DET KONGELIGE
FINANSDEPARTEMENT

Royal Ministry of Finance

The National Budget 2018

A summary

National Budget 2018

Main economic policy features and outlook for the Norwegian economy

A policy for employment, activity and structural adjustment

Faced with the most severe oil and gas price slump in 30 years, the Government has over the last few years actively used fiscal policy to counter unemployment. This has worked as intended. Targeted fiscal policy has, along with low interest rates and a distinct improvement in competitiveness, served to promote growth and reduce unemployment, also in southern and western Norway where economic activity was the most affected by lower oil prices. Economic growth is expected to be in line with trend growth this year and higher than trend growth next year. For the current year, this represents a significant increase from previous estimates, and the rebound appears to be swifter than had been anticipated.

The foremost challenge in coming years will be to create new profitable jobs in private sectors, primarily in those exposed to international competition. Norway's wealth is premised on international trade and free markets. Longer-term welfare development in Norway is determined, in particular, by the growth capacity of the mainland economy. High labour utilisation and productivity growth are the foundations for strong economic growth.

The petroleum industry has for several decades been a key driver for economic growth in Norway. Demand from this industry has stimulated activity in the mainland economy and generated high incomes and an ever-increasing number of well-paid jobs. The petroleum industry will remain important for the Norwegian economy for years to come, but will provide less of a growth impetus than before. Hence, new growth in other industries needs to be promoted. The petroleum industry has itself been leading the way on structural adjustment, and is now delivering profits at a much lower oil price than it was capable of only a few years ago.

The last few decades have been a golden period for the Norwegian economy, as well as for Norwegian public finances. Key economic trends have worked in our favour. The tide is now turning. The Government Pension Fund will not continue to grow at the same rate. Returns are expected to be lower than before, and it is not anticipated that the oil price will regain its former peaks. An aging population means that a smaller proportion of the population is working and paying tax, whilst expenditure on pensions, as well as on health and care services, will mount. Hence, the room for fiscal policy manoeuvre will be much less over the next 10-15 years than we have become accustomed to. When the time perspective is extended, the pressure on public finances becomes more severe. Revenues need to be increased, or expenditure decreased.

High employment is a cornerstone of Norwegian society. For individuals, having a job means stable income, personal development and participation in a social arena. At the same time, comprehensive government-funded welfare schemes are predicated on a balance between the number of people contributing to revenues and the number of people receiving benefits. It therefore poses a challenge to both individuals and society if many people fall outside the labour force.

We need to build skills to enable more people to participate in economic life, and to allow more people to stay on in jobs for longer now that we live longer lives. Highly skilled manpower is important for productivity, whilst at the same time offering more choice for individuals.

Wealth must be created before it can be shared. The appropriate response to the structural adjustment challenge is to facilitate new profitable jobs in private sectors exposed to international competition, and not to preserve old structures. All areas of Norway shall have growth capacity and an equitable standard of living. The Government will therefore continue to promote a business-friendly environment, 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. Competition promotes productivity growth and efficient resource utilisation. Structural adjustment involves the establishment and development of new businesses. Promoting such adjustments therefore requires a regulatory framework that is conducive to start-ups.

Public spending represents a large part of the Norwegian economy. The Government emphasises the need for balance between the public sector and the private sector. We need to get more value from public spending. The public sector needs to become more effective and efficient. The Government therefore wants to focus more on performance and value for money. Public sector productivity growth means that services can be improved without increasing expenditure, which also enhances competitiveness and facilitates new private sector initiatives.

The Government is committed to ensuring high employment and low unemployment. The economic policy framework for 2018 addresses both short- and long-term challenges:

- The Government's policy promotes activity, employment and structural adjustment. After several years of steep increases in petroleum revenue spending, the outlook for the Norwegian economy suggests a fiscal policy normalisation in 2018. Growth is picking up and unemployment is declining. The Government is therefore proposing a neutral fiscal policy stance. Petroleum revenue spending corresponds to 2.9 percent of the capital of the Government Pension Fund Global. The budget orientation, with tax reductions and a focus on infrastructure, research and innovation, promotes growth and structural adjustment. The same applies to monetary policy, with business competitiveness being strengthened by a weaker Norwegian krone than before the oil price decline. Real growth in underlying fiscal budget expenditure is estimated at 1.0 percent, which is well below estimated growth in the mainland economy.
- 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 percent in 2013 to 24 percent in 2017, and the Government is proposing a further reduction to 23 percent in 2018. Reductions in net wealth tax are also being proposed to strengthen Norwegian private ownership and redirect investments from real estate to jobs by increasing the valuation discount for shares and operating assets from 10 percent to 20 percent in 2018. The Government is making a number of proposals that will expand tax bases and improve the tax system. The changes to the tax system will promote investment in Norwegian businesses, facilitate higher employment and better protect the Norwegian tax base.
- In line with the Government's political platform and the budgets for the past three years, there is a continued focus on health, transport, education and local government services. We thereby prioritise the welfare schemes on which people depend, whilst at the same time facilitating a long-term strengthening of the growth capacity of the Norwegian economy. The budget proposal also reflects a continued effort to bolster national security and emergency response preparedness through, inter alia, infrastructure investments for the police and the armed forces.

The Government is conducting a responsible economic policy based on the fiscal rule for the spending of petroleum revenues. Petroleum revenue spending is, in line with the fiscal rule, directed towards investments in knowledge and infrastructure, as well as growth-promoting tax reductions. The Government is strengthening welfare at present, whilst safeguarding Norway for the future.

The Norwegian economy is on the rebound, but remains affected by the oil price decline

The oil price decline three years ago spurred a major economic setback, and the Norwegian economy was for a long time characterised by low income growth, redundancies and increasing unemployment. This has now turned into an economic recovery that has gradually strengthened. Businesses across the country are reporting of higher production. Households have also become more optimistic over the last year. Growth in the Norwegian economy has outpaced expectations thus far this year, and unemployment is declining. Low interest rates, a distinct improvement in competitiveness and expansionary fiscal policy have been important drivers.

Improved household purchasing power and higher petroleum investments will serve to strengthen economic growth over the next couple of years. Mainland businesses may at the same time realise higher exports and investments as the competitiveness improvements continue to filter through. For next year, we expect the mainland economy to outpace trend growth, capacity utilisation in the economy to increase, and the labour market improvements to continue.

The economic growth outlook is supported by higher growth in the world economy. Strong investment growth and a continuation of expansionary economic policy in traditional industrialised countries contribute to increasing economic growth abroad. Developments in confidence indicators and in financial markets offer a positive outlook. In Europe, growth has finally improved, and unemployment in the euro zone has declined gradually over the last three years. Growth in China remains high, and the outlook for commodity-exporting countries such as Brazil and Russia is improved. The US economy has experienced increased growth over the course of this year, but expectations that fiscal policy will be less expansionary than previously assumed have served to reduce growth forecasts. In Sweden, expansionary monetary policy has facilitated high economic growth.

In Norway, economic policy has provided a strong growth impetus. The interest rate level is historically low at 0.5 percent, and fiscal policy has delivered significant and targeted measures. Such a response to the steep oil price decline has contributed to the rebound in economic growth.

According to national accounts, growth in the mainland economy was above trend in both the 1st and 2nd quarter of this year. Activity picked up in most industries. Businesses in the regional network of Norges Bank have reported production increases over the last few months and are expecting continued expansion, and will also be investing more over the next twelve months. Other business confidence indicators confirm this improvement.

Petroleum investments look set to be higher over the next few years than previously anticipated, with an increase expected already next year. Oil companies are now accelerating projects because there is spare capacity in the supply industry, and the cost level has been lowered. The Sverdrup and Castberg fields will account for a large share of investments on the Norwegian continental shelf in coming years. In addition, there will be a number of other developments.

