act and Working Environment Act to provide for earlier and closer monitoring of sick leave. Changes that provide for sanctions against the employee, employer and doctor for failure to follow up have also been implemented.

The *rules for temporary lay-offs* were changed in 2009. The intention of the changes was to make it easier for employers to retain qualified labour during periods of low demand. The Government proposes that the extensions of the lay-off rules be reversed from 1 January 2012 for new inflows. In construction and in manufacturing, the sectors that make the most use of lay-offs, employment is again on the rise, while both unemployment and the number of lay-offs are retreating.

Income policy cooperation is a key part of economic policy in Norway. Regular Contact Committee meetings between the Government and the social partners are an important part of this cooperation. Furthermore, the Norwegian Technical Calculation Committee for Wage Settlements works to ensure a shared understanding of the statistical basis for the wage settlements.

Like the other Nordic countries, Norway has a comprehensive social safety net, a high level of trade unionization and relatively coordinated wage bargaining. The social safety net provides economic security for employees and thus provides a basis for flexibility and adaptability in the Norwegian economy. Coordinated wage bargaining, in which the wage growth in internationally exposed sectors are negotiated first, aim to keep the cost level within limits that ensure a sufficient scale of internationally exposed activities over time. This is particularly important in the present situation where the Norwegian cost level compared to that of our trading partners is high.

4 Sustainable development and climate policy

Sustainable development requires meeting the needs of the present generations without undermining the ability of future generations to meet their needs. According to the UN, the primary challenges to sustainable development are global poverty, loss of biodiversity, anthropogenic climate change and the spread of hazardous chemicals. To tackle the environmental and poverty challenges, the consumption of resources and the environmental impact of economic activity need to be reduced.

The Government's aim is for Norway to be in the international forefront in the effort to achieve sustainable development. Progress on sustainable development is reported annually in the National Budget. The reporting is based on the development of 17 sustainability indicators related to development aid to and trade with developing countries, emissions to air, biodiversity, natural resources, hazardous pollutants and economic and social conditions. This year's Budget presents an update of the strategy for sustainable development. The update has resulted in some changes in the set of indicators. Statistics Norway each year publishes a report on the sustainable indicators together with background information.

Since 2009 the Government has met its target that official Norwegian development assistance should equal 1 pct. of gross national income (GNI). In the proposed Budget for 2012 the level of assistance is estimated at 1 pct. of GNI. In practice, Norwegian development assistance is even higher than the official development aid statistics indicate, since Norway, in contrast to a number of other countries, does not include debt relief in the figures. Imports from developing countries as a share of total imports have more than doubled from 1995 to 2010. China and Brazil are the countries from which we import the most. The import share from the least developed countries has, however, changed little over the period.

Norway has met its Gothenburg Protocol commitments with regard to reducing emissions of three out of four long-range transboundary air pollutants. To help Norway meet its commitment regarding nitrogen oxides (NO_x) the Government, in late 2010, concluded a new agreement with industry organizations to cut emissions.

Norway's Assigned Amount Units (emission quotas) under the Kyoto Protocol are on average 50.1 million tonnes CO_2–equivalents annually in the Kyoto period 2008-2012. In addition, 1.5 million tonnes may be added for sinks (LULUCF), but the Government has decided to add less. It is the Government's objective to exceed Norway's commitments under the Kyoto Protocol by 10 pct. Based on updated emission data up to 2010 and projections to 2012 the need for purchases of credits is estimated at about 20 million credits over the course of the Kyoto period.

Norwegian greenhouse gas emissions increased by 4.8 pct. in 2010, largely due to the recovery from the recession in the wake of the financial crisis. Based on current policy and use of policy instruments, emissions are expected to increase in the years ahead, partly as a result of further normalization of the cycles in the Norwegian and international economy, and partly as a result of higher emissions from petroleum activities. After 2020, petroleum activities are expected to contribute to decreasing emissions.

