June 2009

The Kingdom of Norway

General

Norway forms the western and northern part of the Scandinavian Peninsula and has common borders with Sweden, Finland and Russia. Norway's area is 323,802 square kilometers (approximately 125,100 square miles), excluding the Svalbard Island group in the Arctic Ocean and other overseas territories. The population of Norway was estimated at 4,799,252 as of January 1, 2009. Oslo, the capital and largest city of Norway, had a population of 575,475 as of January 1, 2009.

Norway is a constitutional monarchy, with the constitution dating back to 1814. The power is divided between a legislative branch, the Storting, which is also responsible for appropriations; an executive branch, the Government; and a judicial branch, the courts. The Storting has 169 members and cannot be dissolved by the King or otherwise during its four-year term. Parliamentarianism was introduced in 1884. The general election to the Parliament will be held in September 2009.

Memberships in International Organizations

Norway is a party to the Agreement on the European Economic Area (EEA), which generally includes Norway in the internal market of the European Union (EU). Norway is a member of the European Free Trade Association (EFTA), an international free trade partnership.

Norway is a member of a number of other international organizations, including the International Monetary Fund (IMF), Organization for Economic Cooperation and Development (OECD), International Bank for Reconstruction and Development (World Bank) and the World Trade Organization (WTO). Norway is a founding member of the United Nations and its affiliate organizations and has been a member of the North Atlantic Treaty Organization (NATO) since 1949. Norway is also a member of the Inter-American Development Bank (IADB), African Development Bank (AfDB), Asian Development Bank (ADB), European Bank for Reconstruction and Development (EBRD), Council of Europe Development Bank (CEB), Nordic Investment Bank (NIB), Nordic Development Fund (NDF), Nordic Council, Nordic Project Fund (Nopef) and Nordic Environment Finance Corporation (NEFCO).

European Integration

On January 1, 1994, the EEA Agreement between the member states of the EU and the then-existing EFTA states (except Switzerland) entered into force. The purpose of the EEA Agreement is to create a comprehensive economic partnership that extends the internal market of the EU to the participating EFTA states. The EEA Agreement provides for free movement of goods, persons, services and capital among the signatory countries. The enlargement of the EU on May 1, 2004 and January 1, 2007 had direct impact on the EEA Agreement. The Agreement explicitly states that a country becoming a member of the EU shall also apply for membership of the EEA. As from 2007, there are three EFTA states (Iceland, Liechtenstein and Norway) and 27 EU member states participating in the EEA.

The EEA Agreement does not provide for participation by the relevant EFTA countries in certain areas of cooperation among the EU member states, such as taxation, agricultural and fishing policies, economic and monetary policies and EU customs union.

In December 1996, Iceland and Norway signed a cooperation agreement with the so-called “Schengen states”, a group consisting of 13 EU member states, which inter alia provides for common rules for movement of persons into and among participating countries. From May 1, 1999, the Schengen cooperation was integrated into the EU framework. Norway and Iceland have negotiated an agreement concerning institutional solutions for continuing participation in the Schengen cooperation after its integration in the EU. This agreement took effect on March 25, 2001.

Economic sectors

Norway is a diverse industrial society with a free market economy and generally low trade barriers. A significant share of the Norwegian economy consists of service industries, including wholesale and retail trade, banking, insurance, engineering, transport and communications and public services. In 2008, the service sector as a whole accounted for approximately 48 per cent of GDP. Norway’s petroleum industries, including exploration and extraction, accounted for 26 per cent of GDP and about 49 per cent of exports. Manufacturing accounted for close to 9 per cent of GDP.

The major manufacturing industries are machinery, construction of oil platforms and ships, paper products, metal products, basic chemicals and electrical and electronic equipment. All of these industries are highly export oriented. The paper industry, the metal industry and the chemical industry have benefited from the availability of hydroelectric power and to some extent also of raw materials.

Following the discovery of substantial petroleum deposits in the Norwegian sector of the North Sea in the late 1960’s and the commencement of North Sea oil production in 1971, a substantial petroleum related sector was developed in Norway. From the beginning of the 1970’s this sector has been the predominant growth sector in the Norwegian economy.

The exploration and production of petroleum resources on the Norwegian continental shelf has had a major impact on the Norwegian economy. In 2008, Norwegian petroleum production totaled approximately 242 million standard cubic meters of oil equivalents (scm oe.). Norway ranks as the world’s fifth largest oil exporter and the third largest gas exporter.