The Norwegian krone has depreciated considerably in the wake of the oil price decline. This represents a distinct improvement for export businesses, petroleum industry suppliers and other businesses exposed to international competition in the Norwegian domestic market. Adaptations to improved competitiveness take time, but tourism and aquaculture are examples of industries with high growth in revenues. We expect exports and investments to increase gradually moving ahead.

Low wage growth also serves to improve 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 percent this year. The cost level in Norway nonetheless remains substantially higher than the average for Norway's trading partners.

Consumers have become more optimistic in their assessment of the economic outlook. One reason is that interest rates are low, but the optimism also reflects that the Norwegian economy is on the mend. Growth in total household demand for goods and services is expected to pick up in coming years. The increase in the number of start-up permissions for new housing projects is indicative of high housing investment growth this year. Lower growth in housing prices and population point to somewhat lower housing investments ahead, but the level of investments will remain high. After steep housing price growth last year, prices have been falling for the last few months, especially in Oslo. The housing market is currently characterised by a large number of homes for sale, particularly in Oslo. It is not unexpected for price growth to level off after a period of such steep growth. Expanded housing construction may contribute to continued moderate development in housing prices in coming years.

The labour market is improving. Registered unemployment declined for the ninth month in a

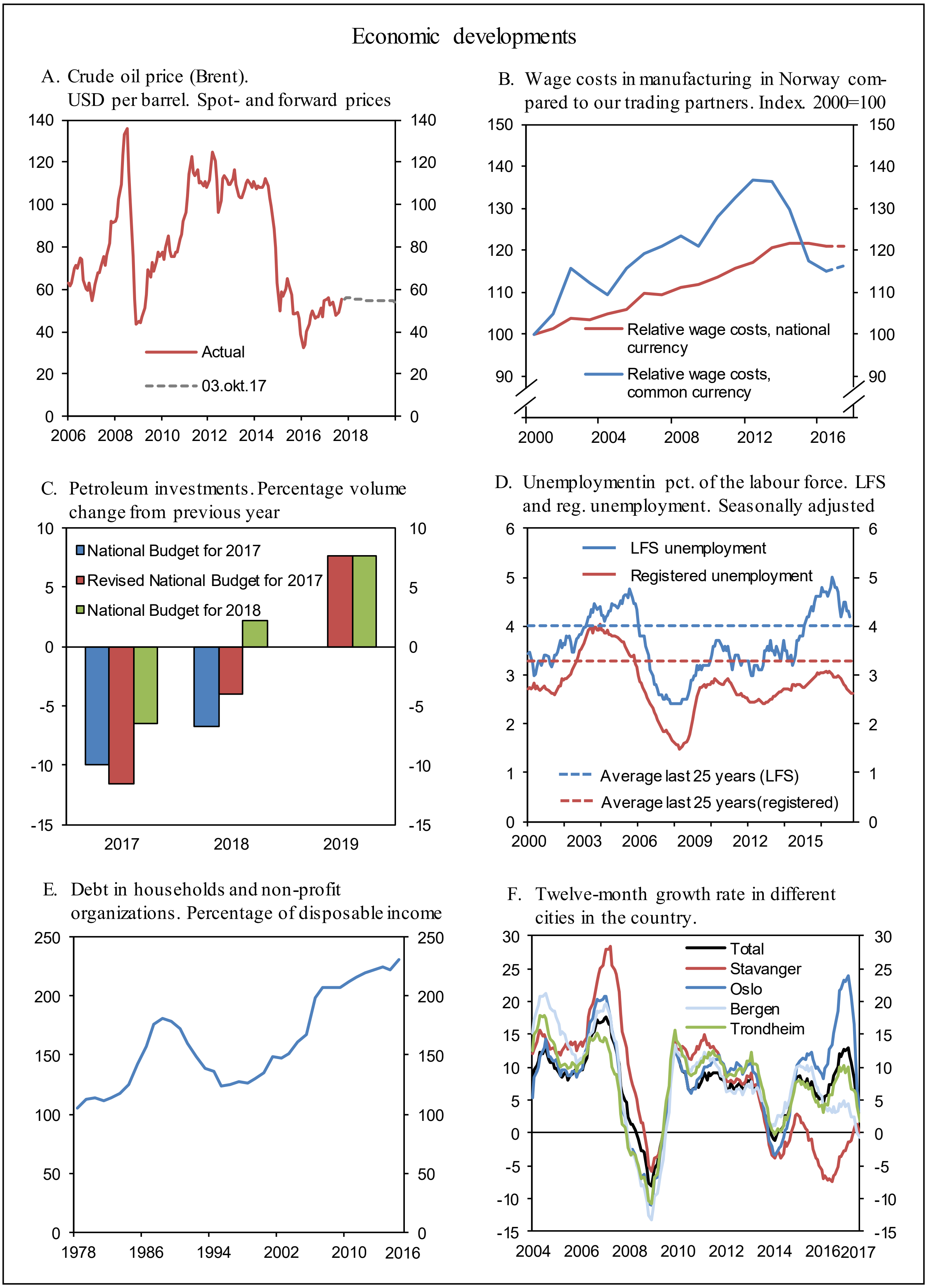

Figure 1 Economic developments

Sources: Macrobond, Statistics Norway, Ministry of Finance, Norges Bank and The Norwegian Technical Calculation Committee for Wage Settlement row in August, and represented 2.6 percent of the labour force (seasonally adjusted) in September. The unemployment figure based on Statistics Norway's labour force survey was 4.2 percent in July, down from 4.7 percent in 2016. Unemployment is falling all over the country, including in southern and western Norway. Employment developments were weak for a long time, but have according to national accounts improved this year. Labour market improvements are expected to continue as economic growth picks up.

Overall, mainland Norway GDP growth is forecast to 2.0 percent this year. This growth estimate is 0.4 percentage points higher than forecasted last spring. For the next two years, growth is expected to increase to 2.5-2.6 percent, well above trend growth in the economy.

The estimates are uncertain. The Brexit negotiations and uncertainty about the policies of the US administration add uncertainty to the international economic outlook. Protectionism and a higher conflict level between countries may rapidly undermine world economic growth. However, in the short run a strong upsurge in optimism amongst businesses and households, especially in Europe, may result in even higher economic growth. The steep credit growth in some countries, including China, adds uncertainty in the medium run.

In Norway, a high debt burden may result in many households having to curtail consumption in the event of an interest rate increase or if housing prices were to continue to fall for a prolonged period of time. This may inhibit the recovery. On the other hand, the increase in business investment may be stronger than anticipated, after a long period of weak growth.

A well-adapted economic policy

The Sundvolden Declaration emphasises that petroleum revenue spending shall be tailored to the economic situation, within the limitations defined by the fiscal rule. Expansionary fiscal policy can avert recession, but can also amplify economic fluctuations if policy is not modified in a more neutral direction when the economic outlook changes.

Growth-promoting tax reductions are an important component of the Government's policy. The economic effect of such measures normally takes some time to materialise. Furter, the strong depreciation of the Norwegian krone is improving business competitiveness, but it takes time before this gives rise to increased economic activity.

After several years of steep increases in petroleum revenue spending, the outlook for the Norwegian economy suggests a fiscal policy normalisation in 2018, i.e. a neutral fiscal policy stance, see figure 1A. Petroleum revenue spending is estimated to correspond to 2.9 percent of the capital of the Government Pension Fund Global, the same level as for the current year, and below the expected real return of the fund.

It is of decisive importance to retaine the improved competitiveness. This implies that fiscal policy should be tightened before monetary policy. If a continued expansionary fiscal policy were to result in monetary policy being tightened earlier than currently anticipated, the risk of a Norwegian krone appreciation is increased.

