DET KONGELIGE
FINANSDEPARTEMENT

Royal Ministry of Finance

The National Budget 2010

A summary

Contents: page

1 Economic outlook

The Norwegian economy has been affected by the global recession, but the downturn seems to be less severe than in many other countries. The implementation of extensive liquidity and credit policy actions, as well as expansionary fiscal and monetary policy measures, has stabilised the economy and provided stimulus to domestic demand. The economy has performed better than expected only a few months ago, and the outlook has improved.

Household demand appears to be picking up more quickly than anticipated. Since around 90 pct. of all home mortgages in Norway have floating rates, the reduction in interest rates has quickly increased the purchasing power of Norwegian households. After five quarters of decline, goods consumption increased by 1 pct. from the first to the second quarter of this year, and the rise appears to have continued into the third quarter. An increase in private consumption of 0.3 pct. is now forecast for 2009 and 4 pct. for 2010. Housing prices, too, have picked up and measured in nominal terms prices are now back at the high levels from the summer 2007. The increase in house prices means a more profitable housing construction sector and may spur a gradual increase in housing starts.

The forecasts for petroleum investment have been adjusted substantially upward since the spring, especially for 2010. Exports of traditional goods are not expected to add to growth in the near future, due to below trend growth internationally and a high Norwegian cost level. The situation for the ship building industry is uncertain due to few new contracts and falling backlog of orders. Business investments in the mainland economy is not expected to pick up substantially again until later in the recovery. Overall, a decline in GDP for Mainland Norway of 1,1 pct. is expected this year, whereas the growth forecast for 2010 has been adjusted upward from 0.8 pct. in the Revised National Budget to 2.1 pct. now.

With growth below trend, the labour market is expected to remain subdued for some time to come. Even so, the labour market has performed better than expected in recent months. Employment was stable in the second quarter and unemployment measured by Statistics Norway's Labour Force Survey remained steady at 3.1 pct. through the first half of this year . This level of unemployment is 1¼ percentage points lower than the average for the preceding 20 years. An unemployment rate of 3.2 pct. is forecast for 2009 and 3.7 pct. for 2010.

Wage growth is expected to slow substantially from 2008 to 2009, due to weaker corporate profitability and higher unemployment. Wages are forecast to grow by 4 pct. this year, down from 6 pct. last year. The carry over into 2010 appears to be low. Slow wage growth in trading partner countries and a continued strained market and profitability situation points towards a further decline in wage growth next year, and a wage growth of 3½ pct. is forecast for 2010. Even so, wage growth is likely to be higher in Norway than among our most important trading partners both in 2009 and 2010.

After being surprisingly high for several months, growth in consumer prices slowed considerably in July and August, owing to, *inter alia*, lower growth in airfares, food prices and rents. The consumer price index is expected to rise by 1¾ pct. in both 2009 and 2010, whereas consumer prices adjusted for taxes and excluding energy products (CPI-ATE) are forecast to increase by 2½ and 1½ pct., respectively, for the two years. It is primarily the slow growth in import prices that will moderate CPI-ATE growth in the near term.

Money market interest rates have fallen sharply since the turmoil in the financial markets began last autumn. This reflects both a cut in key policy rates and a partial reversal of the higher risk premium between money market rates and the key policy rate. Also the banks' lending rates

