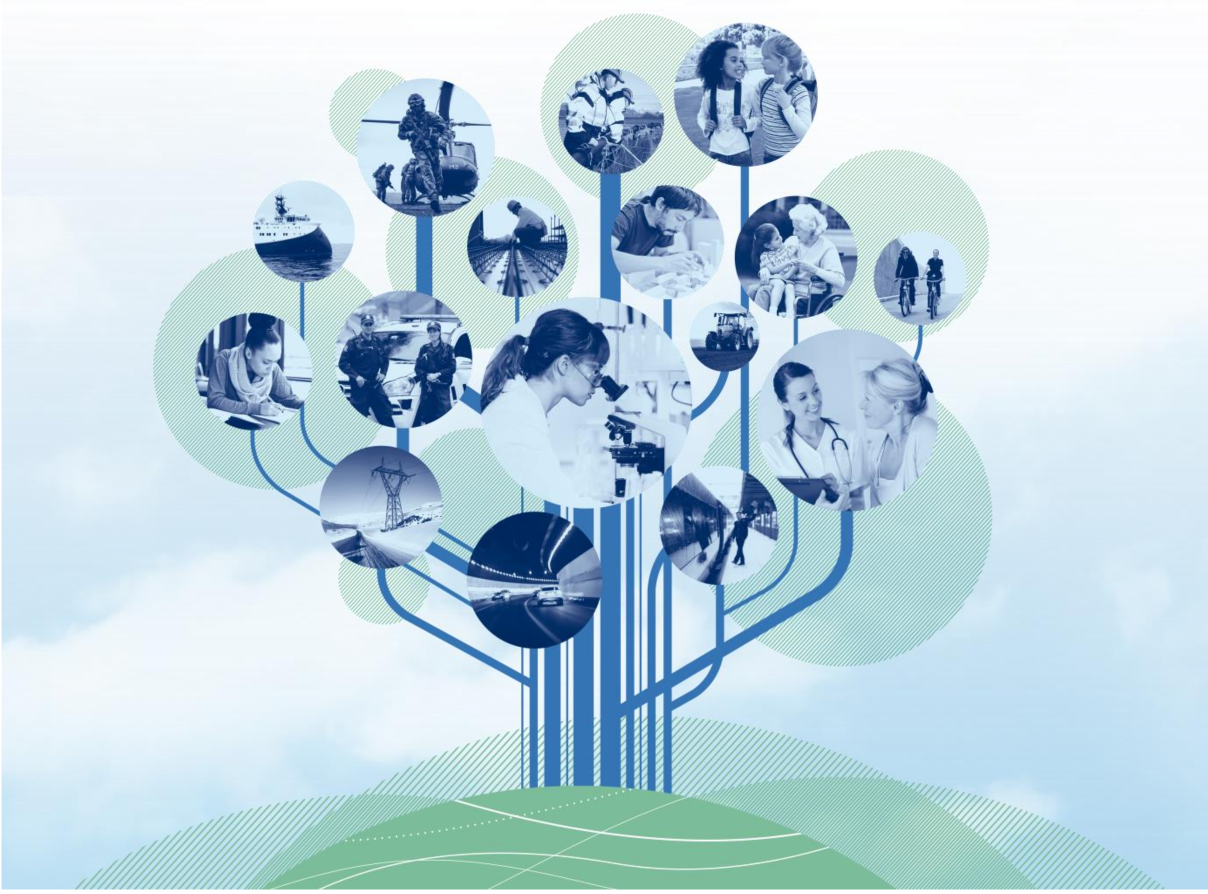
DET KONGELIGE FINANSDEPARTEMENT

Royal Ministry of Finance

The National Budget 2017

A summary



National Budget 2017

Main economic policy features and outlook for the Norwegian economy

A policy for employment, activity and structural adjustment

Norway is a country of great opportunities, with a highly educated population, extensive natural resources, small social differences and an open economy that facilitates efficient production and exchange of goods. Longer-term welfare development in Norway is determined particularly by the growth capacity of the mainland economy. It is therefore a challenge that many people are outside the labour force, and that productivity growth is lower than before. High labour utilisation and productivity growth are the foundations for strong economic growth.

The expansion of petroleum industry activity has been a key driver of economic growth in Norway over several decades. Growing petroleum industry demand has boosted mainland economic activity and contributed to higher revenues and an increasing number of well-paid jobs. Although the petroleum industry will remain important for the Norwegian economy for decades to come, its significance will decline steadily. Steps must therefore be taken to foster new growth industries.

The decline in oil and gas prices has triggered quicker turn-around in petroleum industry demand than anticipated. Reduced activity in petroleum-related industries has increased unemployment, especially in southern and western parts of the country. The key challenge for Norway is to create new, profitable jobs in private sectors exposed to international competition. Safeguarding Norway's level of welfare demands new activity to promote high employment and high overall economic growth.

The Government will therefore promote a business-friendly regulatory framework, with a simpler and more growth-promoting tax system, better infrastructure and a skilled labour force. This will strengthen the competitiveness of businesses. Competitive businesses will expand economic growth and secure jobs for the future. A high level of knowledge promotes productivity growth whilst at the same time giving individuals more choices. The Government will deregulate and facilitate increased competition in both the private and the public sectors. Competition promotes productivity growth and efficient resource utilisation.

The Norwegian economy is improving. Growth is being supported by expansionary economic policy. Confidence indicators point towards continued growth. Both households and businesses are more optimistic about the future, and registered unemployment is falling in a majority of Norway's counties. Nonetheless, economic growth has been moderate thus far. Unemployment based on Statistics Norway's labour force survey has risen, and employment growth has not kept up with population growth. However, the risk of a serious downturn in the Norwegian economy appears to be lower than last winter and spring.

The Government is committed to ensuring high employment and low unemployment. The economic policy framework for 2017 addresses both short- and long-term challenges:

- The Government is continuing to implement the tax reform in accordance with the parliamentary tax agreement. The corporate tax rate has been reduced from 28 per cent in 2013 to 25 per cent in 2016, and the Government has proposed further reductions to 24 per cent in 2017. In accordance with the parliamentary tax agreement the rate will be reduced to 23 per cent in 2018. Reductions in net wealth tax have also been proposed to strengthen Norwegian private ownership and redirect savings from real estate to business investments. A 10 per cent valuation discount will be introduced for shares and operating assets, as well as associated debts in 2017, rising to 20 per cent in 2018. The announced system for deferred payment of net wealth tax for owners of businesses that are recording an accounting loss will be implemented with effect for the tax years 2016 and 2017. The changes to the tax system will promote investment in Norwegian businesses, facilitate higher employment and better protect the Norwegian tax base.

– The Government will reinforce its fiscal policy effort with measures to boost activity, employment and structural adjustment in 2017. Overall, the fiscal budget represents a budget impulse equivalent to 0.4 per cent of mainland GDP. Fiscal policy will thus continue to stimulate economic activity, although the impulse will be lower than in the budgets for 2016 and 2015, due to anticipated higher economic growth in Norway. Petroleum and fund revenue spending will rise to 3.0 per cent of the capital of the Government Pension Fund Global.
– The Government has earmarked about NOK 4 billion for special measures to combat unemployment. The measures will target southern and western Norway and the industries most affected by the petroleum industry downturn, and are designed to be readily reversible once the economic situation improves. The Government is if necessary ready to intensify its efforts.
– The Government is increasing investments in infrastructure, research and innovation. In line with the Government's political platform and the budgets for the past three years, next year's budget features new initiatives that will reduce the transportation costs of industry, strengthen innovation and enhance the qualifications of the population. These are important measures to reinforce Norway's growth capacity and achieve successful structural adjustment of the Norwegian economy.

The depreciation of the Norwegian krone is boosting growth in industries exposed to international competition, while low interest rates and expansionary fiscal policy are fuelling growth in domestic demand. The full effect of current expansionary economic policy has yet to be felt. Both the depreciation of the krone and the implemented tax reductions will also have effects in 2017.

Budget policy must contribute to increasing the return on the money spent in the public sector. Public sector activities must become more effective and efficient. The Government therefore wants to further strengthen its initiatives to improve performance and the return on invested resources. Public sector productivity growth allows the services on offer to be improved without additional expenditure, thereby also enhancing competitiveness and facilitating increased private sector activity.

In line with the fiscal rule, more of the increased petroleum revenue spending is directed towards investment in education, research and infrastructure, as well as growth-promoting tax reductions. The Government is resolving important current issues whilst simultaneously preparing Norway for the future.