The main policy instruments in Norway's climate policy are taxes and tradable emission allowances and credits. The Norwegian permit system is an integrated part of the European Union Emissions Trading System (EU ETS). More than 70 pct. of Norwegian greenhouse gas emissions are covered by economic policy instruments. Due to the restructuring of the initial registration tax average CO_2 emissions from new passenger cars have dropped by nearly a quarter since 2006. The requirement for sales of biofuels is now 3.5 pct. Moreover, the commitment to railway projects continues.

The support for renewable energy and energy efficiency measures through Enova has increased significantly. This summer, Norway entered into an agreement with Sweden on a joint electricity certificate market from 2012. The agreement will make it more profitable to enhance production capacity for renewable energy. With a certificate price of 25 øre/kWh, the total support from Norwegian consumers to producers of renewable power in Sweden and Norway will amount to approximately NOK 560 million in 2012. The support will increase to about NOK 3.5 billion by 2020.

The Government will continue and bolster its efforts to develop reliable carbon capture and storage technology. Together with building and operating the technology centre, planning and preparing the full-scale plant at Mongstad will be a key element in the Government's effort to develop and realize CO_2-capturing and -storage in the years to come.

The Government is following up its commitment to reduce greenhouse gas emissions from deforestation and forest degradation in developing countries, and the appropriations for climate and forest initiatives will be increased to NOK 2.6 billion in 2012.

The Government is actively supporting initiatives to achieve an ambitious international climate agreement to fruition. The international climate talks in Mexico in December 2010 arrived at an agreement that represented a step forward from the climate negotiations in Copenhagen in 2009. Decisions were made in areas such as financing climate measures in developing countries and establishing a mechanism for reducing emissions from deforestation in developing countries. The report from the High-Level Advisory Group on Climate Change Financing co-chaired by Prime Ministers Stoltenberg and Meles (Ethiopia) provided important input to the climate change conference in Cancún. The parties also agreed to establish a Green Climate Fund to finance climate initiatives in developing countries, along with a transition committee to oversee the start-up of the Fund. Norway is represented in the leadership of this committee.

5 The Government Pension Fund

5.1 Introduction

The purpose of the Government Pension Fund is to support government saving to finance the pension expenditure of the National Insurance Scheme and long-term considerations in the spending of government petroleum revenues. Sound, long-term management of the Government Pension Fund will help ensure that Norway’s oil wealth can benefit both today's and future generations.

The Government Pension Fund comprises the Government Pension Fund Global (GPFG) and the Government Pension Fund Norway (GPFN). The operational management of the two parts of the Government Pension Fund is conducted by Norges Bank and Folketrygdfondet respectively, within guidelines laid down by the Ministry of Finance. The Government Pension Fund is not a separate legal entity and does not have its own executive board or administrative staff.

Through the investment strategy, the Ministry of Finance seeks to take advantage of the characteristics of the Fund. The Fund’s investments have a very long time horizon. The strategy is therefore based on assessments of expected long-term returns and risks. Importance is also attached to broad diversification of investments over different regions, asset classes, sectors and companies.

A good financial return over time depends on sustainable development in economic, environmental and social terms. By virtue of the Fund’s long-term investments in a large number of the world’s companies, it follows a responsibility and an interest in promoting good corporate governance and safeguarding environmental and social concerns.

5.2 Performance of the Government Pension Fund

Performance of the Government Pension Fund Global

The market value of the GPFG was about NOK 3 111 billion at the end of the first half of 2011, up NOK 34 billion since the start of 2011. As of end-June 2011, 60.5 pct. of the Fund was placed in equities, 39.4 pct. in fixed-income securities and 0.1 pct. in real estate. During the first six months of the year a total of NOK 94 billion in new capital was transferred to the Fund.

In the end of the first half of 2011 the return on the GPFG was 2.4 pct. measured in the Fund's currency basket. The return on the equity portfolio was 2.2 pct., while the return on the fixed-income portfolio was 2.5 pct. Average annual net return since 1998 was 4.9 pct. and, adjusted for inflation, 2.9 pct.