Lower demand for goods and services from the petroleum industry is a lasting, structural change. The Norwegian economy will therefore need additional growth drivers in the years ahead. Our foremost challenge is to bolster private businesses and facilitate growth and employment in sectors exposed to international competition. Continued expansionary fiscal policy when the economic outlook improves could inhibit adaptation to a more competitive wage and cost level, impair labour market mobility and transfer manpower from the oil and gas industry to the sector sheltered from international competition, instead of to the other industries exposed to international competition. Such a development would not be a sound response to the structural challenges facing the Norwegian economy.

We are now facing a new fiscal policy phase. Petroleum revenue spending has been expanded considerably since the fiscal rule was introduced in 2001. This trend is now being bucked.

Firstly, petroleum prices around the current level and gradually declining production in the North Sea will result in lower new capital inflow to the Government Pension Fund Global than we have become accustomed to. Secondly, the real return estimate was reduced from 4 to 3 percent in the white paper on Long-term Perspectives on the Norwegian Economy 2017, which was published in March this year.

All in all, the value of the Fund is no longer expected to increase as a portion of output in the mainland economy. Consequently, the scope for further expansion of petroleum revenue spending is limited. The average fiscal policy stance in the years ahead should therefore be more or less neutral, but shall continue to be tailored to the cyclical situation of the Norwegian economy in any given year. A decade from now, Fund returns will most likely be on a downward path when measured as a portion of output in the mainland economy, because growth in the Fund capital cannot keep up with growth in the mainland economy.

It was anticipated, upon the introduction of the fiscal rule, that new inflows of capital to the Fund would someday decline, and that revenues from the investments in the Government Pension Fund would become more important. Central government revenues from the Government Pension Fund have now outpaced inflows from petroleum activities. Oil price uncertainty has thereby become gradually less important, whilst uncertainty as to the market value of the Fund's investments is of greater significance as far as central government revenues are concerned. A major decline in the Fund capital would, when taken in isolation, suggest that petroleum revenue spending should be curtailed. The petroleum revenue spending guidelines are flexible for precisely the reason that fiscal policy shall be enabled to handle such situastions and support balanced development in the Norwegian economy. The petroleum revenue spending impact of major changes to the Fund capital or the structural deficit shall be evened out over several years – and this applies to both upward and downward fluctuations.

Norway's economy and competitiveness are affected by the amount of petroleum revenues spent, but also by *how* these are spent. Report No. 29 (2000-2001), a white paper on guidelines for economic policy, emphasised that the increase in petroleum revenue spending should be focused on measures likely to improve the productivity, and thus the growth capacity, of the rest of the economy. In deliberating the white paper on Long -term Perspectives on the Norwegian Economy 2017, the Standing Committee on Finance and Economic Affairs noted unanimously that the Storting emphasised, in 2001, that petroleum revenues could not become an excuse for avoiding necessary systemic reforms. The Standing Committee on Finance and Economic Affairs unanimously endorsed the key prioritisation from 2001, calling for spending to be focused on infrastructure, knowledge and growth-promoting tax reductions. The Government is continuing its prioritisation of these areas in the budget for 2018.

To maintain more or less the same growth in the standard of living as Norwegians have become accustomed to over the last 40 years, productivity will need to increase more rapidly than in the last 10-12 years. Moreover, public revenues will need to be spent sensibly to secure the long-term funding of welfare schemes. This requires a continuation of targeted reforms in the public administration and 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 which was appointed by the Government in 2014, and delivered its recommendations in 2015 and 2016. Both Norwegian and international experience suggests that it may take time for reforms to result in higher productivity.

High 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 are 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-labour force participants 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 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 it is not sufficient to close the gap between central government expenditure and revenues in the long run. New measures will be needed to secure the funding of existing welfare schemes.

Key figures in the budget for 2018

The Government's budget proposal for 2018 provides for a petroleum revenue spending of NOK 231.1 billion, as measured by the structural, non-oil deficit. This corresponds to 2.9 percent of the estimated capital of the Government Pension Fund Global as at the beginning of the year. This is below the long-term fiscal rule of 3 percent, and corresponds to 7.7 percent of mainland Norway trend GDP. Real growth in un-

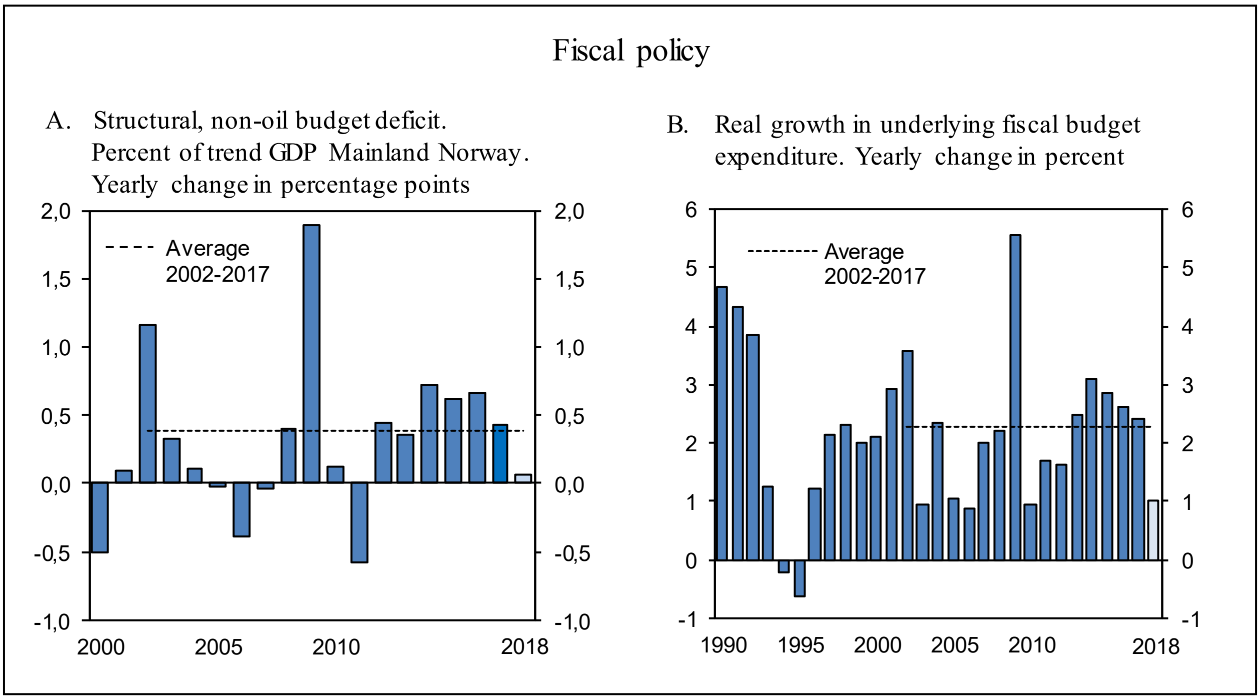

Figure 2 Fiscal policy
Source: Ministry of Finance

derlying fiscal budget expenditure is estimated at 1.0 percent, see figure 1B, which is well below 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 revenue spending by NOK 6 billion from 2017 to 2018, measured in fixed prices. The fiscal expansionary stance is less than 0.1 percent, as measured by the change in the structural, non-oil deficit as a percentage of mainland Norway GDP. This means that the budget has a neutral effect on economic activity.

The consolidated surplus on the Fiscal Budget and the Government Pension Fund, including NOK 213.6 billion in interest and dividends, is estimated at NOK 141.3 billion, see table 1. The general government financial balance is estimated at NOK 133.0 billion, equivalent to 3.9 percent of GDP.

The tax proposal

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 shall be strengthened, and working, saving and investing shall become more profitable.