The Norwegian economy is improving, but structural adjustment is still needed

The drop in oil prices two years ago marked the start of a powerful downturn in the Norwegian economy, featuring lower income growth, higher unemployment and structural re-adjustment. Recently the growth in the mainland economy has increased, and the economy appears to have passed a turning point last winter. Should the present development continue, with a registered unemployment rate well below the average over the past 25 years, the Norwegian economy will have come out of the slump in a better shape than initially anticipated when the oil price started falling. However, economic growth is not strong. Unemployment based on Statistics Norway's labour force survey is clearly higher than registered unemployment. Moreover, employment growth has been weak. Nonetheless, higher oil prices have contributed to reduce the risk of a sharp downturn in the Norwegian economy since last winter and spring.

Oil prices have risen since last winter, and forward prices indicate continued price growth. As a result, oil company revenues are improving, and the prospects for the supplier industry have improved somewhat. However, petroleum sector investments is expected to continue to fall next year, albeit by less than this year.

The Norwegian krone is significantly weaker than before the fall in the oil prices. This is a clear benefit to exporters, suppliers to the petroleum industry and other businesses exposed to international competition in the Norwegian domestic market. While it may take some time for improved competitiveness to take effect, higher activity levels are already apparent in some industries, such as the tourism industry. Furthermore, Norwegian suppliers have won a greater share of assignments linked to the Johan Sverdrup field development, and fish export revenues have risen significantly. The depreciation of the krone is an important shock absorber in the Norwegian economy, and exports from the mainland economy are expected to rise going forward.

Lower wage growth is also improving the competitiveness of Norwegian businesses. In line with the outcome of the wage settlement for sectors exposed to international competition, total annual wage growth is estimated at 2.4 per cent for 2016, significantly lower than in preceding years. However, Norway's cost level remains substantially higher than the average for Norway's trading partners.

Consumers have become more optimistic in their assessments of the economic outlook. This is due not only to low interest rates and the fact that households are benefiting from tax reductions, but also to improved economic prospects. Strong housing price growth is a further indicator of greater optimism among households regarding the future. Weak real wage growth is nevertheless expected to contribute to low growth in private consumption this year. The growth in total household demand for goods and services is expected to pick up in the years ahead. The increase in the number of start-up permissions for new housing projects suggests strong housing investment growth in 2016.

Businesses are also taking a brighter view of the future than before the summer, and anticipate rising production levels going forward. Growth in public-sector demand, improved competitiveness and a more gentle decline in petroleum-sector demand have supported the positive trend.

While several confidence indicators suggest a positive trend, employment growth remains weak. Although the employment rate has been reduced by lay-offs in petroleum-related industries, the effect on unemployment has been mitigated by the transfer of young people into the educational sector and a drop in labour immigration. The unemployment trend has been clearly twofolded since 2014. In southern and western Norway, and Rogaland County in particular, unemployment has risen sharply. In the majority of Norway's counties, however, registered unemployment has dropped over the past 12 months.

Uncertainty about the future of the European economy has increased over the summer, following the referendum on UK membership of the European Union. It may take several years to clarify the UK's broader economic relations with EU member states and Norway. In the USA, growth was unexpectedly weak in the first half of 2016, although it is expected to pick up over the next quarters. Sweden's growth rate is significantly above the average for the past 20 years. In China, growth is weaker than in preceding years, and uncertainty is high due to major economic imbalances.

Overall, mainland Norway GDP is forecast to grow by 1.0 per cent this year, about the same as last year. The growth estimate is 0.8 percentage points lower than forecasted last autumn. Next year, growth is expected to increase to 1.7 per cent before continuing to rise to a level slightly exceeding trend growth in the economy.

All of these estimates are uncertain. Long-term improvement of the terms of trade based on rising oil and gas prices quickly transformed into a significant deterioration. Going forward, petroleum industry demand will decline as a proportion of the mainland economy, a development which has been accelerated by falling prices. Structural readjustments will be required, particularly in industries which supply goods and services to the continental shelf. In addition, productivity growth dropped in the middle of the previous decade, and the aging of Norway's population is likely to result in lower labour force expansion going forward. Future growth will be lower than in the 10 to 15 years preceding the summer of 2014, when oil prices began falling.

Even though the household savings rate has fallen somewhat over the last year, most households are in a strong economic situation. Moreover the level of corporate investment is relatively low. In isolation, both variables suggest that demand for goods and services may increase more sharply than currently anticipated. On the other hand, if housing prices continue to grow strongly, the risk of a new downturn in the Norwegian economy will increase.

A well-adapted economic policy

The Government's political statement as included in the Sundvolden Declaration emphasises that petroleum revenue spending shall be tailored to the economic situation, within the limitations defined by the fiscal rule. There are now signs of improvement in the Norwegian economy. Mainland economic growth looks set to pick up, and unemployment in the country as a whole is expected to remain at the current level before falling somewhat in 2017. Going forward, it is crucial to

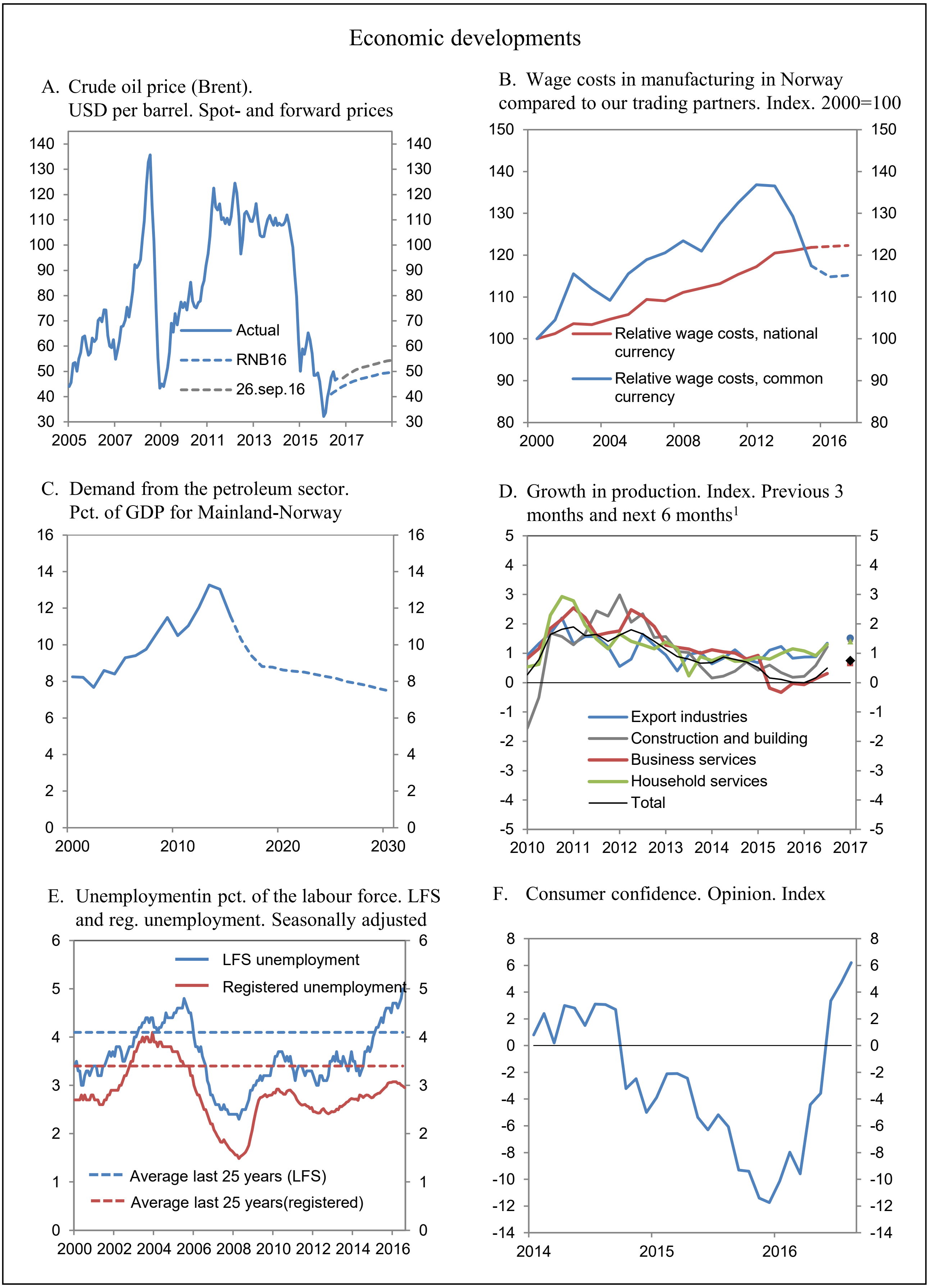


Figure 1 Economic developments

Sources: Macrobond, Statistics Norway, Ministry of Finance, Norges Bank, Opinion and The Norwegian Technical Calculation Commitee for Wage Settlement prevent unemployment from becoming entrenched. Moreover, the situation in southern and western Norway remains serious due to reduced petroleum industry activity, and continues to require targeted efforts.