Economic Developments and Prospects

Since 1970, annual economic growth has averaged 3.4 per cent. Norway experienced a strong economic expansion from 2003 to 2007, with an annual average growth in Mainland GDP of 5 per cent. Growth in the mainland economy reached 6 per cent in 2007, but was reduced to 3.2 per cent in 2008, according to preliminary national accounts figures.

The cyclical peak was passed at the turn of the year 2007/2008, and the Norwegian economy is now experiencing a downturn in economic activity. The turnaround in the Norwegian economy began with a slowdown in housing investments, which became more pronounced during the course of 2008. A decline in demand for consumer durables followed, and there was a clear downward shift in consumption in 2008. The turnaround in the Norwegian economy has been intensified by the international financial crisis and the global economic downturn. However, the impact of the crisis has not been as severe in Norway as in most other countries and the Norwegian economy is expected to fare better also ahead. Strong demand impetus from both fiscal and monetary policy measures is expected to limit the downturn and private consumption is forecast to pick up in course of 2009. Petroleum investment is expected to remain high in 2009. Exports, mainland business investment and housing investments will contribute to lower economic activity. Mainland Norway GDP is estimated to fall by 1 per cent this year. Mainland GDP is expected to pick up in 2010 to an estimated ¾ per cent.

The weak economic development is also reflected in reduced demand for labour. Following several years of strong growth, employment growth came to a halt in the second half of 2008. Employment is projected to decline by 1 per cent from 2008 to 2009, or by 25,000 persons. The decline is expected continue in 2010 but at a lower pace.

There has been a significant reduction in unemployment which reached a 20-year low of 2.4 per cent in the third quarter of 2008. It has since increased to 3.1 per cent in the first quarter of 2009. Outlook for the Norwegian economy suggests that the unemployment rate will increase to 4¼ per cent by the end of 2009 and to an average of 4¾ in 2010.

Inflation in Norway rose appreciably from 2007 to 2008. In particular, a sharp rise in energy prices led to consumer price inflation (CPI) escalating from 0.8 to 3.8 per cent. The rise in energy prices has fed through to other prices. The prolonged economic upturn resulted in a relatively sharp rise in costs and contributed to higher inflation excluding energy products. The underlying consumer price inflation, measured by CPI adjusted for changes in excise duties and excluding energy (CPI-ATE), has increased slightly more than the inflation target since the summer of 2008. The effects of the economic downturn and lower energy prices will probably lead to lower inflation towards the end of this year. CPI-ATE is forecast at 2.4 per cent in 2009 and headline inflation (CPI) at 1.8 per cent

There has been a strong growth in labour costs during the past few years. Wages increased by 6.0 per cent from 2007 to 2008. Weakened profitability and increased unemployment will dampen wage growth, which is forecast at 4 per cent in 2009.

Key figures for the Norwegian economy. Percentage change from previous year

	2008 NOK billion[2]	2008	2009	2010
Private consumption……………………...............	992.3	1.5	0.0	
Public consumption..……………………………...	489.0	3.7	5.7	
Gross fixed investments	527.2	3.3	-6.3	
Petroleum……………………………………...	122.8	7.1	5.5	
Business sector, Mainland Norway……………...	201.9	6.6	-16.1	
Exports…………………………………………	1 196.3	0.9	-5.3	
Crude oil and natural gas………………………...	590.8	-2.3	-4.5	
Traditional goods………………………………...	324.2	4.8	-7.3	
Imports……………………………………………	731.4	4.2	-2.4	
Traditional goods………………………………...	480.0	3.2	-4.0	
Gross domestic product…………………………...	2 537.9	2.0	-1.9	
Mainland Norway…………………….. ………...	1 842.5	2.4	-1.0	¾
Memorandum items:				
Consumer price inflation (CPI)…………………...		3.8	1.8	
Underlying inflation (CPI-ATE)………………….		2.6	2.4	
Wage growth ……………………….................		6.0	4	
Employment growth………………………………		3.2	-1.0	-1½
Unemployment rate (LFS)………………………..		2.6	3¾	4¾
Current account balance (per cent of GDP)………		18.4	9.8	

[1]Constant 2006 prices.
[2] Preliminary national account figures. Current prices.
Sources: Statistics Norway and Ministry of Finance.