In the first half of the year Norges Bank achieved a return on the management of the GPFG that was 0.17 percentage point better than the return on the benchmark index stipulated by the Ministry of Finance. Equities management achieved a return 0.04 percentage point weaker than the return on the benchmark index, while fixed-income management had an excess return of 0.52 percentage point. Over the last three years the active management of equities and fixed income in the GPFG generated an annual gross excess return of 0.28 percentage point, while since its inception in 1998 the annual gross excess return has equaled 0.31 percentage point.

One of the ways the Fund’s exposure to systematic factors is analyzed is to compare the relative return on the Fund with the return on the various factors. The analysis indicates that in the first half of 2011 the Fund's equity portfolio had a higher exposure to small companies than the benchmark index, and was less exposed to value companies. The analysis of the Fund’s fixed-income portfolio indicates that the Fund had a somewhat lower duration than the benchmark index. In addition, the Fund was somewhat more exposed to bonds with credit risk premiums than the benchmark index.

Performance of the Government Pension Fund Norway

The market value of the GPFN was NOK 133.7 billion at 30 June 2011, down NOK 1.2 billion since the start of the year. In all, 59 pct. of the Fund's market value was invested in equities, while 41 pct. was invested in fixed-income securities.

The return on the GPFN in the first half of 2011 was -0.9 pct. The return on the equity portfolios was -2.8 pct. in the Norwegian equity portfolio and -4.2 pct. in the Nordic equity portfolio. The Norwegian fixed-income portfolio had a return of 2.8 pct., while the Nordic fixed-income portfolio had a return of 0.3 pct.

In the first half of 2011 Folketrygdfondet achieved an excess return on the management of the GPFN of 0.94 pct. against the benchmark index, which is set by the Ministry of Finance. The management of the Norwegian equity portfolio gave an excess return of 1.42 percentage point, while the management of the Nordic equity portfolio gave an excess return of 0.33 percentage point. The management of the Norwegian and Nordic fixed-income portfolios gave excess returns of 0.40 and 0.56 percentage point, respectively. Since 1998 the average annual gross excess return on the Fund has been 0.51 percentage point.

5.3 Current issues in the manage ment of the GPFG

5.3.1 Real estate investments

The Ministry of Finance laid down the GPFG guidelines for investments in real estate on 1 March 2010, cf. Report No. 10 (2009-2010) to the Storting. The guidelines stipulate that Norges Bank shall invest up to 5 pct. of the GPFG's capital in a separate real estate portfolio by reducing investments in the fixed-income portfolio correspondingly. As described in Report No. 10 (2009-2010) to the Storting, building up a real estate portfolio representing 5 pct. of the Fund capital is expected to take many years. It is also expected that the portfolio in the initial period will be concentrated in the largest European property markets.

The GPFG's first real estate investment, the purchase of 25 pct. of The Crown Estate's Regent Street portfolio in London, was completed on 1 April this year. The total purchase price was GPB 472 million (NOK 4.2 billion). The return in the second quarter was -4.7 pct. measured in international currency. The negative result was mainly due to transaction costs of NOK 177 million, of which most was stamp duty.

In July, on behalf of the GPFG, Norges Bank entered into an agreement to purchase 50 pct. of seven properties in and around Paris from the AXA group. AXA, which owns the other half of the properties, will retain this ownership upon completion of the transaction and will continue as the manager of the properties. This is GPFG's second real estate investment and the first in France. The purchase price was EUR 702.5 million (NOK 5.5 billion).

5.3.2 Fees to external managers

On 5 September this year the Ministry introduced a general provision in the management mandate for the GPFG stating that Norges Bank's agreements with external managers shall include provisions for a cap on performance-based fees. In line with this the Executive Board of Norges Bank has laid down an investment mandate to the head of Norges Bank Investment Management (NBIM), under which agreements with external managers must contain a maximum limit for payment of fees per year.