Monetary policy is the first line of defence against a cyclical downturn. Interest rates may be changed swiftly if so indicated by economic prospects. The key policy rate is at a record low, and the Norwegian krone has depreciated significantly. The low interest rate implies that the scope for additional or major interest rate reductions is limited. A very low interest rate will over time also entail a risk of mounting financial imbalances and more risk-taking in the financial sector.

Fiscal and monetary policy need to interact when the economy is exposed to a cyclical downturn. In 2016, petroleum and fund revenue spending will increase by 1 per cent of trend-GDP for mainland Norway, considerably above the average for the past 10 to 15 years. The Government will continue to pursue a fiscal policy aimed at counteracting the prospects of sub-trend growth next year, albeit on a smaller scale. Moreover, the Government is proposing about NOK 4 billion in special measures to enhance employment, with an emphasis on areas and sectors hit hardest by the downturn in the petroleum industry. The Government's proposal will provide a fiscal budget stimulus equivalent to 0.4 per cent of trend-GDP for mainland Norway next year.

Growth-promoting tax reductions are a key element in the Government's policy. The economic effect of such measures normally takes some time to materialize. Calculations on the macroeconomic MODAG model indicate that the fiscal policy this year and next will boost mainland GDP by about ¾ per cent in 2017. The effect on private commerce will be greater, with an estimated increase in the gross product of private mainland industries of 1¼ per cent in 2017.

The strong depreciation of the Norwegian krone has improved business competitiveness, but as in the case of tax reductions it will take time before this development results in increased economic activity.

All in all, Norway's economic policy is now highly expansionary. The impulses include not only a substantially weaker krone, but also a historically low key policy rate and a significant fiscal policy stimulus. While a weaker krone is important for new growth in industries exposed to international competition, lower interest rates and expansionary fiscal policy are boosting domestic demand. Norway's fiscal policy is designed both to support activity levels in the short term and to promote structural adjustment and innovation.

Reduced demand for goods and services from the petroleum industry is a lasting structural change. The Norwegian economy will therefore need to have additional legs to stand on in the years ahead. Norway's foremost current challenge is to bolster private businesses and facilitate growth and employment in sectors exposed to international competition. Low oil prices have brought about structural adjustments more rapidly than expected. In the 2017 budget, the Government is intensifying its investment in activity and employment in the areas hit hardest by lower oil prices. In addition, fiscal policy has been made less expansionary to prevent enlargement of the public sector at the expense of private enterprise. More expansionary fiscal policy could slow adaptation to a more competitive wage and cost level, reduce labour market mobility and transfer manpower from the oil and gas industry to the sector sheltered from international competition, instead of to other undertakings exposed to international competition. Such a development would not be a sound response to the structural challenges facing the Norwegian economy.

Lower petroleum prices are reducing the revenues received by the Government Pension Fund Global, and thereby long-term fiscal policy leeway. Large, fluctuating and transient revenues from natural resources make it important for Norway to have a credible budget policy anchor. The Government Pension Fund Global and the fiscal rule serve to facilitate stability and strong economic growth in the mainland economy, whilst also making the petroleum and fund revenues available to future generations.

Measured in NOK, the capital of the Government Pension Fund Global has grown very rapidly in recent years. However, almost half of the increase in the Fund's value over the three-year period 2013-2015 was due to the depreciation of the krone, and has not resulted in greater international purchasing power. In 2016, the krone exchange rate has appreciated somewhat, reducing the value of the Fund. Looking ahead, Norway must be prepared for substantial fluctuations in the value of the Fund.

Although the adopted framework helps to

shield the Norwegian economy against short-term fluctuations in oil prices, lower oil prices mean that Norway has become poorer. Low international interest rates have weakened the Fund's real return prospects. It is likely that the real return will be lower than 4 per cent for the next 10 to 15 years. This restricts the scope for further increases in petroleum and fund revenue spending. The next few years are likely to see the start of a downward trend in the fund return measured as a proportion of mainland economic growth.

Norway's economy and competitiveness are affected by the amount of petroleum and fund revenues spent, but also by *how* the revenues are spent. Report No. 29 (2000-2001) to the Storting on guidelines for economic policy, emphasised that, within the available room for manoeuvre, priority should be given to tax reductions, infrastructure and research and development as means of promoting long-term growth capacity and competitiveness. The Storting endorsed this and emphasised that an increase in petroleum revenue spending should be directed towards measures to enhance productivity, and thus growth capacity, in the rest of the economy. The Standing Committee on Finance and Economic Affairs noted unanimously that tax policy, as well as a focus on infrastructure, education and research on the expenditure side, is important to create a more well-functioning economy. The Government continues to prioritise these areas in the budget for 2017.

To maintain more or less the same growth in living standards as Norwegians have become accustomed to over the last 40 years, productivity will need to increase more rapidly than in recent years. Moreover, public revenues will need to be spent sensibly to secure the long-term funding of welfare schemes. This requires targeted reforms in the public administration and in the rest of the economy. These efforts are well underway, not least in the form of follow-up of the recommendations of the Productivity Commission. Both Norwegian and international experience suggests that it may take time for reforms to result in higher productivity.

Labour utilisation is important for both economic growth and the sustainability of public finances. Employment is high in Norway, but average working hours are low. Accordingly, hours worked per capita is no higher than the average for the EU member states. At the same time, there are many recipients of social security benefits. The proportion of non-participants in the labour force due to illness or impaired work capacity is higher in Norway than in many other countries. Reducing this proportion is challenging, but important.

Norway's aging population will result in considerably higher expenditure on pensions and health and long-term care services in the years to come. Only a minor part of such increased expenditure can be funded by the revenues from the Government Pension Fund. The pension reform is designed to deliver long-term savings and to increase labour supply, but is insufficient to close the gap between government expenditure and revenues in the long run. Consequently, further measures are needed to secure the financing of existing welfare schemes.

Key figures in the budget for 2017

The Government's budget proposal for 2017 provides for a petroleum revenue spending of NOK 225.6 billion, as measured by the structural, non-oil deficit. This corresponds to 3.0 per cent of the Government Pension Fund Global as at the beginning of the year, or about NOK 42,000 per capita. Every seventh Norwegian krone spent by the general government is currently obtained from the Government Pension Fund. Petroleum and fund revenue spending via the fiscal budget is estimated at 7.9 per cent of trend-GDP for mainland Norway in 2017. The real growth in the underlying central government expenditures is estimated at 1.7 per cent, which is on a par with estimated growth in the mainland economy.

Change in the structural, non-oil deficit is often used as a simple yardstick for the effect of the budget on aggregate demand for goods and services. The Government is proposing to increase petroleum and fund revenue spending by NOK 15 billion from 2016 to 2017, with the special measures to combat unemployment accounting for about NOK 4 billion. The fiscal expansionary stance is estimated at 0.4 percentage points, measured as the change in the structural, non-oil deficit as a per cent of mainland GDP.

In line with the Government's objectives, total investment in human capital, infrastructure and tax reductions in the period 2014-2017 clearly exceeds the total spent by the previous government. Over the four-year period as a whole, about 14 per cent of the total budgetary room for manoeuvre has been committed to tax reductions, while 21 per cent has been used to reinforce education and public infrastructure. Further, increased expenditure through the national insurance scheme has absorbed 27 per cent of the room for manoeuvre, and just under 17 per cent has been used to strengthen local government finances, including local government investment in education and infrastructure.

The tax proposal

Tax is a means rather than an aim. The Government will use the tax system to fund public goods, ensure social mobility, achieve more efficient resource utilisation and improve conditions for Norwegian businesses. Private ownership must be strengthened, and working, saving and investing are to be more profitable. Such a tax policy will also have a favourable dynamic impact on the economy. Increased labour force participation and higher economic growth will extend the tax base, thus funding part of the tax reduction over time.

In its 2017 budget, the Government is proposing tax changes to strengthen incentives to save, invest and work. The Government is also proposing a green shift, whereby polluters will pay more for the costs they inflict on society, and revenues generated by environmental taxes will be returned to taxpayers in the form of sectoral tax reductions and compensation through the expenditure side of the budget. The Government's proposals entail new tax reductions totalling approximately NOK 2.8 billion accrued and NOK 1.7 billion booked in 2017.