Foreign Trade

Norway has a very open economy, with per capita foreign trade among the highest in the world. In 2008, Norway's total exports and imports of goods and services represented 47 and 29 per cent of total GDP, respectively. Crude oil and natural gas is the single most important commodity group, representing about half of total merchandise exports in 2008. The strong expansion of the world economy before the financial crisis contributed to high growth in the exports of services and traditional goods. However, growth in total exports has been more moderate because of a reduction in the extraction of crude oil and natural gas.

As a consequence of the sharp decline in the world economy, Norwegian exports of traditional goods fell in the second half of 2008. The largest reduction was in metals, refined oil products and basic chemicals, whereas ship and offshore-related exports was more stable. The decline has continued through the first quarter of 2009, especially for metals and basic chemicals which was down 10 per cent from the preceding quarter. Export of traditional goods is expected to decline by 7¼ per cent in 2009, and total exports is expected to decline by 5¼ per cent

Norwegian terms of trade – as measured by the ratio between export and import prices – improved markedly over the period 2002-2006 at an annual average of 2.4 per cent. Strong growth in China and other emerging economies contributed to strong price growth for metals, crude oil and other intermediate goods in these years. In 2007, terms of trade deteriorated by 1.2 per cent. Following positive developments in the terms of trade in the first three quarters of 2008, overall prices of exported goods fell by 18.5 per cent in the fourth quarter driven by a plunge in the oil price of 26 per cent. Terms of trade declined by 0.9 per cent in 2008, and is expected to decline by a further 4 per cent in 2009.

Budget Policy

Guidelines and challenges

The main objectives of the Government's economic policy are to contribute to high employment, sustainable development, fair distribution of income and well-functioning welfare schemes. This requires sound policies with emphasis on environmental challenges, long-term management of national wealth and the development of a strong and sustainable public sector. The various aspects of economic policy need to work together to reach these objectives.

The fiscal policy guidelines, in place since 2001, stipulate that fiscal policy shall be geared towards a gradual increase in the use of petroleum revenues. Over time, the structural non-oil central government budget deficit shall correspond to the expected real return, estimated at 4 per cent, on the Government Pension Fund - Global. The guidelines also allow fiscal policy to be used actively to counter fluctuations in economic activity, cf. discussion on Budget policy guidelines below. In a cyclical expansion, fiscal policy restraint relative to the spending rule is called for, whereas in a cyclical downturn higher spending of oil revenues is justified to stabilize the economy.

When the Norwegian economy experienced relatively low capacity utilization at the start of the millennium, the structural, non-oil budget deficit was well above the 4 per cent path. During the cyclical boom between 2006 and 2008, spending of petroleum revenues was below the 4 per cent path. To counter the adverse effects on the Norwegian economy from the current financial crises, spending of petroleum revenues has in 2009 once again been brought well above the 4 per cent path.

Although fiscal policy has an important role in dampening the impact of the international economic downturn on the Norwegian economy, it is important not to lose sight of the long term challenges resulting from an aging population. While the demographic structure in Norway has developed favorably in the last 20 years with respect to public finances, a projected increase in the share of elderly in the population will soon put an increasing pressure on public finances. In consideration to the sustainability of public finances, spending of petroleum revenues should be brought back to the 4 per cent path as economic growth regains its momentum.

Budget policy guidelines

In Report No. 29 (2000-2001) to the Storting, the Stoltenberg I Government presented the fiscal policy guidelines, which were supported by a large majority in the Storting:

- Petroleum revenues shall be phased into the economy on par with the development in expected real return of the Fund.
- Considerable emphasis must be put on stabilizing the economy to ensure high capacity utilization and low unemployment.

The fiscal policy guidelines shall facilitate stable developments of the Norwegian economy both in the short and long run:

