

National Budget 2016

Main economic policy features and outlook for the Norwegian economy

A policy for employment, activity and structural adjustment

Norway is a country of great opportunities with a highly educated population and extensive natural resources, as well as an open economy that facilitates efficient production and exchange of goods. Welfare development in Norway will over time be determined, in particular, by the growth capacity of the mainland economy. Hence, it is a challenge that many people are outside the labour force, and that productivity growth is lower than before. High labour force participation and productivity growth are the foundations for sound economic growth.

The expansion of petroleum industry activity has been a key driver for economic growth in Norway over several decades. Growing petroleum industry demand has boosted mainland economic activity and contributed to higher revenues and an increasing number of well-paid jobs. The petroleum industry will remain important for the Norwegian economy for decades to come, but it will not continue to boost mainland economic activity; quite the contrary.

Thus, the Norwegian economy and the industrial structure are in need of restructuring. The oil price decline means that such restructuring may happen more rapidly than was anticipated. Reduced activity in oil-related industries has resulted in unemployment increasing more than previously estimated, especially in southern and western parts of the country. The key challenge for Norway is to create new, profitable jobs in the private sector exposed to international competition. There is a need for new activity that can promote high employment and high overall economic growth, in order to safeguard our level of welfare.

The Government will therefore promote a business-friendly regulatory framework, with a simpler and more growth-inducing tax system, better infrastructure and a competent labour force. This will strengthen the competitiveness of

businesses. Competitive businesses will expand economic growth and secure jobs for the future. A high level of knowledge promotes productivity growth, whilst at the same time expanding the choices of individuals. The Government will deregulate and facilitate competition in both the private and the public sector. Competition promotes productivity growth and efficient resource utilisation.

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

- The Government is submitting, simultaneously with the budget, a report to the Storting on tax reform for the period 2016-2018. It is proposed that the corporate tax rate be reduced from 27 to 25 per cent in 2016, with a further reduction to 22 per cent being announced for 2018. Lower corporate tax will promote investment in Norwegian industry and facilitate higher employment. The Government is proposing tax reductions of NOK 9.1 billion in 2016 for enterprises and individuals. The Government also proposes reductions in the net wealth tax that will strengthen Norwegian private ownership and redirect investments from real estate to jobs. The changes to the tax system will have a favourable effect on the Norwegian economy, make a robust contribution to expanding the capacity for growth and result in improved protection of the Norwegian tax base.
- The Government is reinforcing its fiscal policy effort by earmarking NOK 4 billion for specific measures to increase employment. The package of measures is structured to facilitate long-term restructuring, whilst at the same time delivering swift employment in areas and sectors suffering particularly high unemployment. The measures are designed to be readily reversible. Maintenance, labour market and entrepreneurship measures have been accorded special priority.
- All in all, the Government's proposal for 2016 represents a budget impulse equivalent to 0.7 per cent of mainland GDP.
- The Government is proposing a strong focus

on investment in infrastructure, research and innovation. The budget for next year features, in line with the Government's political platform, as well as the budgets for 2014 and 2015, new initiatives that will reduce the transportation costs of industry, strengthen innovation and enhance the qualifications of the population. These are important measures to reinforce the long-term growth capacity of Norway and achieve a successful restructuring of the Norwegian economy.

The budget for 2016 has a strong focus on employment, activity and restructuring. Future developments in the Norwegian economy are subject to uncertainty. Such developments will show whether there is a need for expanding or curtailing the additional measures. The Government will be ready to act on short notice if necessary.

Budget policy needs to be structured such as to increase the return on the money spent in the public sector. Public sector activities shall become more effective and efficient. The Government therefore wants more of a focus on performance and on output of the resources devoted to the public sector. Public sector productivity growth means that the services offered can be improved without additional expenditure, which also enhances competitiveness and facilitates private sector restructuring. More of the increased petroleum revenue spending is, in line with the fiscal rule, directed towards investment in knowledge and infrastructure, as well as growth-inducing tax reductions.

The Government is resolving important current issues, whilst at the same time preparing Norway for the future.

Weaker growth and need for restructuring of the Norwegian economy

Economic prospects differ from what has typified the last 10-15 years, a period characterised by steep income growth from petroleum exports, lower prices on imported goods and strong growth in the demand for goods, services and manpower in the mainland economy¹.

A number of factors may indicate that the Norwegian economy is moving towards a new norm. Growth in coming years will be lower than over the period since the turn of the millennium. Productivity growth declined in the middle of the previous decade. The ageing of the population is likely to result in lower labour force growth, and the level of labour immigration in coming years is uncertain. Lower net immigration may moderate

the impact of the reduced demand for manpower resulting from the oil price decline. At the same time, petroleum industry demand will fall relative to the size of the mainland economy, which development has been accelerated by the oil price decline. This will require restructuring, especially of industries supplying goods and services offshore. A strong improvement in the terms of trade since the turn of the millennium has turned into a pronounced deterioration as the result of lower prices on oil and other exports.

The oil price reduction, from about USD 110 a barrel last summer to below USD 50 a barrel at present, is making Norway a slightly less rich nation. The State absorbs a major part of the loss in the form of lower revenues from the petroleum sector. This means lower transfers to the Government Pension Fund Global. Although the Government Pension Fund shelters the budget from ongoing oil price fluctuations, the room for manoeuvre in fiscal policy will decline over time if the oil price remains low for a protracted period of time.

The oil price reduction also leads to lower incomes in the petroleum industry, thus adding to the need of oil companies for cutting their costs. This reduces the industry's demand for goods and services from the mainland economy, thus resulting in restructuring of the Norwegian economy. If the oil price remains low, a number of investment projects may be changed, postponed or cancelled. There will, at the same time, still be awarded contracts for development projects that remain profitable at a low oil price, such as the Johan Sverdrup field. Further petroleum investment decline is anticipated for the next two years, but such decline is likely to be less than this year. The role of the petroleum sector in the Norwegian economy is further described in Annex 1.

On the other hand, the oil price reduction will, when taken in isolation, boost growth in the world economy. Low interest rates and other monetary policy measures, especially in the traditional industrialised countries, also support economic growth. Inflation is generally low. Growth has picked up slightly amongst Norway's trading partners, when compared to the weak growth in 2012 and 2013. Developments have nonetheless been unstable and unequally distributed across countries. The international economy is expected to strengthen further next year, driven by improvement in the traditional industrialised countries. The recovery is moderate in Europe, whilst prospects are fairly bright in the US economy. Although growth appears to be declining some-

¹ See box 1 for an explanation of the term Mainland Norway

what in China and a number of other emerging economies, these countries will continue to make significant contributions to overall world economic growth.

The Norwegian krone has depreciated significantly over the last two to three years. This represents a distinct advantage for exporters, petroleum industry suppliers and other businesses exposed to international competition in the Norwegian domestic market. The Norwegian krone depreciation considerably eases the impact on the economy and serves, along with stronger international growth, to stimulate exports from the mainland economy. It is also expected that an increase in mainland industry investment will boost activity in the Norwegian economy ahead.

Lower wage growth serves to improve the competitiveness of Norwegian businesses. Annual wage growth this year is estimated at 2.7 pct., which is significantly lower than in preceding years. The challenging situation of petroleum industry suppliers is expected to contribute to moderate wage growth in 2016 as well. The cost level will nonetheless remain markedly higher than that of our trading partners.

Uncertainty about future economic developments may make households more cautious. A low interest rate level does, at the same time, boost both household demand for goods and services and business investment. Low interest rates also contribute to continued high growth in housing prices and household debt. Norges Bank re-

Box 1 Mainland Norway

Mainland Norway is defined as all economic activity in Norway, excluding petroleum activities and ocean transport. From a stabilisation policy point of view this is the most relevant sector definition.