The Government is prioritising implementation of the tax reform in accordance with the parliamentary tax agreement. The tax rate on ordinary income for companies and individuals is to be reduced from 25 to 24 per cent in 2017, with a further reduction to 23 per cent planned for 2018, in accordance with the agreement. The petroleum tax and economic rent tax on hydropower will be adjusted on a revenue-neutral basis. Viewing corporate income tax and personal dividend tax collectively, the total marginal tax on dividends will be kept at the present level. The risk-free rate of return used in the shareholder, partner and business models will be increased by 0.5 percentage points before tax, and a share investment account scheme is proposed to allow deferred taxation of gains on listed shares and equity funds. The reduction in tax on ordinary income is partly funded by higher bracket tax, although tax reductions will be given at all income levels. The largest marginal tax reductions are proposed for the lowest income levels. The Government also proposes to increase the rate and upper limit of the basic allowance for wages and benefits, and to raise the lower threshold for the payment of employee's social security contributions.

The Government is proposing further reductions in net wealth tax to promote Norwegian private ownership. The valuation of shares and operating assets, as well as associated debts, is reduced by 10 per cent. Further, a deferred payment scheme will be introduced for net wealth tax (for the tax years 2016 and 2017), for owners of businesses which are producing accounting deficits. These proposals will limit the negative effects of net wealth tax on Norwegian ownership and businesses.

In accordance with the parliamentary tax agreement, the Government proposes to introduce a Financial Activity Tax on wages and profits in the financial sector. The tax on wages will be set at 5 per cent of gross salaries paid. Moreover, the corporate tax rate for financial undertakings will be kept at the 2016 level. Accordingly, financial undertakings will not be included in the general reduction in tax on ordinary income. Profits from financial undertakings will then be taxed 1 per cent higher than others. The purpose of the Financial Activity Tax is to tax the value added by financial service provision which is currently exempt from value added tax. The Government is also implementing the proposal in the white paper on taxation to eliminate supplementary initial depreciation on machinery. The SkatteFUNN scheme will be expanded to make it even more attractive for businesses to invest in research and development.

The proposal for a green tax shift is part of the follow-up on the Green Tax Commission's report. The tax shift implies higher taxes on greenhouse gas emissions and fuel consumption. The tax increases are more than compensated for by sectoral reductions in other taxes and further compensatory measures. The Government is also implementing the parliamentary agreement from the 2016 budget by proposing higher road usage tax on fuel gas (LPG) and increased sales requirements for biofuels. The motor vehicle registration tax will be further changed to promote the use of environmentally friendly vehicles.

The Government's main priorities

The Government has in the budget for 2017 given priority to measures promoting employment, improved welfare and increased security. The measures respond to the cyclical downturn in the short run and pave the way for long-term structural adjustments to create new jobs in sectors exposed to international competition as the petroleum industry gradually becomes a less important economic driver.

The budget initiatives focus particularly on the eight areas highlighted in the Sundvolden Declaration, whilst expenditure is reduced for certain other items.

– *Competitiveness for Norwegian jobs.* Declining petroleum industry demand is testing Norway's ability to implement structural adjustments. Reduced activity in the petroleum industry is not a short-term cyclical phenomenon, but rather a more long-term structural change. The Government is proposing lower taxes and an expansion of infrastructure, innovation, research and knowledge to improve long-term growth capacity. The Government will give priority to general, national schemes to promote commercial research and innovation. This will help ensure that the best projects are successful in getting support, and that a smaller share of appropriations is spent on administration. In addition to expanding the Innovation Norway's national entrepreneurship grant scheme, the appropriations for the Programme for User-driven Research-based Innovation and FORNY2020 are to be kept unchanged at the increased levels established in the 2016 budget. The Government is also proposing to expand the SkatteFUNN scheme. As part of its efforts to digitalise and modernise the public sector, the Government proposes to embark on the development of a new administrative processing system at the Brønnøysund Register Centre. The new system will benefit businesses through simplifications and savings.
– *The Government will build the country.* Large-scale investments in roads, rail and public transport will continue. Reduced transport costs improve business competitiveness and promote well-functioning housing and labour markets across the country. The budget proposal implies that the financial requirements for the first four-year period of the National Transport Plan 2014–2023 (NTP) will be significantly exceeded, and reduces the road toll burden on motorists. The Norwegian Public Roads Administration is due to launch two major new national roadbuilding projects in 2017. It is proposed that the appropriation to the development company NyeVeier be increased in line with the Government's aim to make an annual grant of NOK 5 billion to the company in 2018. Greater efficiency and economic profitability in the transport sector are a further aim of the Government. The budget proposal will improve the management of existing infrastructure through the provision of increased resources for operation and maintenance. An annual grant of NOK 500 million is proposed to reduce road toll rates in non-urban areas. Further, an increased grant is to be made to support part-financing by central government of urban public transport projects. The Government will continue to invest in maintenance and renewal of the railways. The budget proposal ensures good progress on all initiated railway projects, and the planning of new projects. Steps will be taken to facilitate implementation of the railway reform in 2017. A three-year pilot project providing grants for the transfer of goods from roads to the sea is to be established under the Norwegian Coastal Administration.
– *Knowledge creates opportunities for all.* Knowledge is acquired throughout life. That is why the Government has high ambitions for quality at all levels, from kindergartens, via schools, to higher education and research. This will provide opportunities to all and lay a solid foundation for increased competitiveness, economic growth and welfare. A draft act on early intervention in schools will be sent on hearing, and local government will receive increased funding to reinforce early-intervention initiatives. Anti-bullying efforts in kindergartens and schools will be strengthened. As part of the Teacher Enhancement Programme, the Government will introduce new five-year primary school teacher training programmes at Master level as of 2017. The plan to increase the period for which students receive educational support to 11 months will be followed up on in the spring of 2017 by paying full-time students in higher education and attending vocational colleges support for one-quarter of a month longer than provided for

by the current guidelines. Implementation of the long-term plan for research and higher education will include the creation of 120 new recruitment positions, new research infrastructure, increased subsidies for participation in Horizon 2020 and larger research grants.

- *A simpler life for people*. The Government will further emphasize the freedom of individuals. Lower taxes will give individuals more freedom in using their own income. Digitalisation allows public services to be made more user-friendly, and the simplification of reporting. Almost 70 per cent of businesses' reports to the authorities can now be made digitally, up from some 50 per cent four years ago. The purpose of the Government's simplification project is to identify simplification measures in the public administration and reduce the cost to businesses of complying with official reporting requirements and regulations. The Government's measures – and measures to simply communication between businesses and the public administration via the Altinn portal – have thus far generated savings for businesses of NOK 11 billion annually, including NOK 6 billion under the present Government. An appropriation of NOK 440 million is proposed for the modernisation of the ICT systems of the Norwegian Labour and Welfare Administration (NAV). User contact with the public administration will be digitalised, and local NAV offices will be given more local freedom and greater expert resources. Electronic title registration will become operational for professional users in the spring of 2017. It is also important that the public can examine how central government spends tax revenues. The Government will publish key figures to permit comparison of resource utilisation by different administrative services across central government.
- *Improved security*. The budget proposal paves the way for an increase in police district capacity and for the number of new police positions to equal the number of new graduates from the Norwegian Police University College. The police service's current helicopters are old. Two new helicopters will be purchased, with an option for a third. Together, these measures will increase the visibility of the police and improve the police service's capacity to prevent, investigate and prosecute criminal offences. Allocations are proposed for modernisation of the police service's ICT solutions and a new analysis system for the Norwegian Police Security Service (PST). Steps will be taken to improve PST's ability to avert digital espionage and sabotage. The execution of sentences will be made more efficient by increasing electronic monitoring capacity, planning a new prison in Agder, completing new prison places at the prisons in Ullersmo and Eidsberg, and continuing to lease prison places in the Netherlands. Court capacity will also be increased, including through the digitalisation of court processes. As proposed in the new long-term plan for the Norwegian Armed Forces, increased activity and greater stand-by capacity are planned for the Army, Navy, Air Force and Home Guard. A new ranger squadron attached to the Sør-Varanger garrison has been proposed, as well as increased Navy maintenance. The ability of the Norwegian National Security Authority and the Norwegian Cyber Defence Force to detect and deal with ICT attacks will be improved. The future number of asylum seekers is highly uncertain. The Government will maintain some of the increased capacity established in the Norwegian Directorate of Immigration, the Directorate of Integration and Diversity, the police, the Norwegian Civil Defence and PST in connection with the increase in asylum seeker numbers in the autumn of 2015. This will improve stand-by capacity and help reduce backlogs in the immigration administration. Further, an increase in the grant given to municipalities which host asylum centres has been proposed, as have additional grants for the settlement of refugees and unaccompanied minors. Measures to promote integration will be strengthened. The Government is prioritising return efforts by maintaining high forced-return targets and providing more funds for return work at asylum centres. Increased funding is also proposed for the identification work of the police and the immigration administration. Norway has helped alleviate the refugee situation in the Mediterranean, and will maintain its contribution to the Frontex operations Triton and Poseidon.
- *A welfare boost for the sick and elderly*. The Government aims for everyone to have access to equivalent health services of a good quality. The Government wishes to reduce waiting times which are unnecessary and not due to medical reasons, and is giving priority to the treatment of psychiatric patients and substance abusers. The budget proposal gives scope for expanding the treatment of patients in hospitals by around 2.1 per cent, which represents continued strong growth. Investment loans are proposed for a new hospital in Stavanger, upgrading of the central block at