- *The Fiscal Budget shall be sheltered from the effects of volatility in petroleum prices*. The revenues from petroleum activities shall be allocated to the Government Pension Fund – Global. The expected real return on the capital in the Fund, estimated at 4 per cent, will be spent over time. This means that short-term changes in oil and gas prices will have limited impact on fiscal policy and the petroleum wealth will be benefiting future generations.
- *The guidelines facilitate a balanced phasing- in of petroleum revenues over time*. In situations of major changes to the Fund's capital, or circumstances that influence the structural, non-oil deficit, the consequences for the spending of petroleum revenues shall be evened out over several years. A smooth phasing-in of petroleum revenues will reduce the risk of sudden and major restructurings between exposed and sheltered industries.
- *The guidelines allow for the automatic stabilizers to work*. The spending of petroleum revenues is measured by the structural, non-oil budget deficit, i.e. the non-oil deficit adjusted for, inter alia, the effects of changes in the business cycle. This involves an increase in transfers from the Fund when tax revenues decline during a recession and vice versa in periods of strong economic expansion. The mechanism ensures that the expenditure side of the budget is sheltered from cyclical movements in taxes and duties. This reduces the risk that budget policy will serve to amplify cyclical fluctuations in the Norwegian economy.
- *The fiscal policy guidelines enable budget policy to be used to stabilize production and employment*. During periods of high unemployment, higher spending than the expected real return on capital in the Fund is called for. Correspondingly, fiscal restraint is needed during periods of high activity in the economy.
- *The fiscal policy guidelines contribute to predictability in the spending of petroleum revenues in the Norwegian economy*. The fiscal policy framework supports monetary policy and lays the foundations for stable expectations as to the phasing-in of petroleum revenues, hereunder in the foreign exchange market. By investing the capital in the Fund abroad the impact on the Norwegian krone from large and varying foreign exchange inflows from the petroleum sector are being offset.

The Fiscal Budget and the Government Pension Fund in 2009

The Fiscal Budget originally proposed by the Government for 2009 implied a structural, non-oil deficit of NOK 92 billion, an estimated increase of NOK14 billion from 2008. Measured as a share of non-oil GDP, the increase in the structural, non-oil budget deficit amounted to 0.7 percentage points. The impulse towards the domestic economy was assessed to be about the same. The structural, non-oil budget deficit was not changed by Parliament.

The fiscal stimulus package, submitted on 26 January 2009 to mitigate the effects of the international economic crises on employment and growth, added another NOK 27 billion to the structural, non-oil deficit in 2009. These measures were adopted by Parliament with amendments amounting to NOK 1.7 billion, leaving the structural deficit at NOK120.5 billion

The Revised Budget, submitted in mid-May, included measures that increased the spending of petroleum revenues by a further NOK 9.5 billion, to a total of NOK130 billion. The structural, non-oil budget deficit is now estimated at 7.2 per cent of non-oil GDP, an increase of 3.0 percentage points from 2008. This is the most expansionary budget in more than 30 years.

Key figures for the Fiscal Budget and the Government Pension Fund. NOK billion

	2007	2008	2009
1. Fiscal Budget			
Total revenues	1 030.1	1 182.6	1 021.9
Revenues from petroleum activities	337.4	437.7	288.4
Revenues excl. petroleum activities	692.7	744.9	733.5
Total expenditures	715.1	778.6	878.1
Expenditures on petroleum activities	21.1	21.8	27.0
Expenditures excl. petroleum activities	694.0	756.7	851.0
Fiscal budget surplus before transfers to the Pension Fund – Global	315.0	404.1	143.8
- Net revenues from petroleum activities	316.4	415.9	261.4
= Non-oil budget surplus	-1.3	-11.8	-117.6
+ Transfers from the Pension Fund – Global	2.8	8.4	117.6
= Fiscal Budget surplus	1.5	-3.4	0.0
2. Government Pension Fund			
Net transfer to the Pension Fund – Global	313.6	407.5	143.8
+ Dividends on the Pension Fund	78.4	103.1	93.6
= Surplus in the Pension Fund[1]	392.0	510.6	237.4
3. Fiscal Budget and Government Pension Fund consolidated surplus	393.5	507.2	237.4

Source: Ministry of Finance.

1. Does not include revaluation of assets.

The real underlying growth in fiscal budget expenditures is estimated at 6¾ percent from 2008 to 2009, corresponding to NOK 51 billion.

Monetary policy

The monetary policy regulation of March 29, 2001 stipulates that monetary policy shall aim for stability in the domestic and international value of the Norwegian krone. Norges Bank’s (the central bank) operational implementation of monetary policy shall be aimed at low and stable inflation, defined as an annual increase in consumer prices that remains close to 2.5 per cent over time. It follows from the regulation that monetary policy shall contribute to stabilizing output and employment, and create stable exchange rate expectations. The interest rate decisions of Norges Bank shall be forward-looking, and pay due attention to the uncertainty attached to macroeconomic estimates and assessments. It shall take into consideration that it may take time for policy changes to have effect on the economy, and it should disregard disturbances of a temporary nature that are not deemed to affect underlying price and cost increases.