Petroleum activities represent a major part of value added in the Norwegian economy. In 2014, about one fifth of total value added in Norway was accounted for by petroleum activities, while ocean transport accounted for only 1 per cent, cf. figure 1. Petroleum activities constitute an even larger portion of total exports; over half in 2014. The significance of the petroleum industry is less marked in terms of employment. The petroleum industry accounted for just over 1 per cent of total employment in 2014, the same did ocean transport. The combination of substantial value added and rather low employment in the petroleum sector reflects the high level of productivity and the resource rent in this sector. Since production in the petroleum industry and ocean transport has limited impact on the demand for labour in the Norwegian economy, these sectors are excluded from the analysis of cyclical developments.

Mainland Norway as a proportion of the total economy

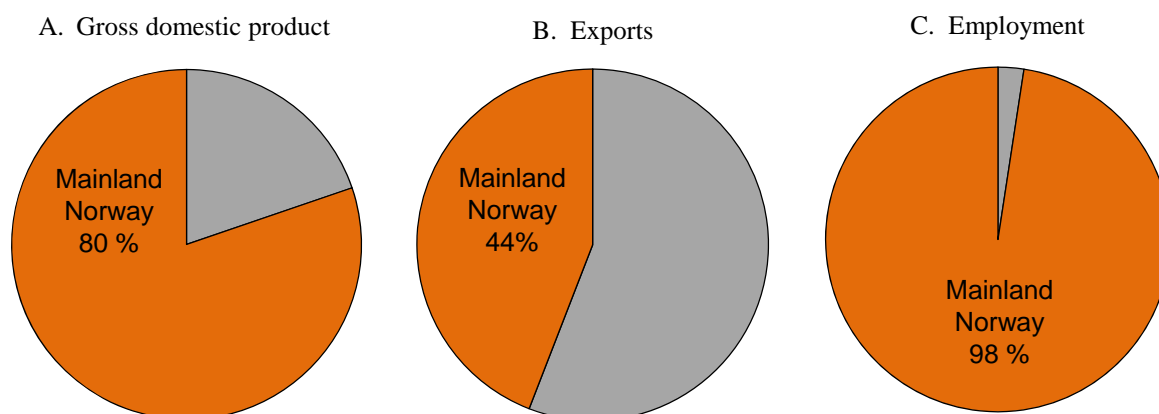


Figure 1 Mainland Norway as a proportion of the total economy

Source: Statistics Norway and Ministry of Finance

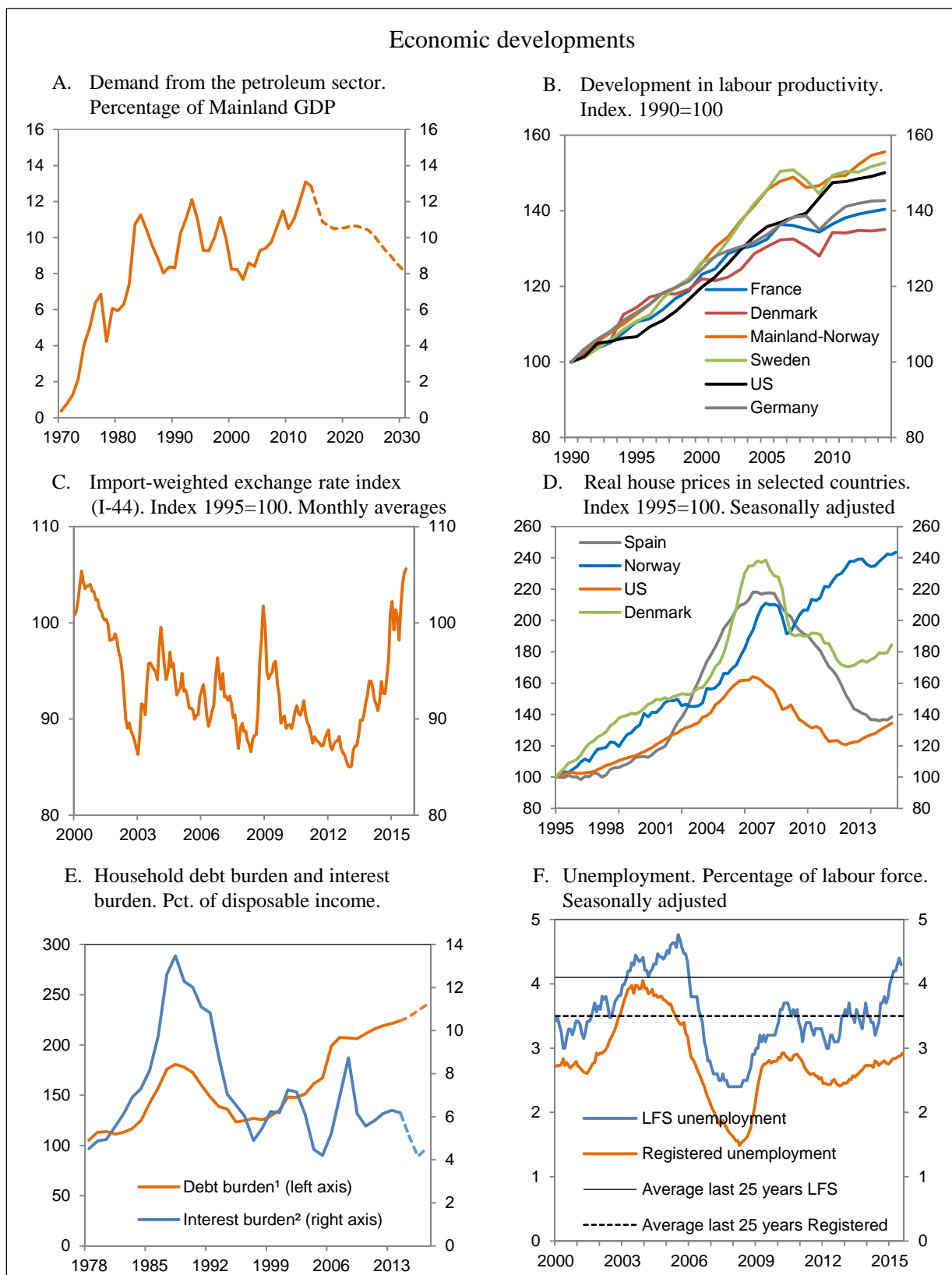


Figure 2 Economic developments

¹ Gross debt measured as share of disposable income.

² Interest rate expenses measured as share of disposable income and interest rate expenses.

Sources: Statistics Norway, OECD, Macrobond, Federal Reserve Bank of Dallas, Real Estate Norway, FINN, Eienomsverdi AS, Norwegian Labour and Welfare Administration and Ministry of Finance.

duced the key policy rate by 0.25 percentage points in both June and September this year. The reasons given for these decisions were that developments in the Norwegian economy have been somewhat weaker than anticipated and that future growth prospects are somewhat lower. Banks have responded by reducing their lending rates to the general public. Norges Bank's most recent estimate suggests that the key policy rate will be reduced towards $\frac{1}{2}$ pct. over the coming year, from the present level of 0.75 pct. Housing prices have continued to increase, and the price level is significantly higher than a year ago. Housing price growth remains very high in large parts of the country.

All in all, mainland GDP growth is expected to decline from $2\frac{1}{4}$ pct. last year to about $1\frac{1}{4}$ pct. this year, and thereafter to increase to $1\frac{3}{4}$ pct. next year. In 2017, growth is expected to increase further, to a level close to the $2\frac{1}{4}$ pct. trend growth of the economy.