Haukeland Hospital, a new psychiatric building at Sørlandet Hospital and upgrades under Førde Hospital Trust. The plan to expand habilitation and rehabilitation will be published at the same time as this budget proposal, and NOK 200 million in funding is proposed for the escalation plan, including NOK 100 million in the form of growth in unrestricted local government revenues. The services offered to persons with substance abuse problems will be improved by requiring regional health authorities to prioritise specialised, inter-disciplinary substance abuse treatment, and by earmarking NOK 300 million of the increase in unrestricted local government revenues for the plan to expand efforts to combat drug and alcohol abuse (2016–2020). The creation of additional full-time care places will be facilitated by providing investment grants for a total of 1,800 places in 2017. The grant scheme will be gradually restructured so that, as of 2021, grants will only be given for investments resulting in a net increase in the number of spaces. Steps will also be taken to create additional day places for persons with dementia who live at home.

– *A stronger social safety net.* It is important to prevent people from falling outside the labour market and important social arenas. This is why the extraordinarily high level of labour market measures is being maintained and the opportunity to receive unemployment benefit while temporarily laid off has been expanded. A new youth initiative will give job seekers under the age of 30 the opportunity to participate in a work programme after eight weeks of unemployment. The scheme will be launched in southern and western Norway first. A fast-track into the labour market will be established for refugees with in-demand expertise, which will incorporate measures such as wage subsidies combined with Norwegian language training. It is important to prevent young people from becoming passive. The Government is therefore proposing the introduction of an activity duty for benefit recipients under the age of 30. The Government also proposes to expand the care benefit scheme and make it more flexible so that care obligations can be better combined with labour force participation. It is important to ensure a safe and positive childhood for all children. Efforts will be intensified to reduce violence in close relationships and protect children vulnerable to violence and assault. Appropriations to the national child welfare service will be increased to enable the service's heavier workload to be dealt with through the purchase of private child welfare services.
– *Vibrant local democracy.* The Government will renew and improve the local government structure to build stronger municipalities which are better equipped to resolve tomorrow's welfare challenges. Subject to a parliamentary resolution, a regional reform will be implemented at the same time with the aim of reducing the number of elected regions from 19 to around 10. The local government reform and regional reform are to be implemented simultaneously, so that new municipalities and regions can begin operating from 1 January 2020. Robust and foreseeable local government funding is important for municipalities and county authorities to be able to perform their tasks. In 2017, the real increase in unrestricted local government revenues will total close to NOK 4.1 billion, while total revenues will increase by NOK 3.4 billion in real terms, as calculated by reference to the estimated level of revenues in 2016 following the Storting's consideration of the Revised National Budget for 2016.

It is a particular challenge that many people are now losing their jobs in the industries and counties most affected by low oil prices. The Government is proposing special *measures for increased employment* totalling approximately NOK 4 billion as part of the budget. The measures will particularly target southern and western Norway and oil-related industries. The Government has emphasised that priority shall be given to temporary measures which are capable of taking rapid effect and can be reversed if conditions so indicate. The measures include grants for maintenance work by municipalities and hospital trusts in southern and western Norway, the surfacing of roads, walkways and cycle paths, flooding and landslide protection, the DEMO 2000 research programme, upgrading of research vessels and Navy maintenance work, as well as grants for the maintenance of churches and repair of museums. Further measures include the continuation of labour market measures at a high level, expanded entitlement to unemployment benefit during temporary lay-offs, and motivational grants for laid off and terminated apprentices. Recruitment posts at universities and university colleges, and new student places, will be kept at a high level, as will general schemes targeting the commercial sector. The Government will also accelerate the procurement of new coastguard vessels by two years. In the interests of national security, only Norwegian companies will be permitted to participate in the procurement, which will generate new work for Norwegian yards from 2018 onwards.

The Government will administer taxpayer funds with respect and combat wasteful spending. The Government will therefore continue its de-bureaucratisation and effectivisation reform in 2017. Reducing bureaucracy and requiring a higher return on money spent releases resources for priority objectives.

Financial stability and the housing market

In order to facilitate financial stability, Norwegian authorities are committed to promoting solvency, liquidity and sound conduct through government regulation and supervision. The rules governing Norway's financial services industry largely reflect EU and EEA rules.

Favourable developments in the Norwegian economy have contributed to strong performance and robust earnings on the part of Norwegian financial institutions. Banks, in particular, have registered strong revenues, capital adequacy and profits. The market share of Norwegian banks in the Norwegian banking market has remained fairly stable since 2008. Capital adequacy continues to be tightened to satisfy new capital requirements in force since the summer of 2013. The strong performance of banks suggests that these will be well placed to improve their solvency further. The combination of guaranteed payments, rising life expectancy and ongoing low interest rates represents a challenge for life insurers. The introduction of new solvency rules means that companies will over time become subject to capital requirements that better reflect the risks they face.

Financial imbalances normally build up over a long period before triggering a crisis. The most important instruments for preventing financial instability are framework conditions that ensure that financial institutions are solvent at the individual level. Even if financial institutions appear individually solvent, imbalances may increase systemic risk in the financial markets, and the risk of financial instability. In recent years, greater emphasis has therefore been given to the need to reinforce supervision and regulation of the financial system as a whole to identify and reduce systemic risk.

The strong growth in house prices could threaten financial stability. A slowdown in house price growth during last autumn and winter has been followed by renewed, strong growth throughout the spring and summer. Nationally, house prices have risen by 8.8 per cent over the past year. Regional differences remain, but Rogaland is the only county where house prices have fallen the past year. While house prices have risen by 15 per cent in Oslo over the last 12 months, they have fallen by approximately 6 per cent in Stavanger. Household debt continues to grow faster than household disposable income, and continued strong growth in house prices raise the prospect of further debt escalation. Many people who experience loss of income will have to cut back on consumption to service their debts. This may trigger a drop in house prices, reinforce a downturn in the Norwegian economy and threaten financial stability.

The Government has adopted a number of measures to slow house price growth and improve the capacity of the financial system to deal with a drop in house prices. Capital requirements for banks have been increased. Good lending practice requirements for housing purchases have been tightened, and Finanstilsynet (the Financial Supervisory Authority of Norway) has recently proposed further restrictions. Finanstilsynet's proposals have been sent on hearing, and the Government will return to the matter later this autumn. In the context of net wealth tax, the valuation discount for second homes has been reduced to 20 per cent, and the Government is now proposing a corresponding cut in the value of debt allocated to second homes.

The Government has made various proposals to make it easier and quicker to regulate for construction of new homes. The Government has also made proposals to reduce construction costs for new buildings. Together, these measures will cut development costs, strengthen competition in the residential construction sector and create a more flexible housing market capable of responding more rapidly to higher prices and demand. Residential construction has escalated in 2016, and is expected to continue to do so in 2017. Over time, this will help improve the balance in the housing market.

Employment and income policy

High employment and low unemployment are key economic policy priorities for the Government. Employment policy is aimed at facilitating a flexible labour market, to enable as many people as possible to work and use their abilities, and to give businesses access to the skills they need.

Labour market measures are an important part of efforts to help the unemployed to return to work quickly during an economic downturn, and to protect vulnerable groups with weak or few in-demand skills against permanent exclusion from the labour force. The number of work placements has been increased significantly over the past couple of years, and the Government proposes to maintain the current high level in 2017. The priorities for measures in 2017 are young people, immigrants from non-EEA countries and persons in southern and western Norway left unemployed by the downturn in the petroleum industry.

The Government will intensify efforts targeting vulnerable young unemployed persons and persons with reduced work capacity under the age of 30. Today's system of youth guarantees will be replaced by a new youth initiative. The aim is to improve the individual follow-up provided by local NAV offices to motivate unemployed persons to look for work and transition more quickly into employment or education.

The rules on unemployment benefit for persons who have been temporarily laid off were further expanded on 1 July of this year in response to the challenging situation in some segments of the labour market, and because the social partners identified this as an important instrument. Changes have also been made to make it easier to participate in educational programmes while receiving unemployment benefit. As the unemployment rate varies considerably between different parts of the country, it is important to enforce the mobility requirements under the unemployment benefit regulations.