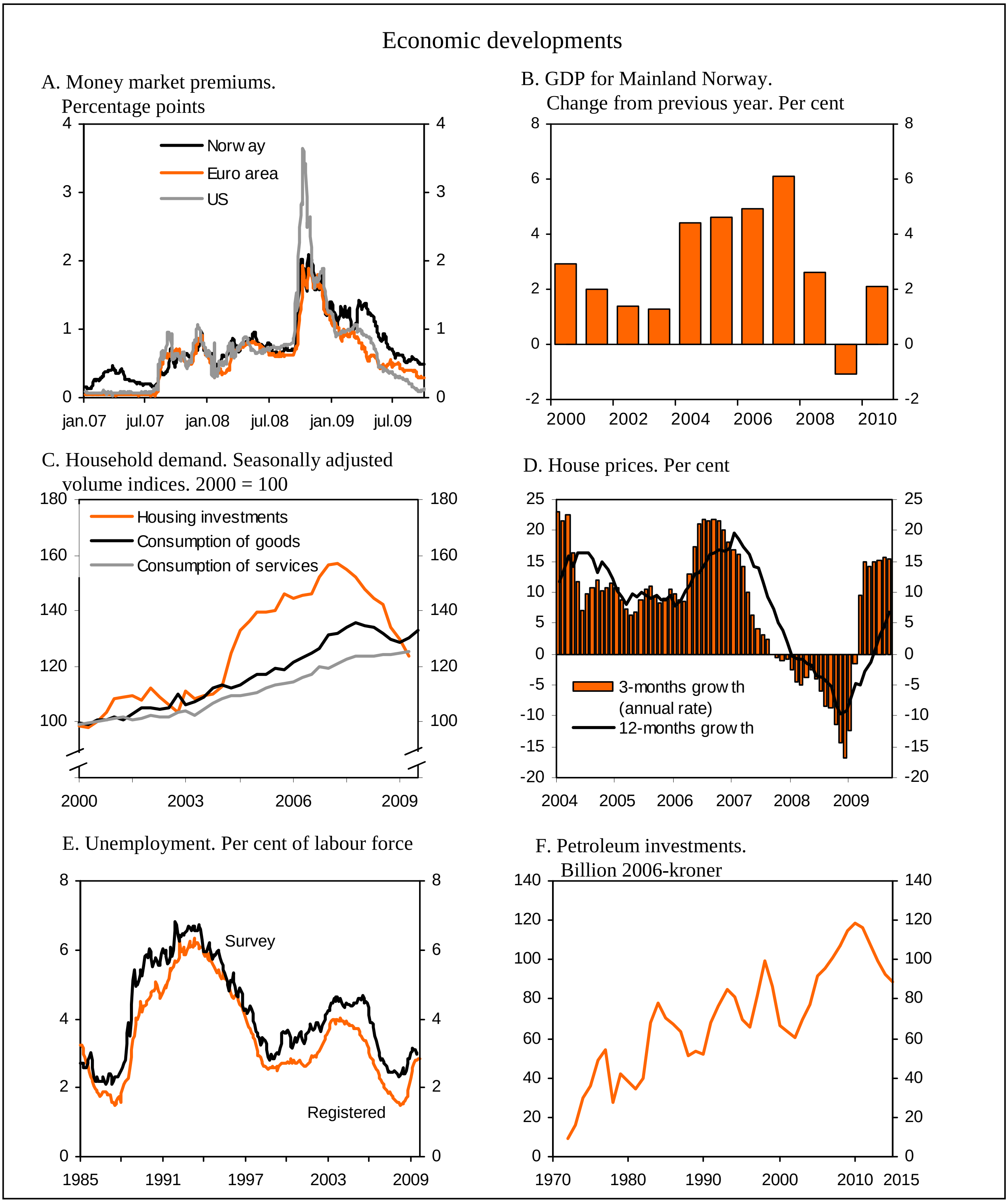


Figure 1 Economic developments

Sources: Statistics Norway and Ministry of Finance.