In the short and medium run, monetary policy shall balance the need for low and stable inflation against the need for output and employment stability. The long-term role of monetary policy is to provide the economy with a nominal anchor. Over time, low and stable inflation is an important prerequisite for growth and welfare. The regulation establishes a flexible inflation targeting regime for monetary policy.

In order to mitigate the impact of the global economic downturn on the Norwegian economy, Norges Bank has reduced the key policy rate by a total of 5.5 percentage points since October 2008, to 1.25 per cent in June 2009. During this period, the central bank has also stepped up its supply of liquidity to banks in the form of short- and long-term loans.

As the funding situation for Norwegian banks deteriorated in September and October 2008, the Government proposed a swap facility to enhance confidence and liquidity in the financial market. The proposal was adopted by the Storting in November 2008, and Ministry of Finance was authorized to swap government securities with covered bonds of a total amount of up to NOK 350 billion. Banks can enter into swap agreements for up to five years and the government securities can be sold or used as collateral. The facility is made available against a market based premium (with a floor price on the premium). The swap facility has made it easier for banks to fund their operations and has, together with lower central bank rates and measures by Norges Bank to provide liquidity, resulted in a significant decline in money market rates. Norwegian banks and mortgage companies have so far entered into swaps with a total volume of NOK 156 billion.

In order to ease access to loans for companies and households and to contribute to stabilize the financial markets, the Storting adopted in February 2009 the Government's proposal to establish two new funds; the State Finance Fund and the State Bond Fund. Each fund has a capital of NOK 50 billion. The State Finance Fund is established as a separate legal entity. The purpose of the Fund is to provide tier 1 capital to financially sound Norwegian banks in order to strengthen the bank’s core capital and to improve their lending capacity. A core capital of NOK 50 billion may itself correspond to a lending capacity of NOK 400-500 billion. Banks meeting ordinary prudential requirements may apply for injection of capital from the Fund.The objective of the State Bond Fund is to contribute to improved capital market liquidity by investing in a diversified manner at fair market prices in fixed income instruments issued by Norwegian companies. The Fund will invest both in the primary and secondary market, and investments will be dominated by bonds with low to moderate credit risks. The operational management is undertaken by Folketrygdfondet (the National Insurance Scheme Fund).

The Government Pension Fund

The Government Pension Fund was established in 2006, encompassing the former Government Petroleum Fund and National Insurance Scheme Fund. The purpose of the Pension Fund is to aid government savings to finance the pension expenditure of the National Insurance Scheme and long-term considerations in the spending of government petroleum revenues.

Ministry of Finance is responsible for managing the Government Pension Fund. The Ministry determines the general investment strategy of the Pension Fund, as well as its ethical and corporate governance principles. The operational management of the Government Pension Fund has been delegated to Norges Bank and Folketrygdfondet, which manage the Government Pension Fund – Global and the Government Pension Fund – Norway, respectively.

Total market value of the Government Pension Fund was NOK 2,363 billion at the end of 2008, an increase of NOK 227 billion from 2007. Inflow of petroleum revenues amounted to NOK 384 billion, but poor developments in the financial markets reduced the value of the Fund by roughly NOK 663 billion. A significant depreciation of the Norwegian krone, as measured against the currency basket of the Government Pension Fund – Global, increased the market value of the Fund by NOK 506 billion. However, the effect of changes in the Norwegian krone exchange rate is not relevant for the assessment of the Fund's international purchasing power.

Government Pension Fund – Global, expected real return, and structural non-oil budget deficit. NOK billion and percentage of Mainland Norway trend GDP

	Current prices			Constant 2009-prices			Structural deficit	
	Government Pension Fund-Global as per the beginning of the year	Expected return (4 per cent on Fund capital)	Structural, non-oil budget deficit	Expected return (4 per cent on Fund capital)	Structural, non-oil budget deficit	Deviation from the 4 per cent trajectory	As per cent of non-oil trend GDP	As per cent of the Fund capital
2001	386.6	-	16.2	-	22.1	-	1.4	4.2
2002	619.3	24.8	29.8	32.4	38.9	6.6	2.4	4.8
2003	604.6	24.2	37.5	30.4	47.1	16.8	2.9	6.2
2004	847.1	33.9	43.8	41.3	53.4	12.1	3.2	5.2
2005	1011.5	40.5	48.7	47.9	57.6	9.7	3.4	4.8
2006	1390.1	55.6	52.4	63.6	59.9	-3.7	3.4	3.8
2007	1782.8	71.3	57.0	78.3	62.5	-15.7	3.5	3.2
2008	2018.5	80.7	72.2	83.8	74.9	-8.9	4.2	3.6
2009	2279.6	91.2	129.9	91.2	129.9	38.7	7.2	5.7
2010	2400.0	96.0	-	93.1	129.9	-	-	-

Source: Ministry of Finance.