The outlook is uncertain. The oil price decline since last summer demonstrates that the outlook for the Norwegian economy may change quickly. Economic developments in China are particularly uncertain. A setback in China and other emerging economies may further reduce the oil price and create financial market turbulence, as observed at the end of this summer. The euro zone recovery remains fragile. Domestically it is uncertain how strongly petroleum industry demand will react to the lower oil price, and what impact this will have on the Norwegian economy and the labour market. Developments also depend on how businesses and households react to a weaker economic outlook and on how competitiveness develops ahead. High housing prices and high household debt may trigger and reinforce a setback in the Norwegian economy.

Although employment continues to grow, the labour market is becoming gradually less tight. Thus far, unemployment has mostly been increasing in southern and western counties with a heavy reliance on deliveries to the petroleum industry. Unemployment has declined or remained unchanged in the majority of other counties. The Statistics Norway Labour Force Survey (LFS) indicates that unemployment has increased to 4.3 pct. Unemployment as registered by the Norwegian Labour and Welfare Administration (NAV) has remained below 3 pct., adjusted for seasonal variations. The difference between these two unemployment measures is the largest for a long time. Much of the difference is caused by a significant increase in LFS unemployment amongst individuals below the age of 25 years, many of whom will not register as unemployed at NAV offices. It would appear that it has become more

difficult for youth to enter the labour market alongside education and upon the completion of education. Unemployment is expected to increase somewhat from current levels.

A well-adapted economic policy

The Government has a special focus on measures to promote employment, activity and restructuring in the fiscal budget for 2016. The Sundvolden Declaration emphasises that petroleum revenue spending shall be tailored to the economic situation, within the limitations defined by the fiscal rule. Mainland economic growth has abated, and unemployment has increased somewhat. Economic growth is expected to pick up next year, but the outlook is uncertain. A more significant economic setback and continued unemployment increase cannot be excluded.

Monetary policy is the first line of defence against a cyclical downturn. Monetary policy shall in the short and medium run balance the need for low and stable inflation against the need for production and employment stability. Interest rates may be changed swiftly if thus merited by economic prospects. The key policy rate is at a record low, and the Norwegian krone has depreciated significantly. In September the Norwegian krone was 12 pct. weaker than a year ago and 20 pct. weaker than at the beginning of 2013. The low interest rate implies that the scope for additional or major interest rate reductions is limited. A very low interest rate will over time also entail a risk of mounting financial imbalances and more risk taking within the financial sector.

Fiscal and monetary policy need to interact when the economy is exposed to a cyclical downturn. For 2015, the Government proposed to increase petroleum revenue spending by $\frac{1}{2}$ pct. of mainland GDP. Hence, the budget was more expansionary than has been the norm for the last ten-fifteen years. The Government will also for next year be pursuing a fiscal policy aimed at counteracting an economic slump. The fiscal policy stimulus is reinforced by NOK 4 billion in special measures to enhance employment, with an emphasis on areas hit particularly hard by the downturn. The Government's proposal provides a budget impulse equivalent to 0.7 pct. of mainland GDP for next year.

All in all, economic policy currently has a strongly expansionary effect. The overall impulses are comprised of a significant Norwegian krone depreciation, interest rates at a record low and a targeted fiscal policy stimulus. Whilst Norwegian krone depreciation is important to facilitate new growth in industries exposed to international competition, a lower interest rate and more expansionary fiscal policy serve to increase domes-

tic demand growth. Fiscal policy has not been more expansionary since the international financial crisis in 2008-2009. Fiscal policy is designed both to boost activity in the short run and to promote restructuring and innovation. The Government is thereby strengthening the growth capacity of the Norwegian economy, thus facilitating economic growth in coming years as well. In aggregate, this economic policy represents a forceful response to a challenging cyclical situation.

Lower demand for goods and services from the petroleum industry implies that Norwegian industry needs to turn to new markets. The sector exposed to international competition need to strengthen over time. A lower oil price means that such restructuring may happen more rapidly than previously assumed. The budget is premised on an expansionary fiscal policy to lessen the short-term effects. The Government notes, at the same time, that an overly expansionary fiscal policy may slow down adaptation to a more competitive wage and cost level, reduce labour market mobility and transfer manpower from the oil and gas industry to the sector sheltered from international competition, instead of to other industries exposed to international competition. Such developments would not be a sound response to the structural challenges facing the Norwegian economy.

Large, fluctuating and transient revenues from natural resources make it important for Norway to have a credible budget policy anchor. The Government Pension Fund Global and the fiscal rule serve to facilitate stability and economic growth in the mainland economy, whilst also making the petroleum and fund revenues available to future generations.

The capital of the Government Pension Fund has grown very rapidly over the last few years. For 2013 and 2014 as a whole, the Norwegian krone value of the Fund increased by an amount corresponding to one year's value added in the mainland economy. This has lifted the so-called 4 per cent path, and the actual spending of petroleum and fund revenues is currently well below 4 pct. of the Fund value. The estimates are subject to considerable uncertainty. Close to half of the increase in Fund value over the last two years is caused by the Norwegian krone depreciation, and does not increase international purchasing power of the Fund. One need to be prepared for major fluctuations in Fund value in coming years. Although there is currently a large gap between petroleum revenue spending and the 4 per cent path, it is most likely that Fund returns will in a few years hit a downward trend, measured as a proportion of value added in the mainland economy. The lower the Fund return and the oil price

fall, the quicker and steeper will such decline be.

The Thøgersen Committee submitted its assessments in June this year. A majority of the committee members noted that a number of considerations suggest that petroleum revenues should be phased more gradually into the economy in coming years than during the period from 2001 until now. When taken in isolation, uncertainty about future developments in funding contributions from the Government Pension Fund suggests, according to the Committee, that restraint should be exercised in phasing in petroleum revenues over the coming years. This will make for a smoother petroleum revenue spending path and a reduced need for swift future restructuring, whilst also leaving a larger Fund for coming generations. The Committee emphasises, at the same time, that annual petroleum revenue phase-in needs to be tailored to the situation of the Norwegian economy.

The economy and competitiveness are affected by the amount of petroleum revenues spent, but also by how these are spent. Report No. 29 (2000-2001) to the Storting on the fiscal rule, submitted by the Stoltenberg I Government, emphasised that tax reductions, research and development, as well as infrastructure, suitable for promoting long-term growth capacity and competitiveness, should be accorded priority within the available room for manoeuvre. The Storting endorsed this and emphasised that an increase in petroleum revenue spending should be focused on measures to enhance productivity, and thus the capacity for growth, in the rest of the economy. The Standing Committee on Finance and Economic Affairs noted unanimously that tax policy, as well as a focus on infrastructure, education and research, is important to create a more well-functioning economy. The Government continues to prioritise these areas in the budget for 2016.

If more or less the same growth in the standard of living as Norwegians have become accustomed to over the last 40 years is to be maintained, productivity will need to increase more rapidly than in recent years. Moreover, society's revenues will need to be used in a sound manner in order to secure the long-term funding of welfare schemes. This requires targeted reforms in the public administration and in the rest of the economy. This effort is well under way through, inter alia, the follow-up of the first report from the Productivity Commission. Both Norwegian and international experience suggests that it may take time for reforms to result in higher productivity.

Work input is important for both economic growth and the sustainability of public finances. Employment is high in Norway, but average working hours are low. This means that work in-

put per capita is no higher than the average for the EU countries. There are, at the same time, many recipients of social security benefits. The portion outside working life as the result of illness or an impaired capacity for work is larger in Norway than in many other countries. It is challenging, but important, to reduce such portion.

Ageing of the population will result in considerably higher expenditure on pensions, as well as on health and care services, in the years to come. Only a minor part of the increased expenditure can be funded by the revenues from the Government Pension Fund. The pension reform is designed to deliver long-term savings and to increase labour supply, but is insufficient to close the gap between government expenditure and revenues in the long run. Consequently, it will be necessary to take further measures to safeguard the funding of the welfare schemes already in place.