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

	NOK Billion[2] 2008	2008	2009	2010
Private consumption	991.4	1.4	0.3	4.0
Public consumption	490.2	3.8	5.6	2.1
Gross fixed investments	529.3	3.9	-5.9	-1.0
Petroleum extraction and pipeline transportation	122.2	6.6	7.0	3.0
Mainland Norway businesses	202.1	6.8	-16.4	-2.6
Housing investments	99.6	-8.1	-12.0	0.5
Public sector	78.0	5.8	13.2	-2.0
Demand from Mainland Norway[3]	1 861.4	2.2	-0.3	2.4
Exports	1 225.8	1.4	-6.5	0.1
Of which: Crude oil and natural gas	620.5	-1.5	-4.4	-2.1
Traditional goods	324.2	4.8	-11.0	1.6
Imports	732.7	4.4	-4.9	2.4
Of which: Traditional goods	477.6	2.7	-7.1	1.9
Gross domestic product	2 548.3	2.1	-2.1	1.3
Of which: Mainland Norway	1 829.9	2.6	-1.1	2.1
Mainland Norway without electr.	1 771.9	2.5	-0.7	1.9
Other key figures:				
Employment (persons)		3.1	-0.4	-0.4
Unemployment rate. LFS (level)		2.6	3.2	3.7
Annual wage		6.0	4	3½
Consumer price index (CPI)		3.8	1¾	1¾
CPI adjusted for tax changes and excluding energy products (CPI-ATE)		2.6	2½	1½
Oil price. NOK per barrel		536	375	425
Current account balance (pct. of GDP)		19.5	12.0	12.2

1) Calculated in constant 2006 prices unless otherwise indicated.
2) Current prices.
3 Excluding inventory changes.
Sources: Statistics Norway and Ministry of Finance.

have been reduced considerably, and according to Norges Bank's bank lending survey, the banks do not envisage any further tightening of lending terms.

Along with other commodity prices, the price of North Sea crude oil has risen the past few months. North Sea oil is now trading at around NOK 390 a barrel, against around NOK 360 in the middle of May. Also the price of oil for future delivery has risen since the Revised National Budget was presented. The assumption is for an average oil price of NOK 375 per barrel this year and NOK 425 per barrel next year. Aluminium prices have risen by 25 pct. in the same period. There has also been an increase in the prices of other metals.

2 Economic policy

Economic policy trade-offs

The Norwegian authorities confronted the international financial crisis and the severe downturn in the world economy with extensive measures to improve conditions in the financial market and stimulate domestic demand. Monetary policy was quickly eased, and from October of last year until the middle of June Norges Bank lowered its key policy rate by 4.5 percentage points to 1.25 pct. In Monetary Policy Report 2/09, which was published in June, Norges Bank signalled that interest rates would remain at this low level until spring 2010. However, at the meeting in August, the Bank gave notice that raising the key rate sooner was a possibility if the positive trends in the Norwegian economy were to continue. At the meeting on 23 September the key policy rate was kept unchanged at 1.25 pct., but in its press release Norges Bank wrote that the board had considered raising the rate at this meeting.

Fiscal policy, too, is providing a powerful stimulus to total demand in line with the fiscal policy guidelines, cf. box 1. Measured by the change in the structural deficit as a share of trend GDP for Mainland Norway the fiscal stimulus in 2009 can be estimated at 3 percentage points. This is the strongest fiscal stimulus recorded in the last 30 years, and fiscal policy in Norway is very expansionary compared to the policies of most of our trading partners.

Given the decline in activity in 2009 and below-trend growth in 2010, unemployment is expected to rise somewhat in the near term. On this background, the Government has chosen to base the 2010 Budget on a slight additional increase in the spending of oil revenues. Measured as a share of trend GDP for Mainland Norway, the Government proposes to increase the structural, non-oil deficit by around ½ percentage point from 2009 to 2010. Calculations on the macroeconomic model MODAG, which also takes into account the composition of incomes and expenditures, indicate that the expansionary effect of the 2010 Budget is weaker than suggested by this indicator. The result is partly explained by a reduction in dividend incomes received by the central government of more than NOK 6 billion in 2010. Such income reductions normally have a smaller expansionary effect than a corresponding increase in expenditure.