In order to consolidate the positive developments in the Norwegian economy, the Government is giving priority to tax changes that will strengthen the growth capacity of the economy, facilitate structural adjustments and generate new jobs. The tax reform is followed up in accordance with the parliamentary tax agreement by further shifting the tax burden from corporate tax and taxes on savings and labour to other taxes, whilst revenues from the economic rent industries remain unaffected. This is in line with international recommendations from, inter alia, the OECD.

It is proposed that the marginal tax rate on wages be reduced for the vast majority of people, and by most for those earning the lowest incomes. The tax rate on ordinary income for individuals and corporations is reduced from 24 to 23 percent, and the valuation discount for shares and operating assets in the net wealth tax is increased from 10 to 20 percent.

The Government is making a number of proposals to improve the tax system and fund tax reductions that are more conducive to enhancing the growth capacity of the economy. These include, inter alia, changes to the deduction rules for commuters food expenses, abolition of tax class 2, abolition of the special discount for electric cars in the taxation of company cars and an increase in the low rate of value added tax.

The Government is also proposing a number of

Table 1. General government financial balance. NOK million

	2016	2017	2018
Central government financial balance	137 675	172 775	148 153
Fiscal Budget surplus and Surplus in Government Pension Fund	113 020	149 800	141 283
Non-oil budget surplus	-208 388	-232 373	-255 366
Net revenues from petroleum activities	124 779	175 373	183 049
Interest and dividends on the Pension Fund	196 629	206 800	213 600
Surplus in other central government and social security accounts	1 468	1 177	1 175
Definitional differences between Fiscal Budget and national accounts[1]	23 188	21 798	5 695
+ Local government financial balance	-11 573	-8 268	-15 145
= General government financial balance	126 102	164 507	133 007
In per cent of GDP	4.0	5.0	3.9

1 Includes central government accrued but not recorded taxes. Direct investments in state enterprises, including government petroleum activities, is defined as financial investments in the national accounts.
Sources: Statistics Norway and Ministry of Finance.

changes to improve the climate and environmental impetus of the tax system. Several of the proposals of the Green Tax Commission are followed up, such as to improve the pricing of environmental damage. The Government proposes, inter alia, that the CO_2 tax be made more effective by abolishing exemptions and low rates.

It is proposed, in follow-up of a petition resolution from the Storting, that the weight allowance against the motor vehicle registration tax for plug-in hybrid cars be differentiated by electric range from 1 July 2018. Electric cars will also be granted a full weight allowance upon it now being proposed to abolish the exemption from motor vehicle registration tax for electric cars. Electric cars will still be accorded significant advantages in comparison with cars running on fossil fuels.

It is proposed that the low rate of value added tax be increased from 10 to 12 percent. This serves to strengthen value added tax as a general tax on consumption.

The Government is also proposing several changes to the property tax rules, including changing the valuation rules for «works and installations» under the property tax in such a way that machinery and equipment shall no longer, as a main rule, be subject to property tax.

Total new tax reductions in 2018 as the result of the Government's proposals are about NOK 3.0 billion accrued and NOK 0.7 billion booked.

The Government's priorities

The Government has in the budget for 2018 given priority to measures promoting job creation, improved welfare and increased security. The measures are tailored to the economic outlook 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.

- *Competitiveness for Norwegian jobs*. Declining demand from the petroleum industry has tested Norway's ability to implement structural adjustments. Lower activity in the petroleum industry is not simply a short-term cyclical phenomenon, but rather a more long-term structural change. Handling this challenge has been a key objective of the Government's economic policy. Economic growth is currently on the rise, whilst unemployment is falling. This goes to show that the Government's policy is working, and that businesses are restructuring. This has been facilitated by a sound general regulatory framework and improvements to the tax system, most notably the reduction in corporate tax. The same applies to the targeted measures for southern and western Norway. Special schemes for stimulating entrepreneurship and innovation are additional thereto. The Skattefunn research and development (R&D) tax incentive scheme has been expanded and appropriations for research and innovation have increased significantly in recent years. The focus has been on general, national schemes.
- *The Government will build the country*. The

National Transport Plan for 2018-2029 (NTP) has been published. The strong focus on road, rail and public transport is maintained. Reduced transport- costs improve access for businesses and facilitate well-functioning housing and labour markets across the country. Close to NOK 61 billion is proposed for NTP purposes in 2018, i.e. about NOK 3 billion more than in the consolidated budget for 2017. Appropriations for the development company Nye Veier AS will be increased in line with the Government's ambition of making an annual grant of NOK 5.3 billion to the company from 2018 onwards. The budget proposal is giving priority to the commencement of a major public-private partnership (PPP) road project in 2018 (Rv 3/Rv 25 Ommangsvollen – Grundset/Basthjørnet in Hedmark). Moreover, commencement of three major new national road projects under the Norwegian Public Roads Administration is proposed for 2018 (E16 Eggemoen – Olum in Buskerud and Oppland, E6 Kappskarmo – Brattås – Lien in Nordland and E69 Skarvberg tunnel in Finnmark). The focus on expanded road maintenance is continued, such as to improve road standards. Furthermore, increased grants for central government co-funding of key public transport projects in the largest cities are proposed. The commencement of two new railway projects as part of the inner InterCity network, along the Dovre railway (Venjar – Eidsvoll – Langset) and the Østfold railway (Sandbukta – Moss – Såstad) is being facilitated. Good progress of initiated projects is facilitated, and more resources are proposed for the planning of new projects. The high level for railway operation and maintenance is continued.

– *Knowledge creates opportunities for all*. Knowledge is acquired throughout life. The Government has high ambitions for quality at all levels of education – from kindergartens, via schools, to higher education and research. This will provide opportunities for all and lay a solid foundation for improved competitiveness, economic growth and welfare. A proposal for the introduction of an obligation for schools to provide intensive reading, writing and numeracy teaching for pupils in years 1–4 who are at risk of lagging behind in their education was circulated for consultation in the summer of 2017. NOK 200 million of the increase in unrestricted local government revenues is earmarked for early intervention in kindergartens and schools, whilst the same objective is reinforced via the budget of the Ministry of Education and Research. The expansion of the period for which students receive educational support to eleven months is followed up by the payment of educational support for an additional one-quarter of a month to full-time students in the spring of 2018. The long-term plan for research and higher education will be followed up by, inter alia, increased appropriations for research - infrastructure, increased subsidies for participation in Horizon 2020 and initial - appropriations for a new life sciences building at the University of Oslo. Businesses shall in future have access to sufficient skills, and funds are proposed for adding capacity in vocational colleges and for expansion of ICT studies.
– *A simpler life for most people*. The Government will further emphasise the freedom of individuals. Lower taxes will give individuals more freedom in using their own income. Digitalisation enables public services to be made more user-friendly and allows for reporting to be simplified. Almost 70 percent of businesses' reporting to the authorities is now being effected digitally, up from some 50 percent four years ago. The Government's simplification project shall identify simplification measures in the public administration and reduce the costs to businesses of complying with official reporting requirements and regulations. The Government has aimed to reduce the annual costs to businesses of complying with official reporting requirements and regulations by NOK 15 billion by the end of 2017, relative to the costs in 2011. The annual savings to businesses as at the beginning of 2017 are estimated to be about NOK 15.2 billion, including the Government's proposal for amendments to the Accounting Act, which will be deliberated by the Storting in the autumn of 2017. The Government is proposing NOK 612 million for new ICT and digitalisation measures in 2018. In order to speed up digitalisation, the Government is proposing, inter alia, NOK 100 million for the funding of local government ICT projects. In addition, major ICT initiatives are continued in key areas, including the modernisation of ICT in the Norwegian Labour and Welfare Administration, a modernised national population register and a new systems solution for tax administration. In addition, it is proposed that a project for new digital tax returns to be launched in the Tax Administration. This project is expected to deliver significant time savings for businesses and individuals. The public shall also be able to examine how central government spends tax revenues. October 2017 will see the launch of statsregnskapet.no, a new web portal that makes it easy for citizens

and the media to obtain information from the central government accounts and the accounts of central government entities.