The pension reform has been designed to increase the labour supply and thereby improve the robustness of the pension system as life expectancy increases. The effects of the reform are limited by the fact that public-sector pension schemes have not been amended. The Government intends to continue working with the social partners on a solution consistent with the principles of the pension reform.

Wage bargaining is the responsibility of the social partners. Coordinated wage bargaining, in which key industries in sectors exposed to international competition are the first to bargain, is intended to keep wage growth within limits that are sustainable over time for undertakings exposed to international competition. The authorities are responsible for ensuring that laws and regulations facilitate a well-functioning and flexible labour market. Income policy cooperation helps the authorities and social partners to develop a common understanding of the economic situation and the challenges facing the Norwegian economy. Wage settlements that are tailored to the economic situation will serve to reduce the impact of lower petroleum industry demand on production, jobs and unemployment.

The Cappelen Committee, which examined the consequences of lower oil prices and high refugee immigration for wage determination, issued its recommendations on 20 September 2016. The recommendations have been sent on hearing, and the Government will return to the matter in the Revised national budget for 2017.

Measures to promote a more productive and efficient economy

Weak productivity development in Norway is a cause for concern. The Government is premising its policy on the objective of making the most effective and efficient use of society's resources, and is committed to increasing productivity in the Norwegian economy. Efficient resource utilisation in the private and public sectors will boost economic growth, and is therefore important in terms of living standards and the sustainability of welfare schemes. Moreover, good capacity for structural adjustment will leave the Norwegian economy better placed to respond to changing international realities. The Government is committed to a continuous efficiency enhancement effort.

In its two reports (Official Norwegian Report (NOU) 2015:1 and Official Norwegian Report (NOU) 2016:3), the Productivity Commission examined a broad range of areas and proposed numerous measures to improve productivity growth. A particular priority was the need to effectivise the public sector. Special emphasis was given to creating a more purposive administrative structure, including through local government reform, and the considerable efficiency gains promised by implementation of best practice. Public sector effectivisation is also important for productivity growth in the private sector. Among other things, the Commission identified public sector ICT projects as an area with potential to generate substantial gains for businesses and households.

Climate policy

The climate challenge is global in nature, and is best solved globally. At the United Nations Climate Change Conference held in Paris in December 2015, agreement was reached on a global climate agreement. The main objective of the agreement is to strengthen global efforts to combat climate change such that the average temperature increase is kept well below 2°C compared to pre-industrial levels, and to seek to restrict the temperature increase to 1.5°C. To achieve this, the agreement establishes a collective emissions target. The parties' aim is to turn the increase in global greenhouse gas emissions into a rapid reduction as quickly as possible, so that a balance is achieved between anthropogenic emissions and greenhouse gas absorption in the second half of this century (climate neutrality).

Norway ratified the agreement on 20 June. Thus far, 29 parties representing just under 40 per cent of emissions have acceded to the agreement. The Paris Agreement will enter into force once 55 countries representing at least 55 per cent of emissions have ratified it.

Norway has a conditional obligation to reduce its greenhouse gas emissions by at least 40 per cent by 2030, compared to the level of emissions in 1990. This is in line with the estimates of the Intergovernmental Panel on Climate Change regarding the steps necessary to achieve the 2°C target, and matches the EU's commitment. Norway is engaged in a dialogue with the EU concerning an agreement on joint fulfilment of the climate obligation.

The Government is pursuing an ambitious climate policy and reinforcing the parliamentary climate agreement. The most important climate policy measures are taxes and EU ETS participation. This year's budget strengthens the Government's climate policy. The Government is proposing a green tax shift as part of its follow-up of the work of the Green Tax Commission. The proposal envisages an increase of up to NOK 1.6 billion in taxes on greenhouse gas emissions and fuel consumption. Among other things, higher road usage tax on auto diesel and petrol will improve the pricing of external costs of road usage. The tax increases will be more than compensated for by sectoral reductions in other taxes and direct compensation. Motorists and transporters will in total get a net benefit of some NOK 900 million in the form of lower annual motor vehicle tax, reduced road tolls, a higher tax deduction for travel expenses and increased depreciation rates. The Government proposes to continue investing in the development of energy and climate technologies, including through Enova and the establishment of a new investment company. Climate research will be strengthened, and carbon capture and storage will be promoted. The railway investment programme will continue.

Implementation of UN Sustainable Development Goals

In September 2015, the UN adopted new global sustainable development goals for the period to 2030. The 17 goals and 169 secondary targets cover most parts of society. The overarching goal is to eliminate extreme poverty and hunger. There are also several other universal goals, including protection of human rights, the natural environment and economic development, and reduction of inequalities. The goals build on the eight Millennium Development Goals adopted by the UN in the year 2000 for the period 2000–2015.

The Government has appointed a coordinating ministry for each of the 17 sustainable development goals. The coordinating ministries will report on their follow-up of assigned goals in their budget proposals. The Ministry of Finance has coordination responsibility for goal 8 (relating to economic growth and employment), and goal 10 (relating to the reduction of inequalities).

Table 1. Key figures for the Norwegian economy. The national budget 2017

	2015	2016	2017
Real economy. Percentage change from the previous year. Volume.			
Private consumption	2,1	1,4	2,3
Public consumption	2,1	2,6	1,7
Gross fixed investment	-3,8	0,0	1,6
Of which: Public sector	3,0	5,3	5,1
Petroleum extraction and pipeline transp.	-15,0	-14,0	-10,0
Demand from Mainland Norway[1]	1,8	2,5	2,6
Exports	3,7	-0,3	-0,4
Of which: Traditional goods	5,8	-1,5	4,6
Imports	1,6	-0,5	3,0
Gross domestic product	1,6	1,2	0,6
Of which: Mainland Norway	1,1	1,0	1,7
Labour market.			
Employment, persons (percentage growth)	0,3	0,2	0,7
Unemployment rate, LFS (level)	4,4	4,7	4,6
Unemployment rate, registered (level)	3,0	3,1	3,1
Prices and wages. Percentage change from the previous year			
Annual wage	2,8	2,4	2,7
Consumer price index (CPI)	2,1	3,4	2,0
Underlying inflation (CPI-ATE)	2,7	3,0	2,1
Oil price. NOK per barrel (level)	430	371	425
Interest rates and exchange rates			
Three-month money market rates (pct.)	1,3	1,1	1,0
Import -weighted exchange rate (yearly change in pct.)[2]	9,4	2,8	0,1
Central government			
Non-oil deficit, NOK billion	185.3	220.2	259.5
Structural non-oil deficit, NOK billion	169.8	205.6	225.6
Deviation from 4%-path, NOK billion	-87.4	-92.8	-71.2
Fiscal impulse, per cent of trend-GDP mainland Norway[3]	0.6	1.0	0.4
Real underlying expenditure growth, per cent.	2.8	3.3	1.7
Government Pension Fund Global, NOK billion[4]	7 461	7 420	7 671
General government			
Financial balance (NOK billion)	200.8	96.0	97.5
In per cent of GDP	6.4	3.1	3.0

1 Excluding inventory changes.
2 A positive number indicates a depreciation of the krone.
3 Measured by the change in the structural, non-oil deficit as a share of trend-GDP mainland Norway.
4 End of year.
Sources: Statistics Norway and Ministry of Finance

Appendix 1

Norway's fiscal framework

Norway's petroleum industry presents particular challenges for fiscal policy in ensuring a stable economic development. The public revenues from petroleum are large, vary considerably from year to year, and will be depleted over time. Many countries have found that temporary large revenues from natural resource exploitation produce relatively short-lived booms that are followed by difficult adjustments as production and revenues diminish. Moreover, income from non-renewable resources like oil and gas should also benefit future generations.

The Government Pension Fund Global (GPFG) and the fiscal rule for the use of oil and fund revenue address these challenges, and are designed to support a stable development of the Norwegian economy in both the short and long term. The State's net cash flow from the petroleum industry is transferred in full to the GPFG, in addition to the direct returns from the Fund itself. The fiscal rule specifies that the transfers back from the Fund to the central government budget shall, over time, reflect the expected real return on the Fund. The implementation of the rule is based on a real return of 4 per cent. This framework *delinks the earning and use of petroleum revenue*, which is a necessary condition for sound macroeconomic management. The framework helps buttressing petroleum price volatility and lessens the risk of overspending.