Box 1 The Fiscal Policy Guidelines

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

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

The fiscal guidelines takes due account of uncertainty and aims at a gradual increase in the spending of oil revenues up to a sustainable level:

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

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

Most of the extraordinary spending proposed in the Amended Budget in January (Proposition No. 37 (2008-2009) to the Storting) will be phased out in 2010, including subsidies for maintenance and rehabilitation of local government infrastructure. However, both the option of business and industry to set off carry-back losses in 2008 and 2009 against taxed profits for the two previous years and the increased initial depreciation for machines in 2009 will result in lower recorded taxes in 2010 as well. At the same time there is relatively strong growth in expenditures under the National Insurance Scheme.

The structural, non-oil deficit for 2010 can be estimated at NOK 148.5 billion, which is NOK 44.6 billion above the 4 pct. trajectory. The spending of petroleum revenues is almost in line with the expected return on the Fund for 2018, measured in constant prices.

The extraordinary escalation in the spending of oil revenues to deal with the financial crisis and the global recession has brought spending of petroleum revenues to a high level. The room for further increases in spending is small. This underscores the need to quickly return to the 4 pct. trajectory as growth recovers and the outlook improves. In this way fiscal policy leeway can be restored, at the same time as we bolster our ability to meet the growth in expenditure that will follow in the wake of an aging population.

Measured as shares of mainland GDP, the proposed spending of oil revenues in 2010 is estimated to be 2.3 percentage points higher than the expected return on the Fund. This is a far more favourable starting point than in most other countries. The OECD estimates that the structural budget deficit in the US will rise to nearly 9 pct. of GDP next year, while the deficit in the UK is estimated at over 10 pct. Also Japan and some euro area countries are now facing large budget deficits. At the same time, many of these countries entered this recession with a substantial net government debt. The strategies that the various countries choose to recover sustainability in public finances will have an impact on the economic performance of our trading partners in the medium term and will also represent a factor of uncertainty for the future development of the Norwegian economy.

Fiscal policy in 2010

The main features of the proposed Budget for 2010 are as follows (all amounts are stated in 2010 kroner):

- A structural, non-oil budget deficit of NOK 148.5 billion, which is NOK 44.6 billion higher than the expected return on the Fund in 2010.
- An increase in the structural non-oil deficit of NOK 14.6 billion in real terms from 2009 to 2010. Measured as a share of Mainland trend-GDP increases the structural, non-oil deficit increases by ½ per cent.
- A constant tax level.
- A real, underlying growth in the Fiscal Budget expenditure of around 1¾ pct. from 2009 to 2010.
- A real growth in local governments' total revenues from 2009 to 2010 of around NOK 8.0 billion or 2.6 pct., compared to the income level of 2009 as estimated in the Revised National Budget 2009.
- The non-oil budget deficit in 2010 is estimated to be just under NOK 154 billion, an increase of just under NOK 36 billion from 2009. Automatic stabilisers contribute NOK 25 billion to this weakening. Measured in relation to trend GDP for Mainland Norway, the non-oil deficit is 8.1 pct. in 2010, as opposed to 0.7 and 6.5 pct. in 2008 and 2009, respectively.

The structural, non-oil budget deficit measures the underlying use of oil revenues after adjusting for, *inter alia*, cyclical tax revenues. The actual withdrawal from the Fund is equal to the non-oil deficit, which is estimated at NOK 154 billion in 2010. The central government's cash flow from petroleum activities is estimated at around NOK 220 billion, which is NOK 44 billion lower than the estimate for the present year. Subtracting the withdrawal from the fund from this figure, net allocations to the Government Pension Fund – Global, is estimated at just under NOK 67 billion. Adding interest and dividends on the fund capital of just under NOK 106 billion, the total surplus in the Fiscal Budget and in the Government Pension Fund can be estimated at around NOK 172 billion.