Appendix 1

The structural, non-oil budget surplus

The overall budget balance can change considerably from year to year without this being the result of changes in fiscal policy. The surplus is affected not only by the fiscal policy stance, but also by fluctuations in petroleum revenues, changes in the economic situation, as well as other factors. To gain a better picture of the underlying fiscal stance and the use of oil revenues it is necessary to consider the development of the budget balance exclusive of revenues and expenditure relating to petroleum activities, i.e. the non-oil budget balance. Furthermore, it is also necessary to correct for *inter alia* cyclical fluctuations in taxes and excise duties and in unemployment benefits.

Since the 1987 National Budget, the Ministry of Finance has used an indicator for the structural non-oil budget balance to assess the fiscal stance. After the fiscal rule was adopted in 2001, the level of the structural, non-oil deficit has played an important role in steering fiscal policy, as a measure of the underlying use of petroleum revenues over the fiscal budget. By steering according to this measure the Government aims at allowing automatic stabilizers to work, while ensuring that actual transfers from the Fund on average and over time will follow the expected real return on the Government Pension Fund Global.

The following adjustments are required to get from the *non-oil* to the *structural, non-oil budget balance*:

- Adjustments are made for the budgetary effects of various tax revenues deviating from their trend levels over the business cycle. The estimated adjustments for 2011 and 2012, cf. table A.1, reflect the fact that tax revenues (minus employment benefits) are estimated to be below trend both years. The positive correction for 2010 must in particular be viewed in the context that unusually large gains in the financial industry in 2009 helped boost corporate taxes paid in 2010.
- Adjustments are made for the difference between actual and estimated normal levels of central government interest revenues and expenditures and transfers from Norges Bank.
- Adjustments are made for accounting changes and for changes in the division of functions between central and local government that do not affect underlying developments in the budget balance.

The separation of public revenues and expenditures into a cyclical and a structural component cannot be based on direct observations, but must be estimated on the basis of analyses of accounting data, economic statistics and forecasts for the years to come. Normally, the distinction between cyclical and structural changes is drawn by estimating trend levels for the aggregates under consideration. The resulting estimates are subject to revisions when more information on the economic situation becomes available, even after the central government accounts for each year are

Table A.1 The structural non-oil budget surplus. Mn. NOK

	2009	2010	2011	2012
Non-oil budget surplus	-96 561	-104 070	-106 117	-120 247
- Net interest payments and transfers from Norges Bank. Deviations from estimated trend level	-751	-733	3 671	2 589
- Accounting technicalities	-6 058	-1 364	0	0
- Taxes and unemployment benefits. Deviations from trend	10 465	6 258	-1 005	-636
= Structural non-oil budget surplus	-100 217	-108 231	-108 784	-122 200
Measured in pct. of Mainland Norway trend GDP	-5.4	-5.5	-5.3	-5.6
Change from previous year in percentage points[1]	-2.0	-0.1	0.3	-0.3

[1] The change in the structural non-oil budget surplus as a percentage of the trend GDP for Mainland Norway is used as a rough indicator of the budget's impact on the economy. Negative figures indicate that the budget has an expansionary impact. Unlike the model computations presented in the National Budget, this indicator does not take account of the fact that different revenue and expenditure items may have different effects on economic activity.
Source: Ministry of Finance.

closed.

The calculation of structural levels for taxes and excise duties is based on central government accounts data, as well as estimates for the projection period. Taxes on income and wealth paid to local government administration are also included. The calculations cover the period 1960-2020 for the various types of taxes and excise duties. The point of departure for the projection period is the Ministry of Finance's medium-term projections, cf. box A.1. The various types of taxes and excise duties can be divided into the following main groups:

- *Labour taxes.* The category includes employers' national insurance contributions and personal taxes, including wealth tax on individuals.
- *Capital taxes.* The category includes arrears taxes from companies and other non-personal taxpayers other than petroleum activities, tax at source and inheritance tax.
- *Excise duties.* The category includes VAT, duties on vehicles and other special charges, including stamp duty and miscellaneous sector fees.