Key figures in the budget for 2016

The Government's budget proposal for 2016 implies petroleum revenue spending of NOK 194 billion, as measured by the structural, non-oil deficit. This corresponds to 2.8 pct. of the Government Pension Fund Global as at the beginning of the year. Petroleum revenue spending via the fiscal budget is estimated at 7.1 pct. of trend-GDP for mainland Norway in 2016. This amounts to about NOK 37,000 per capita. Every eighth Norwegian krone spent via government budgets is currently obtained from the Government Pension Fund. The real growth in underlying fiscal budget expenditure is estimated at 2.6 pct. Nominal growth is estimated at 5.2 pct., which somewhat outpaces nominal 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 the aggregate demand for goods and services. The Government is proposing to increase petroleum revenue spending by NOK 22.6 billion from 2015 to 2016, of which the special measures to enhance employment account for a total of NOK 4 billion. The budget impulse is 0.7 percentage points as measured by change in the structural, non-oil deficit, as compared to about ½ percentage points for this year.

For the period 2014-2016 as a whole, the total room for fiscal policy manoeuvre from underlying growth in taxes and increased spending of petroleum and fund revenues can be estimated as just under NOK 115 billion. Increased expenditure through the national insurance scheme has absorbed about ¼ of this room for manoeuvre, whilst close to 23 pct. has been used to reinforce knowledge and communications and 14 pct. has

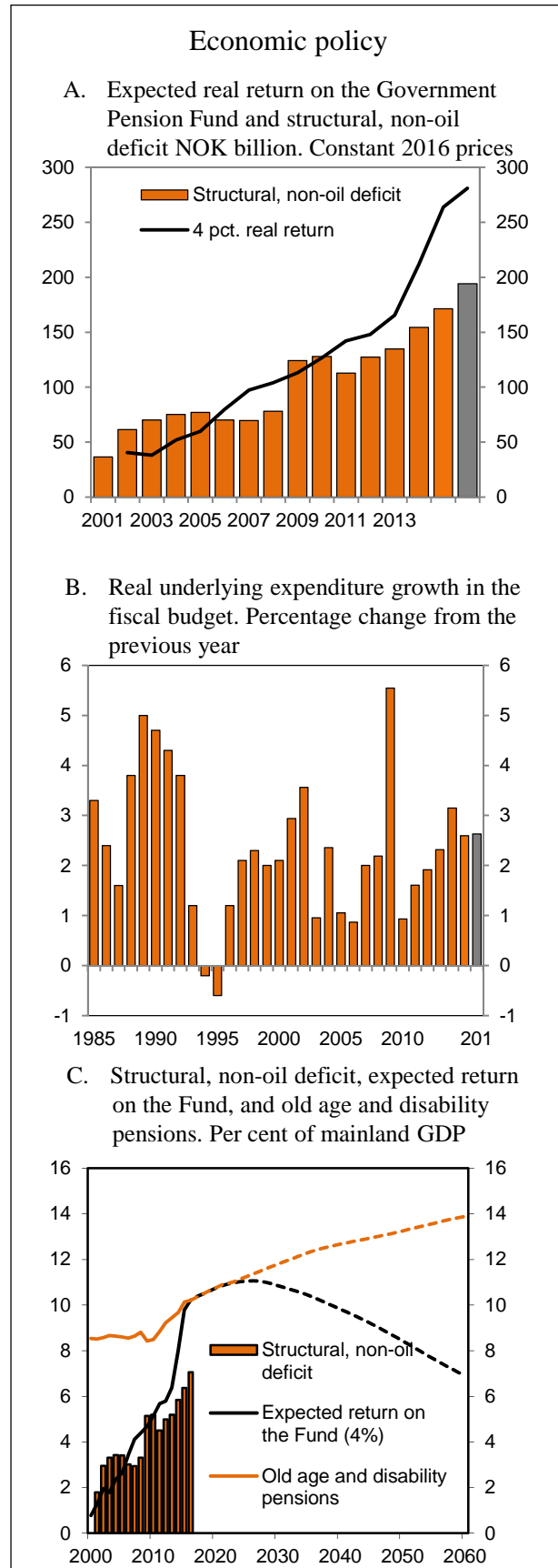


Figure 3 Economic policy
Sources: Statistics Norway and Ministry of Finance.

been committed to tax reductions. Strengthening of local government finances accounts for 19 pct. of the overall room for manoeuvre, including the reinforcement of knowledge and communications under local government auspices. Norway's fiscal framework is elaborated more in Appendix 1, whilst calculation of the structural, non-oil budget balance is discussed in Appendix 2.

The tax proposal

The main role of taxes is to fund public goods and services in the most efficient manner. An improved tax system may also make the economy more productive. The Government is seeking a simpler tax system that is more conducive to growth. A lower tax level and a better tax system shall make it more profitable to work, save, invest and behave in an environmentally friendly manner.

Such a tax policy will also have a favourable dynamic impact on the economy. Increased labour force participation and higher economic growth will extend the tax base, thus funding part of the tax reduction over time. The Government is also submitting, simultaneously with the submission of the fiscal budget for 2016, Report No. 4 (2015-2016) to the Storting; Better Taxation – A Tax Reform for Transformation and Growth. In that report the Government proposes, inter alia, to reduce the statutory corporate tax rate to 22 pct. in 2018, and to make necessary changes to personal taxation. This is in follow-up of the Tax Commission's report, cf. the NOU 2014: 13 Capital Taxation in an International Economy.

In order to facilitate restructuring and strengthen the basis for growth in the Norwegian economy, the Government would like to commence its follow-up of the Tax Commission's recommendations already in the 2016 budget. The budget proposal for 2016 includes new tax reductions totalling about NOK 9.1 billion accrued and NOK 3.1 billion booked. The Government is proposing to reduce statutory corporate tax rate from 27 til 25 pct. in 2016. The Government also proposes to reduce the tax rate on ordinary income for individuals from 27 to 25 pct. The Government is also proposing the introduction of a bracket tax on personal income to replace the current surtax, but in such a way as to reduce the overall marginal tax rate in all brackets. The tax on dividends will be adjusted to make the overall tax on distributed profits about the same as at present. The Government is proposing additional reductions to the net wealth tax. The tax rate will be lowered, whilst the basic allowance and taxable values will be increased. This will make it more profitable to save and to invest in productive activities.

The Government proposes, in order to counteract tax planning and simplify the regulatory framework, that loans to personal shareholders shall for tax purposes be treated as dividends on the part of the shareholder. The Government is also proposing to tighten the rule that limits interest deductions for interest paid to associated companies (the interest deduction limitation rule). The limit will be reduced from 30 to 25 pct. of earnings before interest, taxes, depreciation and amortisation. The Government is proposing to increase the low rate of value added tax from 8 to 10 pct.

The Government is proposing, as part of its simplification effort, improvements to the taxation of benefits from occupational vehicles, as well as abolition of the deductibility of minor expenses and the right to tax-exempted compensation for such expenses.

The Government is proposing, in connection with a review of agricultural taxation, to exclude gains from the sale of agricultural properties from the personal income base, whilst at the same time abolishing the special tax exemption for gains from intra-family agricultural property sales.

Certain other tax proposal are additional to the above. The rate of electricity consumption tax for businesses with data storage as their main activity will be reduced to the lowest industrial rate, and a road usage tax on gas will be introduced. A tax scheme for household energy efficiency investments will also be introduced.

The Governments main priorities

The Government has in the budget for 2016 accorded priority to measures promoting employment, activity and restructuring. It is necessary both to facilitate employment growth to respond to the cyclical downturn in the short run and to pave the way for long-term restructuring to create new jobs in the sector exposed to international competition as the petroleum industry will gradually become a less important driver for the economy.