The fiscal rule is a long-term guide for the use of the money in the GPFG. It also puts emphasis on evening out economic fluctuations to contribute to good capacity utilisation and low unemployment. Several mechanisms have an effect in this regard. Spending of petroleum income is measured by the non-oil structural budget deficit. This means that the fiscal rule allows automatic stabilisers to play out in full. The automatic stabilisers in the budget are estimated to be stronger in Norway than in many other countries due to Norway's comprehensive welfare systems. The spending rule also allows budget policy to be used actively to stabilise production and employment. However, experience indicates that fiscal policy has a limited capacity for fine-tuning of the business cycle. Since 2001, monetary policy has been the first line of defence in the policies for economic stabilisation.

Together, the fiscal rule and the GPFG comprise a fiscal framework that insulates the fiscal budget from fluctuations in petroleum revenue, stemming either from volatile oil and gas prices or from changing production or investments in the petroleum sector. Through the GPFG, a large proportion of the State's oil and gas income is invested in other countries. Investing foreign exchange earnings abroad protects the krone against the large, varying foreign exchange earnings generated by the petroleum industry. The fiscal policy framework thus supports Norway's monetary policy, and lays a foundation for more stable expectations in the currency market.

Following a decline in the second half of the 1990s, the use of petroleum revenue has increased again since 2001, see figure A1. Nevertheless, measured as a share of trend-GDP for mainland Norway, the level is not much higher now than in the 1980s and early 1990s, and is now also based on the expected real return of a large fund. The figure shows how the spending rule helps

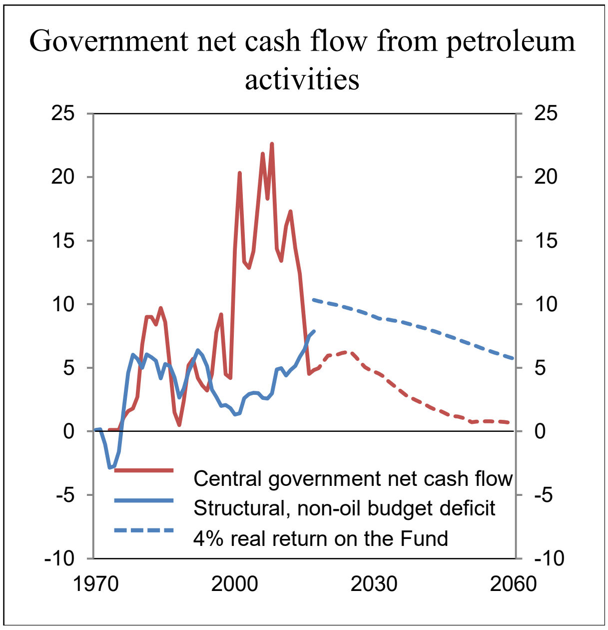


Figure A.1 The State's net cash flow from the petroleum sector, the structural, non-oil deficit and 4 per cent real return on the Government Pension Fund Global. Per cent of trend-GDP for mainland Norway

Sources: Ministry of Finance and Statistics Norway.

Norway to convert substantial, yet temporary and fluctuating income from the petroleum industry into more stable spending over public budgets. Norway has managed the most intensive harvesting phase fairly successfully. The contribution of Fund returns to the Fiscal Budget as a proportion of mainland GDP may increase for some more years, and then peak. The proportion will then fall gradually as flows into the Fund diminish and the mainland economy continues to grow.

The last three years have seen a rapid increase in the value of the GPFG. In September this year the value of the Fund amounted to more than 2½ times mainland GDP. Much of this increase is due to a weaker NOK exchange rate, which does not affect the Fund's international purchasing power. Experiences show that both exchange rates and equity and bond prices can change significantly in a short period of time, and that these changes can go both ways. Volatility in the Fund's value and return may become more significant both in relation to the size of the state's other incomes and in relation to the underlying growth in the mainland economy. High volatility may make the expected return of the Fund less appropriate as a short-term operative target for fiscal policy. An expert commission has assessed the application of the fiscal rule in light of the stark increase in the value of GPFG, possible relative low real rate of return the forthcoming 10 – 15 years and long run challenges the Norwegian economy is facing. The commission has advised a more cautious spending of fund revenues than the current 4 per cent rule over the coming 10-15 years. The government will address the reccommendations from the expert commission in the forthcoming (spring 2017) white paper on Long-term Perspectives for the Norwegian Economy. These considerations will also be based on the the recommendations from the Commission that assess the equity portion of the GPFG.

Appendix 2

Calculation of the structural, non-oil budget balance

The total public budget surplus can vary considerably from year to year without this being the result of structural changes in the budget. To get a better picture of the underlying development of budget policy, it is sensible to examine the development of the budget balance excluding petroleum-industry revenue and expenditure. It is also useful to correct for factors such as the effects of economic fluctuations on direct and indirect taxes and unemployment benefit, see table A.1.

The classification of public revenues and expenditure into a cyclical and a structural part cannot be based on direct observations, but needs to be estimated on the basis of analyses of accounting figures, economic statistics and projections for coming years. The distinction between cyclical and structural changes is usually made on the basis of estimated trend levels for the relevant variables. The findings may be influenced by new economic development data, and are subject to revision even after the national accounts for each year have been finalised.

The calculation of structural direct and indirect taxes is based on data on actual revenues recognised in the national accounts, as well as forecasts for the projection period. The calculations also include taxes on income and wealth payable to municipalities, and essentially cover the period 1960–2015, extended to 2025 using forecasts. The projection period is based on the Ministry of Finance's medium-term projections and the continuation of the proposed tax programme for 2017. The assumptions may be summarised as follows:

- *Taxes on labour.* This category includes employers' national insurance contributions and personal taxes, including net wealth tax levied on individuals. The development in the number of normal man-years employed is an important indicator of developments in employers' national insurance contributions and total personal taxes. The estimates are based on population projections from Statistics Norway, which among other things assume high immigration from the EEA.
- *Taxes on capital.* This category includes taxes paid in arrears by companies and other non-individual taxpayers outside the petroleum industry, withholding tax and inheritance tax (until its abolition as of 2015). It has been assumed that taxes from enterprises outside the petroleum industry will remain approximately unchanged as a proportion of mainland GDP after 2017.
- *Indirect taxes.* This category includes value added tax, motor vehicle registration tax and

Table A.1 The structural, non-oil budget deficit. NOK million

	2015	2016	2017
Non-oil budget deficit	185 312	220 248	259 506
+ Net interest payments and transfers from Norges Bank. Deviation from trend	716	17 937	7 185
+ Accounting technicalities	-989	-281	-6 155
+ Taxes and unemployment benefits.Deviation from trend	-15 223	-32 296	-34 927
= Structural, non-oil budget deficit	169 815	205 607	225 609
Measured in pct. of trend-GDP for mainland Norway	6,5	7,5	7,9
Change from previous year in percentage points (budget impulse)[1]	0,6	1,0	0,4
Memo:			
Income from investments in The Government Pension Fund Global.[2] Estimated trend	171 155	184 490	196 987
Structural, non-oil budget deficit, including income from investments	-1 339	21 117	28 622
Measured in pct. of trend-GDP for mainland Norway	-0,1	0,8	1,0

[1] Positive figures indicate that the budget has an expansionary impact
[2] Does not contain capital gains or -losses
Source: Ministry of Finance.

other excise duties, and other indirect taxes including stamp duty and miscellaneous sectoral taxes. It also includes the investment tax until its abolition in 2002. Private consumption developments are an important influence on indirect taxes.

On the expenditure side of the budget, a cyclical correction is made to unemployment benefit expenditure based on estimated trend deviations for the number of unemployment benefit recipients.

Developments in the three main groups of direct and indirect taxes and the number of unemployment benefit recipients are shown in Figures A.2A to A.2D.