The changes in these three main groups of taxes and excise duties are shown in figures A.1.1A-C. Actual taxes according to central government accounts adjusted for changes in tax rates and tax bases and converted to constant

Underlying trends in taxes and excise duties and in unemployment benefit claimants

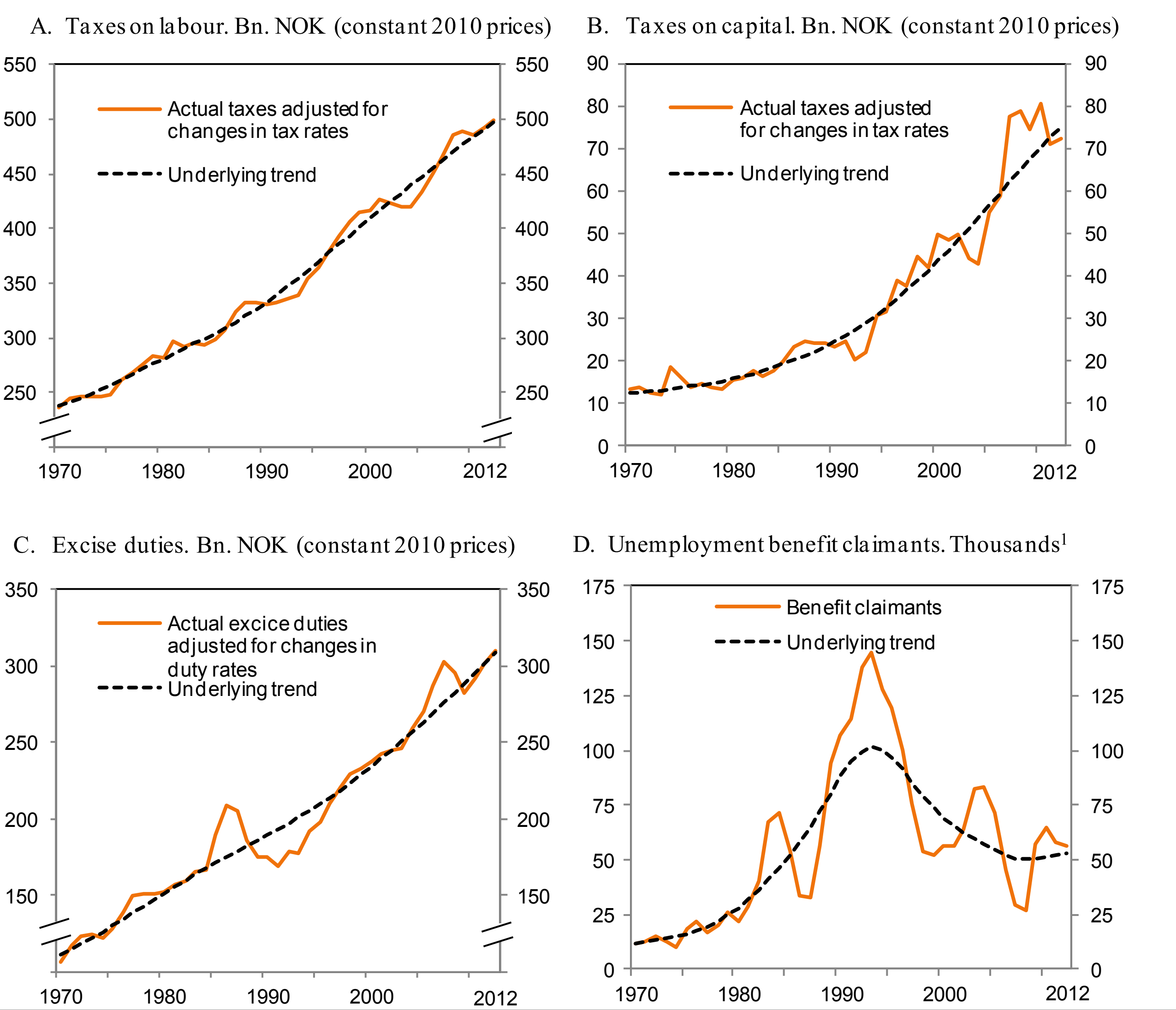

Figure A.1.1 Underlying trends in taxes and excise duties and in unemployment benefit claimants