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

– *Competitiveness for Norwegian jobs.* The costs of Norwegian business are much higher than those of our trading partners. Productivity growth has, at the same time, declined since the middle of the previous decade. This challenges the ability of businesses to compete with their international peers. The decline in petroleum industry demand will also test our capacity for restructuring. Lower petroleum industry activity is not a short-term cyclical

phenomenon, but a more long-term structural change. Petroleum revenue spending needs to be both tailored to the situation in the Norwegian economy and focused on measures to improve its long-term growth capacity. The Government is proposing lower taxes and an expansion of infrastructure, innovation, research and knowledge, in order to stimulate employment, savings and investment. The Government will stimulate more business entrepreneurship and proposes, inter alia, expanded appropriations for Innovation Norway's entrepreneurship grant scheme and pre-seed capital fund. The Government proposes to embark on the development of a new administrative processing system at the Brønnøysund Register Centre, as part of its effort to digitalise and modernise the public sector. The new system will benefit business through simplifications and savings.

- *The Government will strengthen infrastructure.* Efficient communications reduce costs and travel times for businesses and individuals. The Government's budget proposal increases appropriations for road purposes under the Ministry of Transport and Communications by NOK 4.9 billion. The Government is proposing a NOK 1 billion start-up appropriation for the road development enterprise and is planning to increase the annual contribution to the enterprise to NOK 5 billion in 2018. In addition, it is proposing a NOK 30 billion capital contribution to the infrastructure fund. This will bring the fund capital to NOK 100 billion. The National Transport Plan 2014-2023 (NTP) outlines an ambitious expansion of road and public transport investment. The Government's budget proposal entails a real increase in appropriations for NTP purposes in the amount of NOK 3.8 billion, compared to 2015. The budget proposal implies that the financial requirements under the first part of the NTP will be exceeded in 2017, even without further increases and without continuation of the package of measures for 2016. The level of railway investment activity has been very high thus far in the NTP period. Expenditure on the large ongoing projects will be reduced somewhat in 2016 to facilitate rational progress. It is proposed, at the same time, to increase appropriations for railway maintenance and renewal. The appropriation proposal implies a significant reduction of the maintenance lag for both roads and railways in 2016. The Government is also reforming the transport sector in important ways. The railway sector is being reorganised and more competition is being introduced. The

new road development enterprise is to focus on integrated development, enhanced efficiency and improved economic profitability.

- *Knowledge creates opportunities for all.* The Government harbours high ambitions for Norway as a knowledge nation. This requires quality at all levels, from kindergartens, via schools, to higher education and research. The Government is proposing increased appropriations to enhance qualifications and quality in kindergartens, and will in 2016 realise the objective of equal treatment of municipal and non-municipal kindergartens. The Teacher Enhancement Programme is the Government's initiative to promote robust academic and pedagogical teacher qualifications as a prerequisite for improving quality in Norwegian schools. The number of recruitment posts will be expanded. Appropriations are proposed for establishing a more appropriate structure for higher education and research institutions. Financial terms for students are improved for the third year in a row through increasing basic support by more than the rate of inflation. Considerable appropriations are also proposed to follow up the long-term plan for research and higher education.
- *A simpler life for people.* The Government will focus more on the freedom of individuals. This signals trust in the population and will expand the scope for private, voluntary and local initiatives. Lower taxes will give individuals more freedom in using their own income. Less bureaucracy will simplify people's life. The Government is continuing the de-bureaucratisation and efficiency reform in 2016, thus requiring all central government bodies to increase productivity by no less than 0.5 per cent from the previous year. The budget for 2016 facilitates increased digitalisation of public services. Such facilitation includes, inter alia, completing the development of electronic applications in the Norwegian State Housing Bank. The National Registry will be modernised, and the systems for electronic interaction between individuals and the health and care sector will be enhanced. These measures will result in new services that are easier to use for both individuals and businesses. Increased digitalisation will also contribute to enhancing the efficiency and effectiveness of the public sector.
- *Improved security.* The Local Police Reform will be implemented from 1 January 2016. This reform will reduce the number of police districts, which requires conversion of police

operations centres. The budget proposal provides scope for follow-up of the reform, modernisation of police ICT systems and hiring all graduates from the Norwegian Police University College. A concept selection study and initial quality assurance (QA1) have been completed for a new emergency response co-ordination centre for the police, and appropriations for planning and design are proposed for 2016. Correctional service expenditure on renting prison capacity in the Netherlands is increased. The budget proposal also implies that prison capacity at Ullersmo and Eidsberg will be expanded to accommodate 181 additional inmates, which is intended to replace capacity lost when Oslo Prison, Department A, is closed down. Maintenance is also expanded in a number of prisons as part of the Government's package of employment enhancement measures. The Government is also according priority to the Norwegian Police Security Service, which is in need of, inter alia, additional premises. The budget proposal also entails an expansion of processing capacity at the Norwegian Directorate of Immigration and strengthening of the civil protection capabilities of the country governors. Moreover, the Government will improve the border checks of Norwegian Customs and Excise through video recording at all road-based border crossings and expansion of its personnel.

- *A welfare boost for the sick and the elderly.* The Government aims for everyone to have access to equivalent health services of a good quality. The budget proposal gives scope for expanding the treatment of patients in hospitals by 2.5 per cent, which is a large number compared to previous years. The establishment of a PET centre is proposed for the University Hospital of North Norway in Tromsø, along with maintenance investments at the Oslo University Hospital. The Government will in 2016 continue the free choice of treatment reform to reduce waiting times, improve freedom of choice on the part of patients and stimulate public hospitals to enhance efficiency and effectiveness. Care services shall be adapted to enable more of the elderly to live longer at home and afford everyone the opportunity to live an active and good life. The budget facilitates municipal expansion of full-time care and improved capacity in daytime services for people with dementia. Trials involving central government funding of care services will commence in 2016.
- *A stronger social safety net.* It's important to prevent people from falling outside the labour market and important social arenas in the re-

structuring process facing Norway. One of the challenges is to enable more adults to gain the basic skills and qualifications required in working life. The Government is proposing tailored module-based training. The Government will also develop and make use of tools to survey fundamental skills in adults, and initiate trials in basic Norwegian training through the programmes to enhance fundamental qualifications in working life and the voluntary sector. Furthermore, a new two-year training initiative under the auspices of the Norwegian Labour and Welfare Administration (NAV) is proposed for individuals with weak basic skills. The Government is committed to ensuring more equivalent opportunities for children who grow up in poor families, and is following up *Children Who Live in Poverty – the Government's Strategy* through measures and initiatives in the budget for 2016. A strengthening of central government child welfare services is proposed. The Government is also proposing subventions for additional rental accommodation and improvements to the housing benefit scheme. The Government will launch a plan to expand efforts to combat drug and alcohol abuse in the autumn of 2015. This plan is reflected in the budget for 2016 through, inter alia, increased grants for employment training, mobilisation, etc., under the auspices of voluntary organisations, as well as the establishment and expansion of a court-supervised anti-drug treatment programme. The budget also enables hospitals and municipalities to improve their services for individuals with drug and alcohol problems, as well as those with mental disorders.

- *Vibrant local democracy.* The Government will give individuals, local communities and municipalities more freedom and more influence over their everyday existence. The Government has embarked on a local government reform to prepare municipalities for dealing with future challenges. The objectives of the local government reform are good and equivalent services for the population, integrated and coordinated social development, sustainable and financially robust municipalities and strengthened local democracy. Central government micromanagement shall be curtailed, with power and accountability being shifted closer to where people live. The framework for local government reform was defined through the Storting's deliberation of the Local Government Proposition for 2015, whilst the assignment of responsibilities to municipalities was addressed in Report No. 14 (2014-2015) to the Storting. The report also discussed how re-

gional democracy can be enhanced. The real growth in total local government revenues for 2016 is NOK 7.3 billion, as calculated by reference to the estimated level of revenues in 2015 following the Storting's deliberation of the Revised National Budget for 2015. This is more than was announced in the Local Government Proposition for 2016. NOK 4.7 billion of such overall revenue increase is in the form of unrestricted revenues. More efficient local and regional government resource use may give scope for strengthening the services offered beyond that implied by the real growth in revenues.