Central Government Debt

Central government debt consists of government bonds, treasury bills and deposits with the Treasury by other state institutions.

The non-oil fiscal budget deficit is financed by transfers from the Government Pension Fund - Global. Capital transactions, including debt amortization, net lending to state entities and net equity investments, are covered by borrowing and/or a reduction in the Treasury's cash reserves. The main objective for central government debt management is to cover the central government borrowing requirement at the lowest possible cost, risks taken into account. Government borrowing shall also contribute to maintaining and developing well functioning and efficient financial markets in Norway. The ordinary domestic borrowing requirement is relatively small and the government therefore concentrates its borrowing on a limited number of loans with maturity up to 10-11 years. Each loan is gradually built up to a substantial volume in order to maintain a liquid and well-functioning secondary market.

The Storting (Parliament) has authorized the Ministry of Finance to borrow based on an annual proposition to the Storting. For 2008 and 2009 combined, the Ministry is authorized to borrow up to NOK 430 billion in long term loans and to have up to NOK 450 billion in outstanding short term market loans.

The Storting has also authorized Ministry of Finance to swap government securities (T-bills) with covered bonds issued by financial institutions in amounts up NOK 350 billion. Banks can enter into swap agreements for maturities of up to five years. The government securities can be sold or used as collateral. This scheme has lead to a substantial increase in the outstanding volume of government securities.

To ease access to funding for business and households the Government has established two new funds, the State Finance Fund and the State Bond Fund, cf. discussion on the Banking Sector. In line with the fiscal guidelines, these transactions will be covered by borrowing in the market and/or drawing on the Treasury's cash reserves.

Employment and Income Policy

Employment policy is aimed at facilitating good availability of manpower, low unemployment and the inclusion of groups characterized by low labour force participation. A comprehensive safety net and good public services in day-care centers, education and health contribute to a well-functioning labour market and high labour force participation. A pension reform in line with the resolution passed by the Storting in spring 2007 entails appropriate work incentives.

The steep increase in demand for labour in recent years has resulted in a significant reduction in unemployment. The labour force has increased as a result of both higher labour force participation amongst Norwegians and extensive labour immigration. Labour force participation in Norway has never been higher, and it is also high by international standards. However, the overall number of hours worked is relative low due to short working hours per employee. The shorter working hours in Norway is caused by, inter alia, a high proportion of part-time work among women and high sickness absence. At the same time, the manpower potential is curtailed by the fact that an ever-increasing number of people draw benefits under various health-related benefit schemes. Reversing this trend is a challenge. Exits from working life into health-related benefit schemes and collectively-agreed early retirement pension schemes (AFP) have increased considerably since the mid-1990s. About 480,000 persons received disability benefits, medical, vocational rehabilitation benefits or AFP at the end of the first quarter of 2008.

Income policy cooperation is a key feature of economic policy in Norway, and is one of the reasons why Norway over the last 30 years has had lower unemployment than most other OECD countries. The Norwegian wage bargaining model is based on the premise that wage growth must over time be kept within limits that can be accommodated by the sector exposed to international competition.

Like the other Nordic countries, Norway has a comprehensive social safety net, a high degree of unionization and relatively coordinated wage formation. The social safety net provides economic security for employees and thereby lays the foundations for flexibility and adaptability in the Norwegian economy. Coordinated wage formation has contributed to fair distribution of income and a low unemployment rate. The Nordic countries have a tradition for a broad-based social dialogue and participation from the social partners. This contributes to a joint understanding with regard to economic policy and the importance of wage formation for the situation in the Norwegian economy.