[1] Correction is made for unemployment benefit recipients who may be partly unemployed by converting the number of recipients into full-time equivalents. In the conversion partial recipients are assigned a weight of 0.75.

Sources: The Ministry of Finance and the Norwegian Labour and Welfare Administration (NAV).

2010 kroner are shown for the years up to and including 2010.

On the budget's expenditure side, the cyclical adjustment relate to the expenditure on unemployment benefits. The adjustment is based on the estimated trend deviation for the number of unemployment benefit recipients. The trend in the number of unemployment benefit recipients and estimated trend is shown in figure A.1.1D.

The change in the non-oil and the structural, non-oil fiscal budget surplus is shown in figure A.1.2. As can be seen, the use of oil revenues, measured by the structural, non-oil deficit, escalated rapidly around the mid-1970s. Since the mid-1970s, both the non-oil and the structural, non-oil deficit have fluctuated around an average level of about 4 pct. of mainland GDP.

In line with the fiscal rule the use of oil revenues has increased since 2001. The escalation was particularly pronounced in 2009 due to the special measures for mitigating the effects of the international financial crisis. Estimates of the structural, non-oil deficit show an increase in the underlying use of oil revenues of NOK 90 billion 2012 kroner from 2001 to 2012, to just over NOK 122 billion.

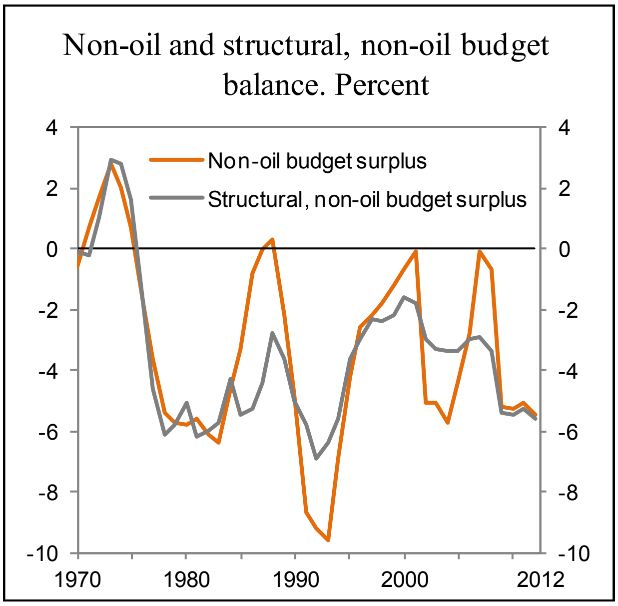

Figure A.1.2 Non-oil and structural non-oil budget balance
Source: Ministry of Finance.

Box A.1 Projection of taxes and excise duties in the medium term

When forecasting taxes and excise duties, the relevant laws and regulations are assumed to remain unchanged after 2012. Starting from the macroeconomic projections used in the National Budget 2012, the following additional assumptions are made:

– *Labour taxes*. The change in the number of employed full-time equivalents is an important indicator for the evolution of both social security contributions and income taxes. The forecast is based on an assumption of average annual growth in the number of full-time equivalents of about 1¼ pct. from 2012 to 2015, and about ¾ pct. from 2015 to 2020. This implies higher employment in the years ahead than what has previously been assumed. The upward revision to employment forecast should be viewed in light of the upward revision to net immigration from countries in the European Economic Area in the new population projections from Statistics Norway. Revenues from the wealth tax are assumed to grow at an annual rate of about 5 pct. (nominally) over the forecast period.