The market value of the Government Pension Fund – Global at the end of 2010 is estimated at NOK 2,824 billion, while the value at the end of the present year is estimated at just under NOK 2,600 billion. Including the Government Pension Fund – Norway, the total capital of the Government Pension Fund at the end of 2010 is

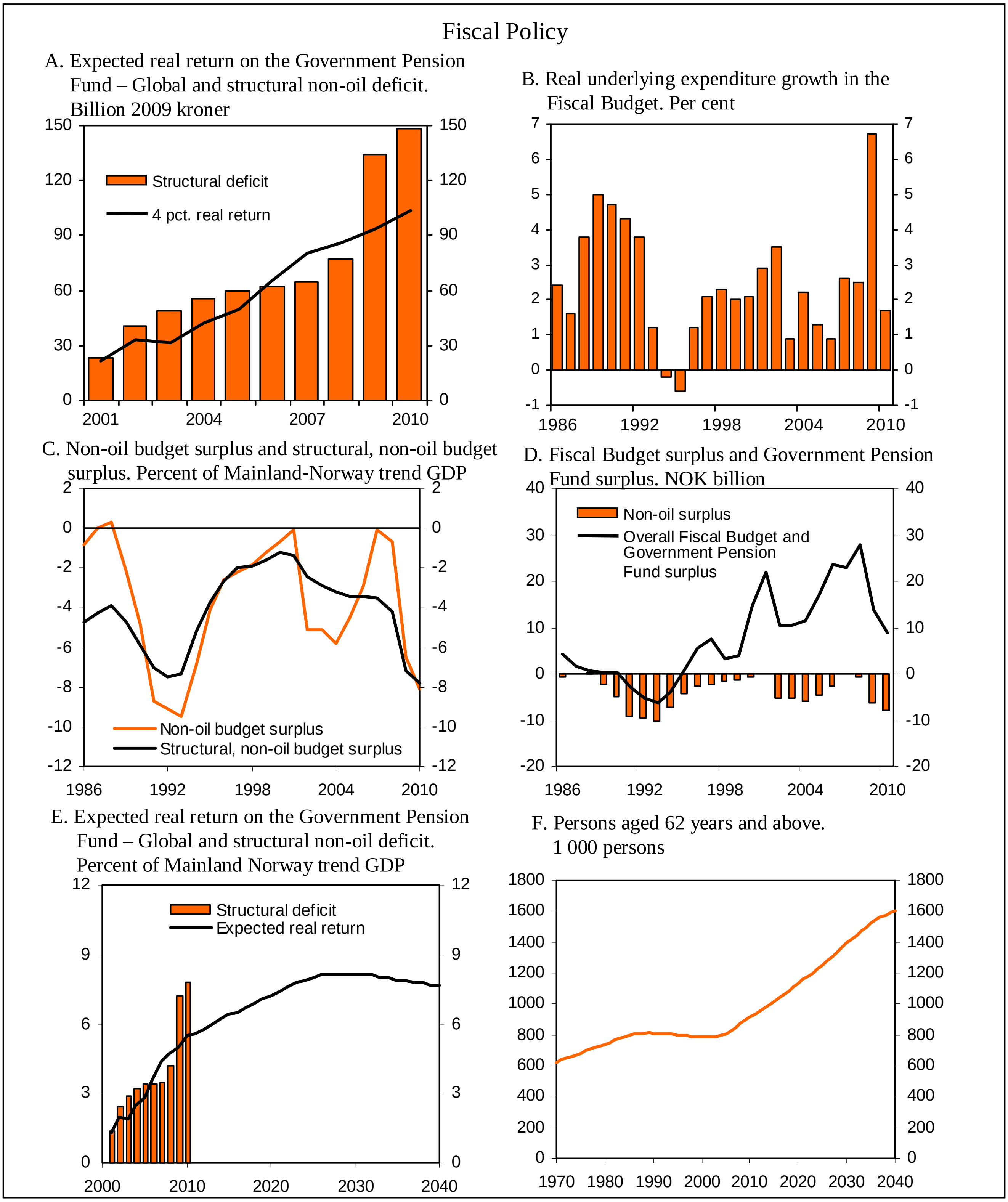


Figure 2 Fiscal policy
Sources: Statistics Norway and Ministry of Finance.