It is a particular challenge that many people are now losing their jobs in the industries and counties most affected by the low oil price. The Government is proposing a *package of measures for increased employment* in the total amount of NOK 4 billion as part of the budget. The special measures in this package will be temporary and structured such as to be readily reversible. These measures include, inter alia, accelerated maintenance investment in hospitals, expanded maintenance and renewal of road and railway sections, research and innovation grants, one-time subventions for maintenance and rehabilitation of municipal schools and care homes, maintenance and upgrading of research vessels, improved flooding, landslip and avalanche protection, rehabilitation of the University Museum of Bergen and upgrading of other university buildings. The package also includes additional work placements for the unemployed, expanded capacity in practical pedagogical education and more recruitment posts in universities and university colleges.

Financial stability

Financial stability is an important prerequisite for macroeconomic stability, and vice versa. In order to facilitate financial stability, Norwegian authorities are committed to promoting solvency, liquidity and sound conduct through government regulation and supervision. Household debts continue to outgrow household incomes. High household debts and high housing prices have increased the risk that financial imbalances may trigger or escalate a downturn in the Norwegian economy. In June 2015, the Government presented a housing market strategy featuring measures to limit debt increases and make it cheaper to build new homes, in order to promote more healthy housing price and debt developments. The Government has, as a temporary measure, imposed stricter requirements for the granting of new housing loans.

The regulatory framework governing the financial industry in Norway is largely based on EU

and EEA regulations. An important aspect of the EEA effort is the so-called supervisory authorities issue. The EU established a new EU supervision structure with effect from 1 January 2011, comprising one «macro-prudential» body and three «micro-prudential» bodies within the financial markets area. In October 2014, political agreement was reached between the EU member states and the three EEA countries concerning the principles for EEA adaptations to the legislative acts establishing and granting powers to the supervisory authorities. The EU side and the three EEA-EFTA countries are currently collaborating on the formulation of EEA adaptations to enable the legislative acts on supervisory authorities to be incorporated into the EEA Agreement.

Norwegian authorities have attached special weight to strengthening capital adequacy requirements for banking and insurance. The Norwegian rules are based on corresponding EU rules. The Ministry is also in the process of examining other regulations aimed at strengthening the financial sector. The Banking Law Commission is, inter alia, looking into Norwegian implementation of EEA provisions corresponding to the EU Bank Recovery and Resolution Directive. Various legislative committees have been appointed to examine the implementation of EEA provisions on securities markets, financial reporting and money laundering.

Favourable developments in the Norwegian economy have contributed to strong performance and robust earnings on the part of Norwegian financial institutions. Banks, in particular, have registered income, capital adequacy and earnings improvements. The market share of Norwegian banks in the Norwegian banking market has remained fairly stable since 2008. The tightening of capital adequacy requirements continues to be rolled out. The strong performance of banks suggests that these will be well placed to further improve their solvency. A low interest rate level and increasing life expectancy mean that life insurers and pension funds need to expand capital provisions. New capital adequacy requirements for insurance companies better reflect the risks these are facing. Robust financial institutions and an efficient capital market enhance the restructuring capacity of the economy.

Employment and incomes policy

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

The scope of the regulations on temporary

layoffs was expanded with effect from 1 July this year. This makes it easier for businesses to retain qualified manpower. The benefits offered by more generous provisions on temporary layoffs must, on the other hand, be balanced against the risk that these may impair labour market mobility. The unemployment benefit regulations also play a key role in this context. It is of particular importance to enforce the mobility requirements under the scheme when unemployment varies significantly between various parts of the country. In addition, it is necessary to offer assistance to vulnerable groups with limited qualifications, or qualifications for which there is little demand, to prevent these from falling permanently outside the labour market. Work placements were expanded by 1,500 places in the second half of this year in connection with the Revised National Budget. The Government is now proposing to expand these by 3,250 places from the average level of 2015, to an average of 16,000 places for 2016. Measures targeting individuals with an impaired capacity for work are in addition to this, and it is proposed that such measures be continued at the same level as in 2015.

The Government is proposing a designated youth package in its budget for 2016, in order to strengthen the working life prospects of young people. These measures are focused on the labour market, as well as on training and qualifications.

Wage bargaining is the responsibility of the social partners. Coordinated wage bargaining, in which key industries in the sector exposed to international competition are the first to bargain, is intended to keep wage growth within limits that are sustainable over time for industries 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 contributes to a common understanding of the economic situation, as well as the challenges facing the Norwegian economy, on the part of the authorities and the social partners. Wage settlements that are tailored to the economic situation will serve to reduce the impact of lower petroleum industry demand on production, jobs and unemployment.

Measures to promote a more productive and efficient economy

The Government holds the weak productivity developments in Norway to be a cause for concern. The Government is premising its policy on the objective of making the most effective and efficient use of society's resources, and is committed to increasing productivity in the Norwe-

gian economy. Good resource utilisation in the private and public sector will serve to increase value added, and hence is important in terms of the standard of living and welfare schemes. Good capacity for restructuring will, at the same time, leave the Norwegian economy better placed to respond to changing international realities. The Government is committed to a continuous efficiency enhancement effort.

The Government appointed a Productivity Commission in the spring of 2014. The Commission submitted its first report, NOU 2015: 1 Green Paper; *Productivity – Underpinning Growth and Welfare*, in February 2015. The report identifies a number of areas, in both the private and the public sector, offering considerable potential for productivity gains. The Government has already followed up on a number of the Commission's proposals. The Commission will publish its final report early next year.

Climate and poverty challenges

The climate challenge is global in nature, and is best solved globally. The Government works towards an ambitious global climate agreement under the UN Framework Convention on Climate Change, in line with keeping global warming below 2°C. At the end of March, Norway submitted an intended nationally determined contribution to the UN, comprising two elements:

- Norway is committed to at target of at least 40 per cent reduction of green house gas emissions by 2030, compared to 1990 levels.
- Norway is pursuing a dialogue with the EU with a view to to fulfil this commitment through a collective delivery with the other European countries.

The Government believes that an agreement on joint fulfilment with the EU will be the best solution. In the absence of such an agreement, the ambition of reducing emissions by at least 40 pct. by 2030 still stands. In this situation Norway assumes access to flexible mechanisms as in the case with collective delivery with the EU and will continue to use market based mechanisms under the UN.

The Government is pursuing an ambitious climate policy and reinforcing the parliamentary climate agreement. The most important climate policy measures are taxes and EU ETS participation. A Green Tax Commission, which is to complete its work by December 1 2015, is mandated to consider whether our climate objectives can be reached more efficiently through a green tax shift. Climate policy is strengthened in this year's budget. The Government is proposing, inter alia, a NOK 14.3 billion capital contribution to the

Fund for Climate, Renewable Energy and Energy Efficiency Measures in 2016. The fund capital will after this be NOK 67.8 billion.

Combating international poverty and humanitarian crises is also a joint global responsibility. The Government proposes to increase humanitarian aid by NOK 1 billion from the Balanced Budget for 2015, to NOK 4.3 billion. The humanitarian budget is at a historically high level, and a significant portion of this will be allocated to assisting the Syrian population and refugees in the neighbouring countries. Other aid priorities are education, global health and industrial development. Special priority will be accorded to girls and marginalised groups as far as education is concerned.

The Government Pension Fund

The Government Pension Fund is intended to support long-term considerations in the spending of government petroleum revenues and to facili-

tate savings to finance pension expenditure through the national insurance scheme. The Fund shall be managed with a view to achieving the highest possible return over time, subject to a moderate level of risk. Sound long-term management of the Fund contributes to intergenerational equality, by enabling both current and future generations to benefit from the petroleum revenues.