– *Capital taxes*. Corporate taxes from non-oil corporations are assumed to remain broadly constant as a share of mainland GDP after 2012. In total, paid capital taxes are estimated to fall in 2011. This is mainly because the financial services industry, recorded substantial capital gains in 2009 and therefore paid higher taxes than usual in 2010. Revenues from the inheritance tax are assumed to grow at an annual rate of about 10 pct. (nominally) over the forecast period.

- *Excise duties*. The growth rates of private consumption, construction industry turnover and new car sales are important for predicting inter alia VAT, duties on vehicles and other excise duties. Private consumption is assumed to grow at an annual real rate of 3¾ pct. from 2012 to 2015 and 3¼ pct. thereafter. Construction industry turnover is assumed to grow at an annual real rate of slightly over 3 pct. up to 2020. The total car stock is assumed to grow by 2 pct. annually. Stamp duty is assumed to grow at an annual nominal rate of slightly over 6 pct. up to 2020.

Appendix 2

The Norwegian petroleum sector

Oil exploration started in the late 1960s and production of oil in 1971. Since 2000, the production of oil has fallen significantly. At the same time, production of gas has increased and offset some of the decline in total production of petroleum. In 2010 the total production of petroleum amounted to 230 billion standard cubic metres (scm) oil equivalents. Total production is expected to fall in both 2011 and 2012, to 226 billion scm oil equivalents. Whereas gas production is expected to increase by more than 4 pct. from 2010 to 2012, a decline in oil production of 10 pct. is expected in this period. Norway is ranked as the world's seventh largest oil exporter and the second largest gas exporter.

In 2010, the petroleum sector accounted for 23 pct. of value added, and was the largest private sector in Norway. The State's net cash flow from the petroleum sector, which amounted to approximately 26 pct. of total revenues in 2010, is estimated at NOK 341 billion in 2011 and 352 billion in 2012.

The State's revenues from petroleum activities are allocated to a separate fund, the Government Pension Fund Global, which is invested abroad. By the end of 2010, the value of this fund was NOK 3 080 billion or some 123 pct. of GDP. Although direct revenues from the petroleum sector are channelled out of the mainland economy and employment in the sector is less than 1 pct. of total employment, petroleum investments, intermediate inputs and other linkages make activity in the mainland economy dependent on the petroleum sector. After several years of significant growth, the petroleum investments fell by 12.4 pct. last year. Looking ahead, information from the oil companies indicate strong growth in investments. Petroleum investments are expected to increase 12.5 pct. this year and 11 pct. next year.

Table A.2 Key figures for petroleum activities

	2010	2011	2012	2015	Effect of a NOK 10 change in the 2012 oil price in 2012
Assumptions:					
Crude oil price, NOK per barrel	484	588	575	453	
Crude oil price, NOK per barrel (2012 kroner)...................................	508	600	575	427	
Production, million Sm^3 o.e.............					
- Crude oil and NGL........................	124	120	115	109	
- Natural gas	106	109	111	112	
NOK billion:					
Export value[1]	493	585	571	475	6.4
Accrued taxes and excise duties[2]......	180	245	210	121	5.3
Taxes and excise duties paid[2]	159	210	228	120	2.7
Net income for SDFI	104	118	111	90	1.9
The State's net cash flow[3]	276	341	352	219	4.6

Footnote 1 Crude oil, natural gas, NGL and pipeline transport
Footnote 2 Ordinary tax on income and wealth, special income tax, area and carbon tax.
Footnote 3 Total of taxes and excise duties paid, net payments from the State's Direct Financial Interest (SDFI) in petroleum activities, and dividends paid by Statoil.
Sources: Statistics Norway, Ministry of Petroleum and Energy, and Ministry of Finance.