Table 2 Key figures for the Fiscal Budget and the Government Pension Fund. NOK billion

	Accounts		Budget	
	2007	2008	2009	2010
Total revenues	1 030.1	1 182.6	1 022.8	974.1
1 Revenues from petroleum activities	337.4	437.7	290.5	244.8
1.1 Direct and indirect taxes	191.2	245.2	170.9	123.8
1.2 Other petroleum revenues	146.3	192.5	119.6	121.0
2 Revenues other than petroleum revenues	692.7	744.9	732.3	729.3
2.1 Direct and indirect taxes from Mainland Norway	632.9	680.4	674.2	677.0
2.2 Other revenues	59.8	64.5	58.1	52.3
Total expenditures	715.1	778.6	876.2	907.5
1 Expenditures on petroleum activities	21.1	21.8	25.8	24.4
2 Expenditures other than petroleum activities	694.0	756.7	850.4	883.1
Fiscal budget surplus before transfers to the Government Pension Fund – Global	315.0	404.1	146.6	66.6
- Net cash flow from petroleum activities	316.4	415.9	264.7	220.4
= Non-oil surplus	-1.3	-11.8	-118.1	-153.8
+ Transfers from the Government Pension Fund – Global	2.8	8.4	118.1	153.8
= Fiscal budget surplus	1.5	-3.4	0.0	0.0
+ Net allocation to the Government Pension Fund – Global	313.6	407.5	146.6	66.6
+ Interest and dividend revenues to the Government Pension Fund[1]	78.4	103.1	108.4	105.6
= Consolidated fiscal budget surplus and Government Pension Fund surplus	393.5	507.2	255.0	172.2
Memo:				
Market value of the Government Pension Fund – Global1[1]	2 018.5	2 279.6	2 597.3	2 823.8
Market value of the Government Pension Fund[1]	2 135.8	2 367.4	2 697.9	2 930.9

[1] At year-end.

Sources: Statistics Norway and Ministry of Finance.

estimated at NOK 2,931 billion. At the same time, the value of already earned rights to old-age pensions in the National Insurance Scheme is expected to increase by around NOK 250 billion during 2010, to NOK 4,771 billion by year-end. The effect of the pension reform on future pension expenditures is included in this estimate.

Fiscal policy in the medium term

Over time, the leeway in fiscal policy is primarily determined by changes in the tax bases of the mainland economy, expenditure and revenue commitments from previous decisions and the performance of expected real returns on the capital in the Government Pension Fund – Global. In addition, extra spending compared to the 4 pct. trajectory will affect this leeway in fiscal policy until the budget is back on this track. In the coming years, fiscal policy manoeuvring room will be restricted as a consequence of:

- Expenditures under the National Insurance Scheme are expected to increase by a total of NOK 25 billion for the three-year period 2011-2013, corresponding to NOK 8 billion per year. This is higher than what has been recorded in the most recent years. Both a growing number of old-age pensioners and higher pension entitlements than former beneficiaries contribute to this sharp underlying expenditure growth.
- The structural, non-oil deficit in 2010 is almost NOK 45 billion above the 4 pct. trajectory, corresponding to 7.8 pct. of mainland GDP in 2010. This means that most of the phasing-in of oil revenues into the Norwegian economy is behind us, cf. figure 2E.