Developments in the non-oil and the structural, non-oil fiscal budget surplus are shown in Figure A.3. As regards the surpluses in the years 1987–1988 and the small deficits in 2001 and 2007, it is important to note that these years marked the ends of lengthy, strong cyclical up-

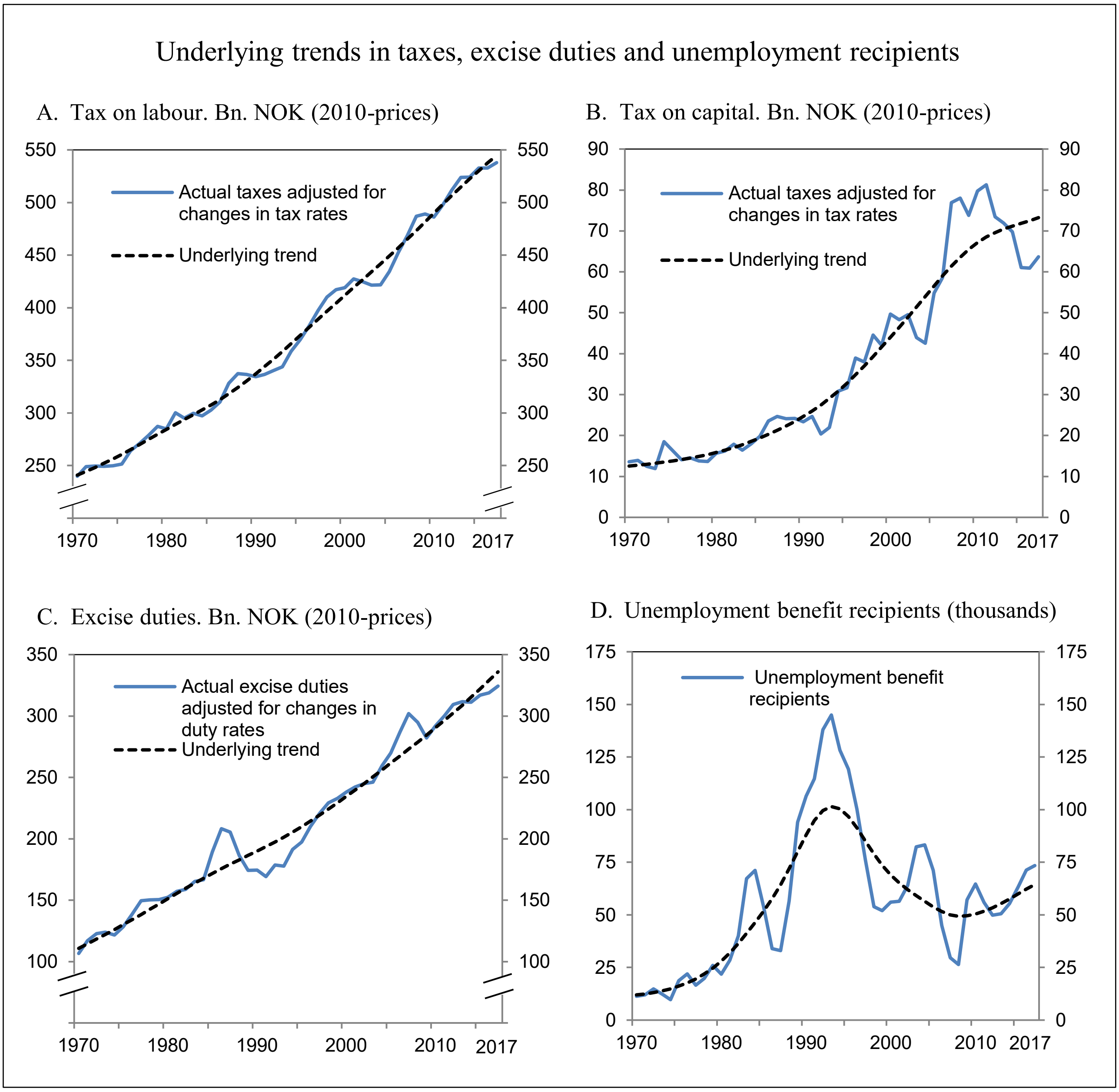


Figure A.2 Underlying trends in direct and indirect taxes and the number of unemployment benefit recipients

[1] For years up to and including 2015, actual taxes as per the national accounts are shown adjusted for changes in tax rates and the tax base and converted into fixed 2010 prices.

[2] A correction is made to take into account that unemployment benefit recipients may be partly unemployed, by converting the number of recipients into full-time equivalents.

Sources: Ministry of Finance and The Norwegian Labour and Welfare Administration.

turns. With the exception of these years, fiscal budgets since 1975 have generally registered significant running deficits when revenues and expenditure relating to the petroleum industry are excluded, although there have been major variations during the period.

The structural, non-oil deficit is now higher than at the end of the 1970s and in the 1980s, see red line in figure A.3. Back then, however, we did not have a fund to help finance the budget. The income from the Fund does not enter the state budget, but is a part of the total surplus for the state budget and the Government Pension Fund. Including the income from the Fund, the structural, non-oil deficit is now close to zero, compared with big deficits in the 1970s and 1980s. This illustrates that the Norwegian fiscal framework with the Government Pension Fund and fiscal rule has contributed to a more responsible wealth management over time.

In the national accounts and public budgets, capital gains are not recorded as income. This part of the Fund's return does therefore not enter the deficit illustrated by the green line in figure A.3. Appreciation of the fund's assets may over time account to a significant part of the fund's total return. The structural, non-oil deficit, including income from the fund, could therefore be somewhat below zero over time without depeleting the wealth of the Fund.

The fluctuations in the structural, non-oil deficit are related to the fact that the budget has at times been used actively to stabilise production and employment trends. The figure shows that the fluctuations in the non-oil deficit are considerably larger than the fluctuations in the structural, non-oil deficit. This is due to the objective of allowing the automatic stabilisers in the budget to function so that cyclical fluctuations in direct and indirect tax revenues, as well as in unemployment benefits, do not influence the expenditure side of the budget.

Experience shows that it is difficult to distinguish the impact of economic cycles from the underlying tax revenue trend. The estimated structural, non-oil deficit may thus be revised considerably if new information emerges.

The petroleum sector generates large, but fluctuating, revenues for Norway. From 1970 until the present day, an industry has been developed whose value added has over the ten last years varied around 17 to 33 per cent of mainland GDP.

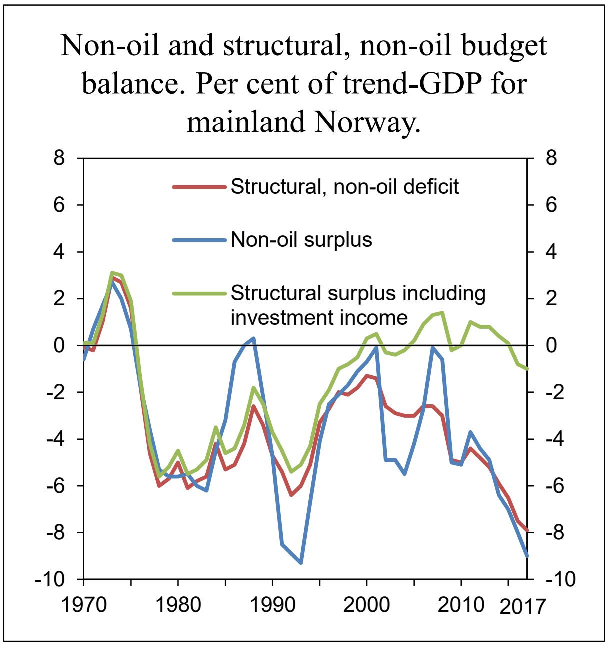


Figure A.3 Non-oil and structural, non-oil budget balance. Per cent of trend-GDP for mainland Norway.

Source: Ministry of Finance.

Appendix 3

The role of the petroleum sector in the Norwegian economy

The petroleum industry contributes, through its demand for goods and services, to considerable activity and to a range of jobs in the Norwegian mainland economy as well. The tax system and the State's Direct Financial Interest (SDØE) ensure that most of the net extraction revenues accrue to the State. Such revenues make a major contribution to the funding of the welfare state and the strengthening of public finances. The State's net cash flow from petroleum activities has represented about 30 per cent of the State's total income since 2000. How the petroleum revenues are handled in fiscal policy is discussed in Appendix 1.

Growth in aggregate demand from the petroleum sector was particularly steep from the mid-1970s to the mid-1980s. Subsequently, demand from the sector fluctuated around a fairly stable level as a percentage of mainland GDP, before picking up significantly again over the period 2005 -2013. In 2014 this trend stopped and last year the demand from the petroleum sector fell sharply, in line with the fall in the oil price. Going forward it is estimated that the demand as a share of mainland GDP will fall.

Direct mainland economy demand from the petroleum sector may be grouped into investments, intermediate inputs and wage costs.

Investments make the biggest share of aggregated demand. In 2015 the petroleum investments corresponded to around 7 per cent of mainland economy value added.

Intermediate inputs have increased gradually. For a long time offshore production increased faster than mainland economy production.

The productivity in the extraction sector is high. Direct petroleum industry employment only accounts for about 1 per cent of overall employment in Norway. Consequently, *wage costs* are low relative to the costs associated with investments and intermediate inputs. Yet the wage level is distinctly higher than the average level within the mainland economy.

Development of the petroleum activities has given rise to a large Norwegian supply industry. As a result a substantial part of total employment is directly or indirectly attached to the petroleum sector. The highest concentration of such employment is found in areas on the southwest coast, but there are supply enterprises in all parts of the country. Moreover, petroleum revenue spending via the fiscal budget results in a higher level of public sector employment.