The Government Pension Fund Norway predominantly invests in equities and bonds in the Norwegian market. The Government Pension Fund Global invests in equities, bonds and real estate across a broad range of countries, sectors and companies. Broad diversification of the investments reduces the overall risk. The Government Pension Fund shall be managed in a responsible manner. Good long-term financial return is assumed to depend on sustainable development and well-functioning markets.

Table 1. Key figures for the Norwegian economy. The National Budget 2016.

	2014	2015	2016	2017
Real economy. Percentage change from the previous year. Volume.				
Private consumption	2,0	2,5	1,9	2,8
Public consumption	2,7	2,4	2,7	1,4
Gross fixed investment	0,6	-2,4	0,2	2,5
Of which: Public sector	8,2	3,5	3,0	3,2
Petroleum extraction and pipeline transportation.....	-1,7	-11,3	-8,1	-5,5
Demand from Mainland Norway ¹	2,1	2,2	2,4	2,9
Exports	2,7	2,5	1,3	2,4
Of which: Traditional goods.....	2,3	4,1	4,0	4,0
Imports	1,9	2,5	2,7	4,5
Gross domestic product	2,2	1,2	1,2	1,6
Of which: Mainland Norway	2,2	1,3	1,8	2,1
Labour market				
Employment, persons (percentage growth)	1,1	0,5	0,5	0,9
Unemployment rate, LFS (level)	3,5	4,4	4,5	4,2
Unemployment rate, registered (level)	2,8	2,9	3,2	3,1
Prices and wages. Percentage change from the previous year				
Annual wage	3,1	2,7	2,7	3,0
Consumer price index (CPI).....	2,0	2,1	2,5	2,1
Underlying inflation (CPI-ATE)	2,4	2,7	2,5	2,1
Oil price. NOK per barrel ² (level)	621	432	440	474
Interest rates and exchange rates				
Three-month money market rates (percent) ³	1,7	1,3	0,8	0,9
Import-weighted exchange rate (yearly change in percent) ⁴	5,0	9,0	1,5	0,6
Main numbers. National budget 2016. Billion NOK				
Structural, non-oil budget deficit.....	146,9	167,2	194,0	..
Change from previous year in percentage points...	0,7	0,5	0,7	..
Expected real return (4%-path).....	201,3	257,2	281,0	..

¹Excluding inventory changes²Current prices³Calculated based on forward rates in September⁴A positive number indicates a depreciation of the krone and

Sources: Statistics Norway and Ministry of Finance

Appendix 1

Norway's fiscal framework

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

The Government Pension Fund Global (GPF) and the fiscal rule for the use of oil 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 to the GPF in its entirety. 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, which is estimated at 4 per cent. This framework *delinks the earning and use of petroleum revenue*, which is a necessary condition for sound macroeconomic management. The framework helps buttressing against 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 GPF. 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 GPF 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 GPF, 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. The figure also shows how the spending rule helps Norway to convert substantial, yet temporary and fluctuat-

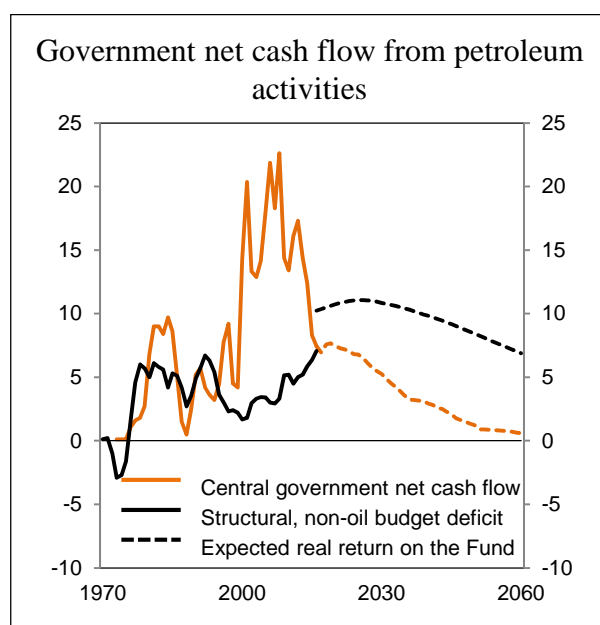


Figure A.1 The State's net cash flow from the petroleum sector, the structural, non-oil deficit and expected real return from the Government Pension Fund Global. Per cent of trend-GDP for mainland Norway

Source: Ministry of Finance and Statistics Norway.

ing 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 is expected to increase for some more years, and then peak. The proportion will then fall gradually as flows into the Fund diminish and the mainland economy continues to grow.

The last couple of years the value of the GPFG has increased rapidly. In September this year the value of the Fund amounted to more than 2½ times mainland GDP. Much of this increase is due to a weaker NOK exchange rate, which does not affect the Fund's international purchasing power. Experiences show that both

exchange rates and equity and bond prices can change significantly in a short period of time, and that these changes can go both ways. Volatility in the Fund's value and return may become more significant both in relation to the size of the state's other incomes and in relation to the underlying growth in the mainland economy. This kind of volatility may make the expected return of the Fund less appropriate as a short-term operative target for fiscal policy. An expert commission has assessed the application of the fiscal rule in light of the stark increase in the value of GPFG and challenges in the Norwegian economy in the short and long run. The report was presented in June 2015 and then sent on a public hearing until 1 November 2015.²

² Read more: <https://www.regjeringen.no/en/whatsnew/Ministries/fin/press-releases/2015/expert-commission-reports-on-the-application-of-the-fiscal-rule/recommends-a-more-gradual-phasing-in-of-oil-revenues/id2423646/>

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 changes in budget policy. To secure the best possible 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.

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 1960–2013, extended to 2025 using forecasts. The projection period is based on the Ministry of Finance's medium-term projections and the continu-

ation of the proposed tax programme for 2016. The assumptions may be summarised as follows:

- *Taxes on labour.* This category includes employers' national insurance contributions and personal taxes, including net wealth tax levied on individuals. The development in the number of normal man-years employed is an important indicator of developments in employers' national insurance contributions and total personal taxes. The estimates are based on population projections from Statistics Norway, which among other things assume high immigration from the EEA.
- *Taxes on capital.* This category includes taxes paid in arrears by companies and other non-individual taxpayers outside the petroleum industry, withholding tax and inheritance tax (until its abolition as of 2015). It has been assumed that taxes from enterprises outside the petroleum industry will remain approximately unchanged as a proportion of mainland GDP after 2016.
- *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. It also includes the investment tax until its abolition in 2002. Private consumption developments are an important influence on indirect taxes.

On the expenditure side of the budget, a cycli-

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

	2014	2015	2016
Non-oil budget deficit	160 008	179 589	207 809
+ Net interest payments and transfers from Norges Bank. Deviation from trend.....	462	9 771	14 644
+ Accounting technicalities.....	0	-1 975	0
+ Taxes and unemployment benefits. Deviation from trend	-13 611	-20 166	-28 426
= Structural, non-oil budget deficit	146 859	167 219	194 026
Measured in pct. of trend-GDP for mainland Norway.....	5,8	6,4	7,1
Change from previous year in percentage points ¹	0,7	0,5	0,7

¹ Changes in the structural, non-oil budget deficit as a proportion of trend GDP for mainland Norway are used as a rough indicator of the budget's impact on the economy. Positive figures indicate that the budget has an expansionary impact.

Source: Ministry of Finance and Statistics Norway.