For a given tax structure the tax bases increase over time on par with the trend growth of the economy. The underlying growth of the tax bases is estimated to strengthen the Fiscal Budget by around NOK 8 billion per year in the

Table 3 General government net lending. NOK million

	2008	2009	2010
Fiscal Budget surplus	-3 427	0	0
+ Surplus in Government Pension Fund	510 613	255 029	172 209
+ Surplus in other central government and social security accounts	1 752	7 301	1 052
+ Definitional differences between Fiscal Budget and national accounts [1]	-13 348	-80 748	-1 448
+ Direct investments in state enterprises	4 241	7 901	2 616
= Central government net lending	499 830	189 484	174 429
+ Local government net lending	-24 873	-15 716	-17 146
= General government net lending	474 957	173 768	157 283
In per cent of GDP	18,6	7,4	6,5

1 Includes central government's accrued, but not accounted for, taxes.

Sources: Statistics Norway and Ministry of Finance.

years to come.

There is considerable uncertainty regarding the future value of the Government Pension Fund – Global. This uncertainty is clearly illustrated by the volatility observed during the last year. The central government's oil revenues, which are allocated to the Fund, have been lower than expected owing to lower oil prices. In addition, withdrawals from the Fund to cover the non-oil deficit in the Fiscal Budget have increased sharply, due to the work of automatic stabilisers during the downturn and the active fiscal measures taken to alleviate the effects of the financial crisis on the Norwegian economy. The actual return on the Fund will fluctuate in line with international financial markets. There is also uncertainty regarding the estimate of the structural, non-oil deficit. Since the spending of oil revenues is well above the 4 pct. trajectory, the room for increased spending of oil revenues seems limited.

Main features of the Government's tax programme

Total accrued tax revenues in Norway will amount to about NOK 932 billion in 2009. Of this, about 85 pct. is paid to the central government, while local government (municipalities and counties) receives 15 pct. Table 4 provides an overall overview of the main categories of direct and indirect taxes, and the administrative levels of the public sector to which the revenues from each of the main categories accrue. The Norwegian tax system is characterised by high indirect taxes by international standards. Value-added tax (VAT) and excise duties represent about 28 pct. of total tax revenue. Personal income tax and the tax on net wealth levied on individuals represent about 37 pct. of the total tax revenues. Corporate tax, including employers' social security contributions, amounts to approximately 19 pct. Taxes levied on petroleum activities represent about 13 pct. of total tax revenues.

Total taxes as a percentage of GDP, estimated at 39.8 pct. for 2009, can give a rough classification of the general tax level.

The Government's objectives for its tax policy are to ensure revenue for common endeavours, contribute to a fair income distribution and a better environment, promote economic growth and employment in the entire country and improve the functioning of the economy. The Government believes that the level of taxation should be kept more or less unchanged to ensure the best possible basis for maintaining the welfare system.

The Government has enhanced the redistributive effects of the tax system by more stringent taxes on dividends and gains on equity investments, a fairer tax on net wealth and inheritance tax and a higher minimum deduction. In addition, the tax system more clearly promotes environmental concerns.

By continuing the systemic changes in the tax reform within a stable tax level, the Government is ensuring predictability in the tax system, making it attractive to invest and do business in Norway. In 2010, the redistributive aspect of the tax on net wealth will be enhanced further, environmental taxes will be strengthened and important measures will be taken to combat tax

Table 4 Accrued direct and indirect taxes broken down by tax creditors. 2009 estimates. NOK billion

	Central government	Local government	Regional government	In total
Individual taxpayers	211.8	111.9	21.5	345.2
Tax on ordinary income	101.1	103.9	21.5	226.5
Surtax	18.6	-	-	18.6
Social security contribution	87.6	-	-	87.6
Tax on net wealth	4.5	8.0	-	12.5
Businesses (which pay their taxes in arrear)	45.0	1.3	0.2	46.6
Income tax (including power stations)	44.7	1.3	0.2	46.2
Tax on net wealth	0.3	-	-	0.3
Property tax	-	6.3	-	6.3
Employers' social security contribution	127.6	-	-	127.6
Indirect taxes	263.5	-	-	263.5
VAT	176.5	-	-	176.5
Excise duties and customs duties	87.0	-	-	87.0
Petroleum	120.1	-	-	120.1
Tax on income	116.1	-	-	116.1
Extraction tax	4.0	-	-	4.0
Other direct and indirect taxes	22.3	0.7	-	23.0
Total direct and indirect taxes	790.3	120.2	21.8	932.3
Of which direct taxes	526.8	120.2	21.8	668.8