- *Improved security and enhanced emergency response preparedness*. The Government is focusing on the police. The budget facilitates the procurement of three new police helicopters, the establishment of a new national emergency response centre and enhanced police efforts for integration in Oslo south. At the same time, it allows for stricter requirements on border controls in the Schengen Area. The Government wants to make the arrival phase for newly arrived asylum seekers efficient and predictable. Further development of the arrival centre function is therefore being proposed. Capacity expansion in the penal service is facilitated through the establishment of a new prison in Agder, the continued leasing of prison places in the Netherlands, and expansion of penal implementation by way of electronic control. The intention is to reduce prison queues and to speed up the transfer of remand prisoners from police custody suites to prisons. The procurement of new search and rescue helicopters is continuing. The long-term plan for the Norwegian Armed Forces is followed up with major expansion of key capacities. The establishment of a ranger squadron attached to the Sør-Varanger garrison is continuing, and funds for training and exercises in the Air Force and the Navy are increased. Increased appropriations are proposed for object protection, the Norwegian Intelligence Service and the Norwegian National Security Authority. Allowances are made for Norwegian contributions to NATO- and UN-led foreign operations. Ambitions for the fighter plane procurement are maintained. ICT security is improved by, inter alia, paving the way for more international fibre cable connections, a pilot for an alternative core network and additional funds for ICT security in the petroleum industry. The Government is initiating the preparation of sound plans for the future decommissioning and demolition of the Norwegian nuclear reactors, and the storage of domestic nuclear waste. For 2018, the Government is proposing the establishment of a new government body for the decommissioning of nuclear facilities and the secure handling of nuclear waste.
- *A welfare boost for the sick and the elderly*. The Government aims for everyone to have access to equivalent health services of good quality. The Government wishes to reduce patient waiting times that are unnecessary and not medically motivated, 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 about 2 percent, which represents continued strong growth. Investment loans are proposed for a new hospital in Nordmøre and Romsdal, for expansion and modernisation of Haugesund Hospital and for a new clinic building at the Norwegian Radium Hospital. In addition, investment loan appropriations for projects that have already been commenced, including a new hospital in Drammen, are maintained. 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, through the NOK 300 million of the increase in unrestricted local government revenues reasoned by 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 1,800 places in 2018.
- *A stronger social safety net*. It is important to prevent people from falling outside the labour market and key social arenas. The Government is therefore proposing a continuation of the special youth initiative. The initiative is aimed at persons under the age of 30 years who have been unemployed for at least eight weeks and who have not been offered work placements, education or jobs. It is also proposed to continue the expanded effort for long -term unemployed persons who are nearing the end of their unemployment benefit period, such as to get more of them back into work. The Government proposes the establishment of a permanent service dog scheme, expansion of the wig grant scheme, expansion of grants for reading and secretarial assistance for the blind and the visually impaired, as well as the introduction of an entitlement to speech fluency devices under the national insurance scheme. The work grant for foster parents will from 1 January 2018 no longer result in a reduction of unemployment benefit and work assessment allowance. Efforts to prevent violence and abuse in close relations are expanded. The Government is preparing the implementation of the child welfare reform and will be presenting a skill strategy for municipal child welfare services. The budget proposal is facilitating an inter-municipal learning network and expanded supplementary training and on-the-job training for employees of municipal child welfare services. Children in the child welfare service are faced with greater health challenges than others. The child wel-

fare service shall, in cooperation with the health service, establish two institutions for children who need long-term care outside the home and who need psychological health care.

- *Vibrant local democracy*. Local government is responsible for absolutely essential welfare services. Robust and predictable local government funding is important to enable municipal and country administrations to perform their duties. The Government is proposing a real increase in unrestricted local government revenues in 2018 of close to NOK 3.8 billion, whilst total revenues will increase by NOK 4.6 billion, as calculated by reference to the estimated level of revenues in 2017 following the Storting's deliberation of the Revised National Budget for 2017. NOK 300 million of the increase in unrestricted local government revenues is reasoned by the treatment of substance abusers, NOK 200 million for early intervention in kindergartens and schools, and NOK 200 million for preventive measures for children, youth and families to prepare municipal administrations for the child welfare reform. NOK 100 million of the increase in unrestricted regional government revenues shall be specially reasoned by the counties operating ferry services. The local government reform will deliver stronger municipalities that are better placed to provide local populations with good services, enhance local development and facilitate more vibrant local democracy. Local government reform resolutions mean that 121 municipalities will be amalgamated into 47 new municipalities. The vast majority of amalgamations will enter into effect from 1 January 2020. The number of municipalities will then be reduced from 428 to 354.
- *An ambitious climate policy*. At the UN Climate Change Conference in December 2015, the parties to the convention reached the Paris Agreement. The central aim is to strengthen the global response to the threat of climate change by keeping the global average temperature increase well below 2 °C compared to pre-industrial levels, and to pursue efforts to limit the temperature increase to 1.5 °C. The agreement establishes a collective emissions target, aimed at reaching a global peaking of greenhouse gas emissions as soon as possible and to undertake rapid reductions thereafter. The ambition is to achieve a balance between anthropogenic emissions by sources and removals by sinks of greenhouse gases in the second half of this century (climate neutrality). Thus far, 166 parties have acceded to the Paris Agreement, which entered into force on 4 November 2016. Norway has registered a conditional commitment to reduce its greenhouse gas emissions by at least 40 percent by 2030, compared to the Norwegian level 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 commitment. Before this summer, the Government presented a strategy for how Norway can meet its climate commitment for 2030. The 2030 target for non-EU ETS emissions will be achieved through cooperation with the EU, with a main emphasis on domestic emission reductions and with necessary use of the flexibility mechanisms under the EU regulations. The Government's strategy for 2030 is paving the way for considerable domestic emission reductions. The most important climate policy measures are cross-sectoral economic instruments in the form of taxes and participation in the EU ETS. In the budget for 2018, the Government is proposing to make the structuring of the CO_2 tax more cost effective by abolishing exemptions and low rates. The Government is continuing to examine whether to include waste incineration plants in the EU ETS or whether to impose CO_2 tax on these. The Government is also proposing a number of initiatives at the expenditure side, including an increase to grants for central government co-funding of key public transport projects in the four largest cities, the appropriation of investment capital for the new company provisionally named Fornybar AS, and an increase to appropriations for climate- and environmentally-oriented assistance.

The Government will continue the debureaucratisation, efficiency and effectiveness - reform in 2018. Reducing bureaucracy and requiring more value for money frees up resources for priority objectives. The Government will manage taxpayers' money with respect and crack down on public sector waste.

Monetary policy

Norges Bank's operational target for monetary policy is low and stable inflation, defined as annual consumer price inflation of close to 2.5 percent over time. In the short and medium term, monetary policy shall balance consideration for low and stable inflation against consideration for stability in output and employment.

The key policy rate is Norges Bank's most important policy tool, and this rate can be changed swiftly if merited by the economic outlook. The key policy rate has been at a record low of 0.5 percent since March 2016. According to Norges Bank's rate path from September this year, the key policy rate will remain at about this level, before being gradually increased to close to1.5 percent towards the end of 2020. Norges Bank estimates that consumer price inflation will be below the inflation target for the next few years, whilst capacity utilisation in the mainland economy is gradually normalised over the forecasting period.

On 10 April 2015, the Government appointed a committee charged with preparing a proposal for a new Central Bank Act. The Committee, which was chaired by Svein Gjedrem, submitted its report (Norwegian Official Report (NOU) 2017: 13) to the Ministry of Finance on 23 June 2017. The committee proposed a new Central Bank Act with provisions on the objectives, duties and governance, etc., of the Bank. The report was circulated for consultation on the same day, with 15 October 2017 as the deadline for submitting consultative comments. The Government will revert to the Storting on this matter.