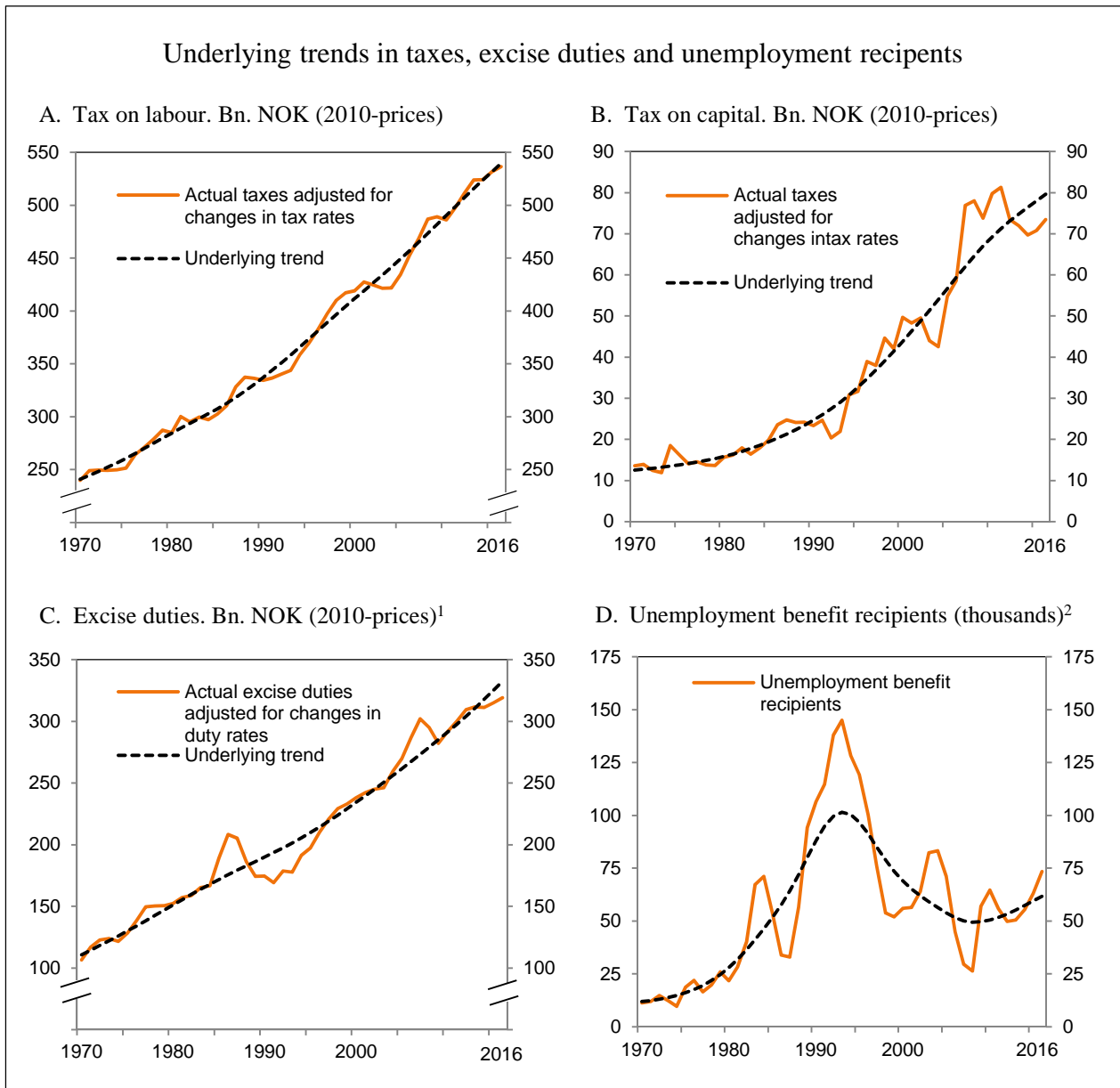


Figure A.2 Underlying trends in direct and indirect taxes and the number of unemployment benefit recipients

¹ For years up to and including 2014, actual taxes as per the national accounts are shown adjusted for changes in tax rates and the tax base and converted into fixed 2010 prices.

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

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

cal correction is made to unemployment benefit expenditure based on estimated trend deviations for the number of unemployment benefit recipients.

Developments in the three main groups of direct and indirect taxes and the number of un-

employment benefit recipients are shown in Figures A.2A to A.2D.

Developments in the non-oil and the structural, non-oil fiscal budget surplus are shown in Figure A.3. As regards the surpluses in the years 1987–1988 and the small surpluses in 2001 and 2007, it

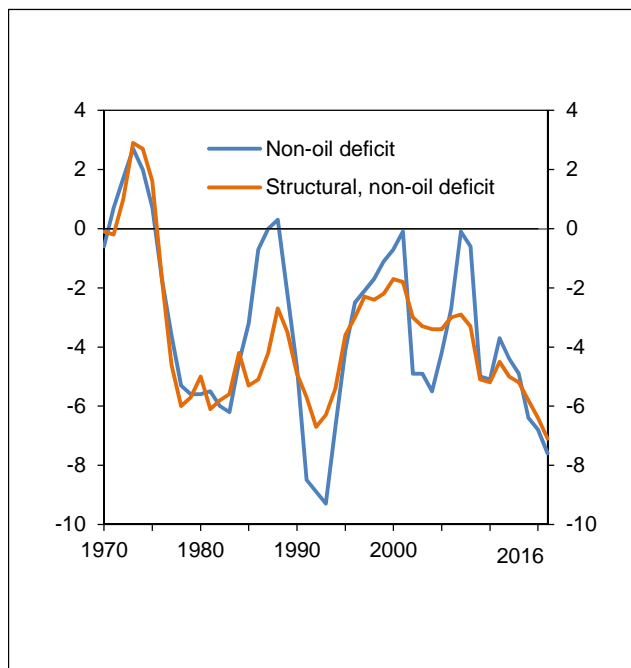


Figure A.3 Non-oil and structural, non-oil budget balance. Per cent of trend-GDP for mainland Norway.

Source: Ministry of Finance

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.

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 mainland economy direct and indirect tax revenues influence the expenditure side of the budget.

Experience shows that it is difficult to distinguish the impact of economic cycles from the underlying tax revenue trend. The estimated structural, non-oil deficit may thus be revised considerably if new information emerges. Table A.1 provides an overview of revised budget position estimates since 2002. The Ministry of Finance's method for calculating the structural, non-oil budget balance is explained further in a working paper which can be downloaded from the Ministry's website (www.regjeringen.no/fin).

Appendix 3

The role of the petroleum sector in the Norwegian economy

The petroleum sector generates large, but fluctuating, revenues for Norway. From 1970 until the present day, an industry has been developed whose value added has over the ten last years varied around 23 to 33 per cent of mainland GDP. The petroleum industry contributes, through its demand for goods and services, to considerable activity and to a range of jobs in the remainder of the Norwegian economy as well. The tax system and the State's Direct Financial Interest (SDØE) ensure that most of the net extraction revenues accrue to the State. Such revenues make a major contribution to the funding of the welfare state and the strengthening of public finances. The State's net cash flow from petroleum activities has represented about 30 per cent of the State's total income since 2000. How the petroleum revenues are handled in fiscal policy is discussed in Appendix 1.

Growth in aggregate demand from the petroleum sector was particularly steep from the mid-1970s to the mid-1980s. Subsequently, demand from the sector fluctuated around a fairly stable level as a percentage of mainland GDP, before picking up significantly again over the period 2005-2013. Last year demand ceased to grow, and it is estimated that the demand as a share of mainland GDP will fall in the next three years.

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

Investments make the biggest share of aggregated demand. In 2014 the petroleum investments corresponded to around 9 per cent of mainland economy value added.

Intermediate inputs have increased gradually. For a long time offshore production increased faster than mainland economy production. In the past decade the increase is partly due to high cost inflation in the sector and partly due to increased complexity.

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

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