Tax Policy

Total accrued tax revenues in Norway accumulated to about NOK 993 billion in 2007. Of this, about 87 per cent were paid to the central government, while local government (municipalities and counties) received 13 per cent The Norwegian tax system is characterized by a relatively high share of indirect taxes. The value-added tax (VAT) and excise duties represent about 28 per cent of total tax revenues. The personal income tax and tax on net wealth levied on individuals represent about 31 per cent of total tax revenues. The corporate tax, including employers' social security contributions, amounts to approximately 20 per cent Taxes levied on the petroleum activity represent about 20 per cent of total tax revenues.

Total accrued taxes as a percentage of GDP is estimated at 43.6 for 2007. Adjusted for the petroleum activity, the tax level is estimated at 46.2 per cent

The main goals of the tax system are revenues for public services and the redistribution of income. The tax system shall raise revenues by means that allow labour, capital and natural resources to be used as efficiently as possible.

In 1992, Norway implemented a broad tax reform. Both the personal income taxation and the corporate taxation were reformed. The main goal was to reduce tax induced distortions to a minimum by lowering the tax rates and broadening the tax base. The reform also involved a significant step towards a more neutral tax system with respect to type of economic activity and the organizational and financial structure of such activity. Up till 2005 capital income of individuals and businesses was taxed at a uniform rate of 28 per cent, whereas wage income was taxed by a progressive rate structure. This was the main feature of a dual income tax system. In 2005 the maximum marginal tax rate on wage income was 51.3 per cent exclusive of employers' social security contributions (61.5 per cent including employers' social security contributions). The difference in the maximum marginal tax rates between wage and capital income created tensions in the tax system, i.e. by increasing the incentives for tax planning. This was a main reason for initiating a new tax reform in 2004-2006. In 2006 the maximum marginal tax rate (including employers' social security contribution) was reduced to 54.3 per cent. Combined with tax on the returns on shares above the risk-free interest rate and on corresponding income for self-employed, which implies a 48.2 per cent marginal tax rate on returns to individuals, it was possible to abolish the prevailing splitting of business income of self-employed into capital and labour income (the split model). It is deemed important to keep this difference in maximum marginal tax rates at a low level.

The Banking Sector

Norwegian banks have so far not been as severely affected by the international financial crisis as many other institutions in Europe and the U.S. The Norwegian financial sector has gained from sound regulation and supervision. As part of the European Economic Area (EEA), Norwegian legislation of financial markets and financial institutions is based upon the common legislation of the EU, but additional national standards are also implemented.

National regulations and practice are based on past experiences of deregulations and lack of supervision and control. The banking crisis in the early 1990's is still vividly remembered by regulators, and by many bankers. As several Norwegian banks were nationalized and share capital written down, the banking sector learned the true cost of imprudent risk taking and insufficient credit evaluations. Legislators and supervisory authorities also learned valuable lessons from the crisis, especially with respect to crisis management and the necessity of adequate capital requirements.

One objective of the Norwegian regulations is to regulate different financial activities and institutions in a consistent manner to single standards for market participants. Risk is equally regulated and supervised across different types of financial institutions. Incentives are not created for financial institutions or groups to «hide» risk in subsidiaries subjected to inferior regulation. Problems that arise when risk is concentrated where regulation is most lenient or where supervision is insufficient are therefore avoided.

In some countries there was a real risk that liquidity problems could be amplified by nervous depositors: deposit guarantee schemes in some countries were clearly insufficient to calm depositors. Norwegian banks however, experienced that the relatively generous (up to 2 mill. NOK) pre-funded Norwegian deposit guarantee scheme stood the test. It stabilized customer deposit levels and calmed depositors. In combination with fairly high ratio of deposits to lending, the overall impact of the liquidity crisis was somewhat mitigated.

The Financial Supervisory Authority is responsible for supervising the whole financial industry, and all types of financial institutions, in Norway. Such a joint authority has a much better basis for following the developments in the industry, and a far better starting point when it comes to effective supervision than, say, several sector-specific authorities. International organizations and others now call for reforms much in line with the current Norwegian practice in this area. Of course Norway fully supports such initiatives.

The Norwegian government has been pro-active and highly aware of international developments, even though the speed and depth of the crisis was more severe than anyone could foresee. In addition to powerful fiscal stimulus, Norway has implemented a range of policy instruments to ensure supply of capital to businesses and households.

During the autumn of 2008, risk premiums increased and banks became reluctant to lend to each other. This resulted in higher money market rates. Norwegian banks have tightened credit conditions to both households and businesses. Measures have been put in place to safeguard the liquidity of banks and to ease access for funding of business and households, cfr discussion in “Monetary Policy” above.