In parallel with the efforts of the Central Bank Act Committee, the Ministry of Finance has been pursuing a modernisation of the Monetary Policy Regulations. This has been a transparent process addressing experience with inflation targets, with contributions from both academia and Norges Bank. The Government is continuing this work.

Financial stability and the housing market

Favourable developments in the Norwegian economy have strengthened the earnings of Norwegian financial institutions. Banks have accumulated capital over the last few years, and are well placed to meet capital adequacy requirements, including a higher countercyclical capital buffer and specific requirements for individual banks (so-called Pillar II requirements). The combination of guaranteed payments, rising life expectancy and persistently low interest rates poses a challenge to 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 are faced with.

Financial imbalances will normally accumulate over a long period of time before potentially triggering a crisis. The key instrument for preventing financial instability is a regulatory framework which ensures that financial institutions are solvent at the individual level. Imbalances may nonetheless increase systemic risk in financial markets, and the risk of financial instability. In recent years, more weight has therefore been attached to the need to reinforce supervision and regulation of the financial system as a whole.

The sustained increase in the household debt burden is an indication that financial imbalances have accumulated. Although housing prices are no longer increasing, the high and still rising debt burden of households means that the financial vulnerability will persist for some time. Lower housing price growth will over time serve to slow down household debt increases.

If housing prices were to fall sharply for a sustained period of time, the economic upturn might be inhibited. In earlier periods of declining housing prices, such as during the banking crisis and the financial crisis, the macroeconomic outlook was weak to begin with, and banks had limited lending capacity and relatively low capital adequacy. Such is not the situation now. The economic outlook is currently good, unemployment is expected to decrease and banks have good solvency and lending capacity.

The Government has introduced a number of measures to curtail financial risk. Stricter capital requirements serve to make the financial system more robust to a decline in housing prices. Lending practice requirements promote a more sustainable development in the housing mortgage market. The valuation discount for second homes and the value of debt allocated to second homes has been reduced, to bring about the equal treatment of investments in real estate and investments in shares, etc., but it is likely that these measures have also served to reduce housing speculation. In addition, the Government has made proposals to make it easier and quicker to complete zoning arrangements for the construction of new homes. Housing construction has expanded and provided a better balance in the housing market.

Employment and income policy

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

Labour market measures are important in helping the unemployed return quickly to work, and to protect vulnerable groups with weak or limited in-demand skills against permanent exclusion from the labour force. The number of work placements has been increased significantly over the last few years. The labour market is improving, and it is proposed to slightly reduce the number of placements intended for the unemployed next year. The number of placements will nonetheless be higher than in 2014 and 2015.

Youth, immigrants from non-EEA countries and persons who have been unemployed for a long time are given priority for labour market programmes in 2018. The Government is thus continuing efforts targeting vulnerable unemployed youth and persons with impaired work capacity under the age of 30 years. The youth initiative ensures that persons under the age of 30 years who after eight weeks of unemployment are not in job, education or participating in labour market programmes, are provided with a work-oriented alternative.It is especially important to prevent long-term passiveness, and the Government is therefore launching an enhanced and more targeted effort for long-term unemployed persons who are nearing the end of their unemployment benefit period.

The pension reform has been designed to increase labour supply, thereby improving the robustness of the pension system as life expectancy increases. Employment amongst the elderly has increased, especially in the private sector encompassed by contractual early retirement pension, but the effects of the reform have been limited in the public sector since occupational pension schemes in the public sector have not been amended correspondingly. The Government has, in consultation with the social partners, been examining potential public sector occupation pension models that are better tailored to the principles underpinning the pension reform, and intends to reach a solution in collaboration with the social partners.

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 businesses 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 the social partners to develop a common understanding of the economic situation and the challenges facing the Norwegian economy.

Measures to promote a more productive and efficient economy

Productivity growth has slowed down in the last decade. Suceeding in continually increasing the output from the resources we use is the key driver behind improved standard of living. Consequently, productivity growth needs to be revived in order for welfare improvements to continue. Economic policy cannot exclusively focus on the distribution of government revenues, but needs to facilitate structural adjustment and innovation that channels manpower and capital into new industries. Efficient use of resources in the private and the public sector will boost economic growth, and is therefore of importance to the standard of living and the sustainability of welfare schemes. Moreover, capacity for structural adjustment will leave Norwegian businesses better placed to face international competition. The Government emphasise a continuous efficiency enhancement effort.

Both the Productivity Commission and the OECD have noted that higher productivity can be achieved through structural reforms that enhance growth opportunities for businesses and through measures to improve public sector efficiency. The de-bureaucratisation, efficiency - reform will be continued, thus reducing bureaucracy and freeing up resources for priority objectives. The Government will reduce businesses' costs connected to official reporting requirements and regulations. The Government has implemented a number of simplifications to the Planning and Building Act. The digitalisation and simplification effort is continuing. Several comprehensive reforms have been implemented to obtain better services and improved use of resources in the public sector, including the local government - reform, the railway reform, the police - reform and the university college reform. Reform efforts that serve to improve the use of society's resources, in both the private and the public sector, are continuing.

Climate policy

The climate challenge can only be solved through broad international collaboration. At the UN Climate Change Conference held in Paris in December 2015, the parties to the UN Framework Convention on Climate Change reached agreement on a global agreement. The objective of the agreement is to improve implementation of the UN Framework Convention on Climate Change and its goals by, inter alia, keeping the average temperature increase well below 2 °C compared to pre-industrial levels, and seeking to restrict the temperature increase to 1.5 °C. To achieve this, the agreement establishes a collective emissions target. This target is aimed at turning 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). Thus far, 160 parties have acceded to the Paris Agreement, which entered into force on 4 November 2016.

As part of the Paris Agreement, Norway has registered a conditional commitment to reduce its greenhouse gas emissions by at least 40 percent by 2030, compared to the Norwegian level 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 commitment.

Before this summer, the Government presented a strategy for how Norway can meet its climate commitment for 2030; see Report No. 41 (2016-2017), a white paper on *Climate Strategy for 2030 – Norwegian Transformation in European Cooperation*. The 2030 target for non-EU ETS emissions will be achieved through cooperation with the EU, with a main emphasis on domestic emission reductions and with necessary use of the flexibility mechanisms under the EU regulations. The Government's strategy for 2030 is paving the way for considerable domestic emission reductions.

Norway is pursuing an ambitious climate policy. The most important policy measures are cross-sectoral economic tools in the form of taxes and EU ETS participation. In the budget for 2018, the Government is proposing to make the structuring of the CO_2 tax more cost effective by abolishing exemptions and low rates. The Government is considering whether to include waste incineration plants in the EU ETS or whether to impose CO_2 tax on these. The Government is also proposing to increase grants for central government co-funding of key public transport projects in the four largest cities, to appropriate investment capital for the new company provisionally named Fornybar AS, and to increase appropriations for climate- and environmentally-oriented assistance, including the climate and forest initiative, as well as Norfund.

Follow-up of the UN Sustainable Development Goals

The UN Sustainable Development Goals, which were adopted in 2015, represent an ambition to eradicate extreme poverty and hunger by 2030. There are also a number of other objectives, comprising a total of 17 goals and 169 targets. The overriding objective is to facilitate a good and secure life without poverty for all people.

Norway is a well developed society and has implemented a lot of measures relevant to the Sustainable Developemnt Goals. Domestically most of the goals are either already achieved or are expected to be achieved within 2030. However, some of the Goals will be challenging also for Norway.

The Government has appointed a coordinating ministry for each of the 17 Sustainable Development Goals. The coordinating ministries report on their follow-up of assigned goals in their budget propositions. The Ministry of Finance has coordination responsibility for Goal 8 on economic growth and employment and Goal 10 on reducing inequalities.

The Government Pension Fund

The purpose of the Government Pension Fund is to support long-term considerations in the government's spending of petroleum revenues, as well as savings to finance pension expenditure under the national insurance scheme. Sound long-term management will help ensure that Norway's petroleum wealth can benefit both current and future generations. The investment objective for the Government Pension Fund is to achieve the highest possible return with an acceptable level of risk. Within the overarching financial objective, the Fund shall also be a responsible investor.

As at the end of the first half of 2017, the market value of the Government Pension Fund Global was NOK 8,018 billion and the market value of the Government Pension Fund Norway was NOK 220 billion.

In the report to the Storting on the management of the Fund in 2016, the Government recommended to increase the equity share of the strategic benchmark index for the Government Pension Fund Global from 62.5 percent to 70 percent. The Government will inform the Storting after the phase-in has been completed. In view of the decision to increase the equity share, the Ministry has also initiated an assessment to examine the composition of the Fund's fixed-income benchmark. This issue will be discussed in the report to the Storting on the management of the Fund in 2017, which will be published in the spring of 2018.

The Central Bank Act Commision, which submitted its report on 23 June this year, was also mandated to assess alternative governance models for the Government Pension Fund Global. The Commission recommended that the Fund shall be managed by a separate statutory entity outside Norges Bank, but has also presented two alternative governance models within the Bank. The Government will revert to the Storting on this issue.

Table 2. Key figures for the Norwegian economy. The national budget 2018

	2016	2017	2018	2019
Real economy. Percentage change from the previous year. Volume.				
Private consumption	1,5	2,3	3,2	3,2
Public consumption	2,1	1,7	1,2	-
Gross fixed investment	-0,2	3,9	2,5	3,0
Of which: Public sector	5,9	5,4	1,5	-
Petroleum extraction and pipeline transp.	-16,9	-6,5	2,2	7,7
Demand from Mainland Norway[1]	2,6	3,1	2,5	2,4
Exports	-1,8	1,1	0,9	1,9
Of which: Except oil and gas...	-8,2	1,7	3,8	5,0
Imports	2,3	3,2	3,3	3,6
Gross domestic product	1,1	1,9	1,5	1,9
Of which: Mainland Norway	1,0	2,0	2,5	2,6
Labour market.				
Employment, persons (percentage growth)	0,3	0,7	1,1	1,1
Unemployment rate, LFS (level)	4,7	4,3	4,0	3,8
Unemployment rate, registered (level)[2]	3,0	2,7	2,6	2,5
Prices and wages. Percentage change from the previous year				
Annual wage	1,7	2,4	3,0	3,0
Consumer price index (CPI)	3,6	1,9	1,6	1,7
Underlying inflation (CPI-ATE)	3,0	1,6	1,8	1,9
Oil price. NOK per barrel (level)	379	438	438	441
Interest rates and exchange rates				
Three-month money market rates (pct.)	1,1	0,9	0,9	1,2
Import -weighted exchange rate (yearly change in pct.)[3]	1,9	-1,1	1,0	0,8
Central government				
Non-oil deficit, NOK billion	208,4	232,4	255,4	-
Structural non-oil fiscal deficit, NOK billion	198,7	219,6	231,1	-
Per cent of capital in the Government Pension Fund Global[4]	2,7	2,9	2,9	-
Per cent of trend GDP mainland Norway	7,2	7,7	7,7	-
Fiscal impulse[5]	0,7	0,4	0,1	-
Real underlying expenditure growth, per cent	2,6	2,4	1,0	-

1 Excluding inventory changes.
2 Measured as per cent of the LFS labour force.
3 A positive number indicates a depreciation of the krone.
4 At the beginning of the year
5 Measured by the change in the structural, non-oil deficit as a share of trend-GDP mainland Norway.
Sources: Statistics Norway, Norwegian Labour and Welfare Administration and Ministry of Finance.

Appendix 1

Norway's fiscal framework

As in most countries, Norway has a fiscal framework that place restrictions on the budget balance. In addition, Norway's fiscal framework is adapted to our situation as a large petroleum producer.

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 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 3 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

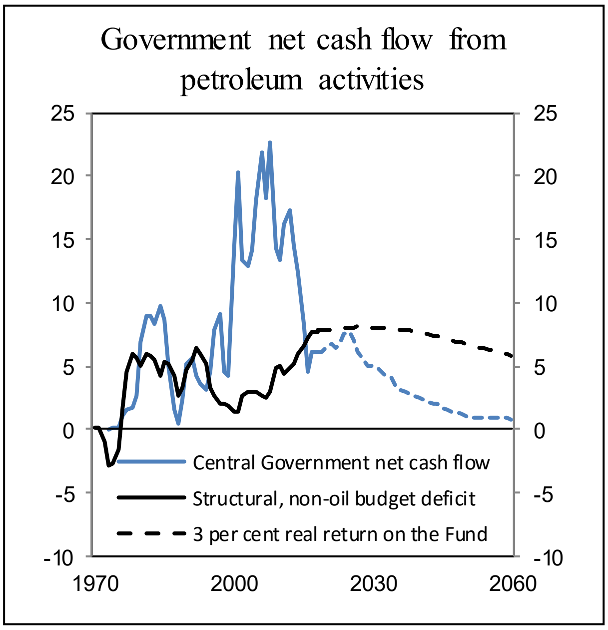

Figure A.1 The State's net cash flow from the petroleum sector, the structural, non-oil deficit and 3 per cent real return on the Government Pension Fund Global. Per cent of trend-GDP for mainland Norway

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 has now peaked. The proportion is expected to stay around 8 pct. for the next 15-20 years or so, but will then fall gradually as flows into the Fund diminish and the mainland economy continues to grow.

The size of the fund has increased significantly over the last decade, In September this year the value of the Fund amounted to more than 2½ times mainland GDP. Combined with a gradual drop in flows into the Fund, this means that the volatility in petroleum prices will be of less importance for the Fiscal Budget than before. However, at the same time the volatility in the value of the Fund will be more important. In the future, the fiscal framework must take into account the risk associated with a large drop in the value of the fund. A permanent, large drop may make it necessary to reduce the contribution of Fund returns to the Fiscal Budget. Isolated, this speaks for caution in the use of Fund incomes.

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 1960–2016, 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 2018. The assumptions may be summarised as follows:

– *Taxes on labour.* This category includes employers' social security 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' social security contributions and total personal taxes. The projections for 2018 and 2019 are based on a 1.1 pct. growth in normal man-years employed. The estimates are based on population projections from Statistics Norway.
– *Taxes on capital.* This category includes taxes paid in arrears by companies and other non-individual taxpayers outside the petroleum industry and withholding tax. It is assumed

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

	2016	2017	2018
Non-oil budget deficit	208 388	232 373	255 366
+ Net interest payments and transfers from Norges Bank. Deviation from trend	16 630	10 524	4 558
+ Accounting technicalities	258	-3 456	-21
+ Taxes and unemployment benefits.Deviation from trend	-26 558	-19 838	-28 769
= Structural, non-oil budget deficit	198 718	219 603	231 134
Measured in pct. of trend-GDP for mainland Norway	7,2	7,7	7,7
Change from previous year in percentage points (fiscal stance)[1]	0,7	0,4	0,1
Memo:			
Income from investments in The Government Pension Fund Global.[2] Estimated trend	187 309	198 123	209 557
Structural, non-oil budget deficit, including income from investments	11 409	21 480	21 577
Measured in pct. of trend-GDP for mainland Norway	0,4	0,7	0,7

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

that taxes from enterprises outside the petroleum industry will remain approximately unchanged as a proportion of mainland GDP after 2018.

– *Indirect taxes*. This category includes value added tax, motor vehicle registration tax and other excise duties, and other indirect taxes including stamp duty and miscellaneous sectoral taxes. 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.

The described methods for calculating the structural budget balance deviate somewhat from methods used by international organizations such as the OECD, IMF and the EU Commission. The Ministry of Finance has access to detailed infor-

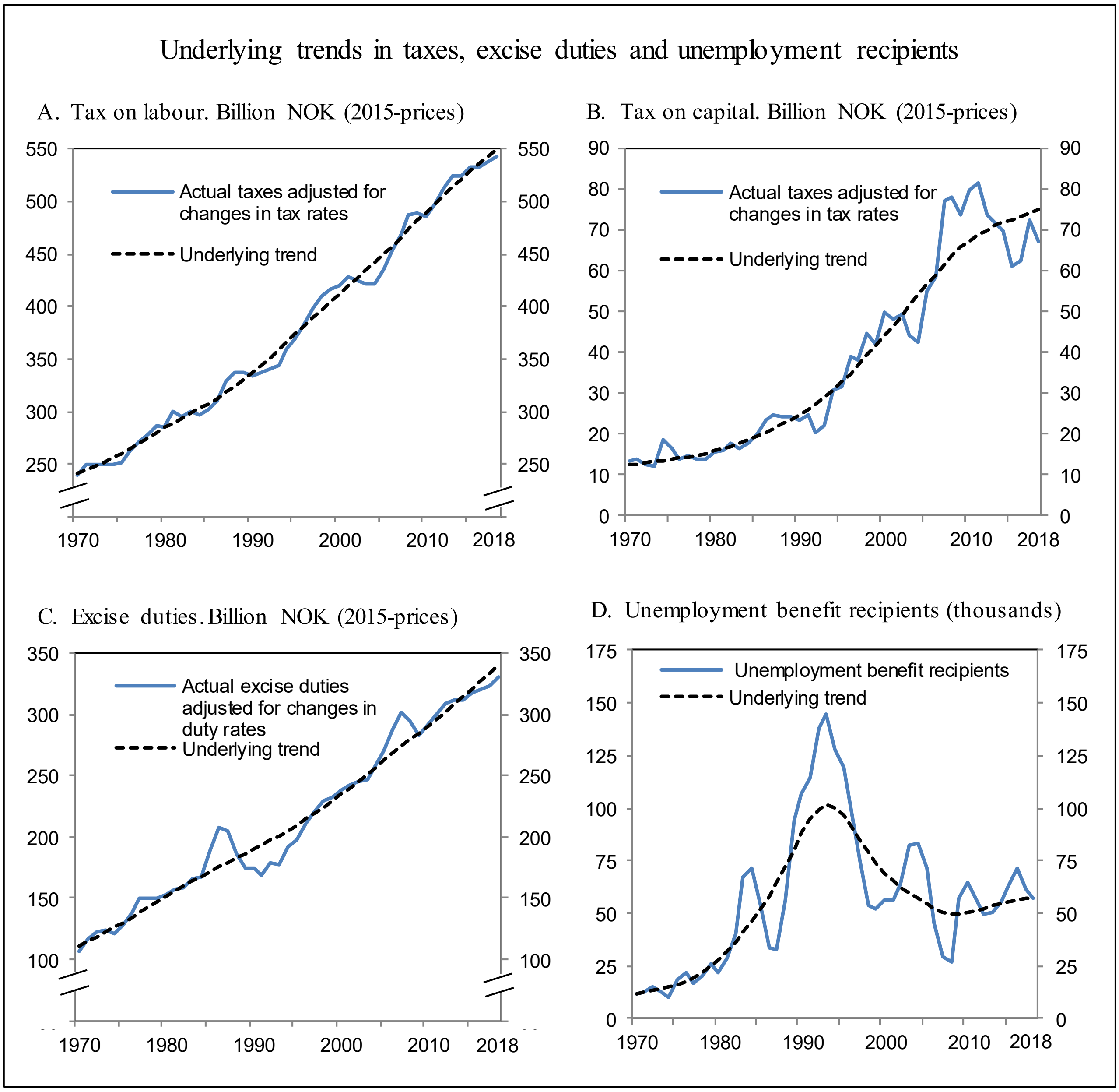

Figure A.2 Underlying trends in direct and indirect taxes and the number of unemployment benefit recipients

[1] For years up to and including 2016, actual taxes as per the national accounts are shown adjusted for changes in tax rates and the tax base and converted into fixed 2015 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.

mation about developments in the Norwegian economy and important tax bases, which allows a comprehensive approach. OECD, IMF and the EU Commission uses a more aggregate approach, which must be seen in connection to their need for a uniform methodology across countries and a more limited access to detailed information from each country.

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. Labour taxes are projected to be near their trend level, while taxes on capital and indirect taxes are expected to be lower than their trend. The significant increase in taxes on capital in 2017 is explained by large advance payments of liable taxes from mainland enterprises, especially from the financial sector. Based on experience, the liable taxes from enterprises in the financial sector varies a great deal from year to year because of gains and losses on financial instruments.

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 upturns. 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. In line with the fiscal rule, the structural, non-oil budget deficit increased in recent years. It is now estimated at 7.7 pct. of mainland trend-GDP.

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 consider-

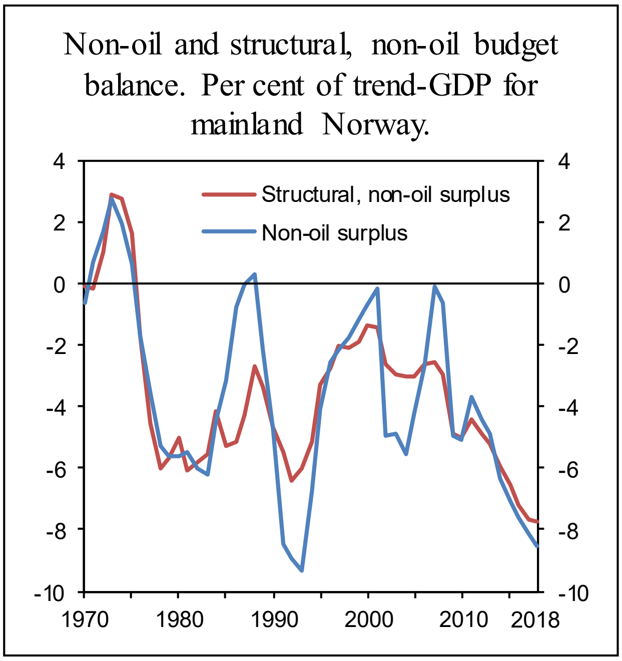

Figure A.3 Non-oil and structural, non-oil budget balance. Per cent of trend-GDP for mainland Norway.
Source: Ministry of Finance.

Appendix 3

The role of the petroleum sector in the Norwegian economy

Through its demand for goods and services, the petroleum industry contributes considerably to activity and employment in the Norwegian mainland economy. 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 27 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 (the sum of investments, intermediate products and wage costs) was particularly steep from the mid-1970s to the mid-1980s. Subsequently, demand from the sector fluctuated around a stable level as a percentage of mainland GDP, before picking up significantly again over the period 2005-2013. In 2014 this trend stopped and over the past couple of years the demand from the petroleum sector has fallen sharply, mostly due to lower investment activity after the decline in the oil price. The forecast for the coming years is for oil investments to increase again, see table 2.

Productivity in the extraction sector is high. Direct petroleum industry employment only accounts for about 1 per cent of overall employment in Norway. Still, extraction of oil and gas constituted 12 percent of GDP last year, down from 22 percent in 2012.

Development of petroleum activities has given rise to a large Norwegian supply industry. According to estimates from Statistics Norway, about 6.7 percent of total employment was directly or indirectly attached to the petroleum sector in 2016, down from about 9 percent in 2013. The highest concentration of such employment is 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 also affects employment, in particular in the public sector.