Source: Ministry of Finance.

evasion:

- Starting in 2010, the Government will introduce new and more accurate systems for determining assessed valuations of residential and commercial property on the basis of market values. Eliminating the disparities in assessed valuations will put an end to the unreasonable discrimination that today's unfair assessed valuations give rise to. At the same time, the tax-free allowance for the net wealth tax will be increased. The changes will have beneficial redistributive effects and will also benefit rural regions.
- To combat tax evasion the Government has in the past four years increased the budgets for the tax administration and customs and excise. In the 2010 budget, the Government is proposing measures aimed at reducing the use of cash as a means of payment. This will ensure that a larger share of the payment flows from businesses and the private market takes place through banks and other financial institutions, so that the transactions are traceable and thus harder to conceal.
- The tax system should promote environment-friendly behaviour. The reorientation of motor vehicle taxes in a "greener" direction will continue, and a carbon tax will be introduced on domestic use of gas for heating in buildings from 1 April 2010. The exemption from the diesel tax for the proportion of biodiesel will be halved in 2010 with a view to a final phase-out in 2011.
- The Government is following up

recommendations by a committee appointed by the Government to assess the VAT treatment of cultural and sporting services. The committee recommended broadening the VAT base by introducing an 8 pct. VAT rate for cultural and sporting services. The Government will make some adjustments that limit the VAT broadening compared to the proposal from the committee. Admission to theatres, opera, concerts etc. will be exempted from VAT, while the aim is to limit the VAT obligation for sports so that it covers health clubs and the most professional part of sports. The Government will introduce specific bills at a later date with a view to implementation from 1 July 2010.

Many of the world's so-called tax havens are changing their policies, and they are now ready to allow disclosure to our tax authorities. During this Parliament session the Government expects that Norway will be able to put in place tax information exchange agreements with a number of countries that till now have been closed to such disclosure. This will include the most important countries where Norwegian taxpayers have been able to conceal money to evade tax. Norway will continue its active participation in international efforts to eliminate these opportunities for concealment and tax evasion.

Monetary policy and financial stability

The monetary policy regulation, established in 2001, stipulates a flexible inflation targeting regime for monetary policy. The long-term role of monetary policy is to provide the economy with a nominal anchor. In the short- and medium-term, monetary policy shall balance the need for low and stable inflation against the outlook for output and employment.

The operational target for Norges Bank's (the central bank) implementation of monetary policy is defined as an annual increase in consumer prices of close to 2.5 per cent over time. 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 take effect, and it should disregard disturbances of a temporary nature that are not deemed to affect underlying price and cost increases.

The turmoil in international financial markets following the Lehman Brothers bankruptcy in the middle of September last year spread quickly, also to Norway. Money market risk premiums soared, with credit flows between financial institutions nearly coming to a halt. At the same time, housing and other property prices dropped sharply. These circumstances prompted banks to be more cautious in lending to household and corporate borrowers.

To mitigate the effects on the Norwegian economy and stabilise the financial markets, the Government and Norges Bank took a number of targeted actions:

- In October 2008 the Government proposed a swap arrangement whereby the banks could borrow government securities in exchange for covered bonds. Shortly afterward the Storting approved the necessary authorisations for implementing the arrangement. The swap arrangement has a ceiling of NOK 350 billion for 2008 and 2009. Up until the beginning of October, government securities in the amount of NOK 228 billion have been auctioned to the banks in this arrangement.
- In the period from October 2008 to June 2009 Norges Bank's key policy rate was reduced by a total of 4.5 percentage points to 1.25 pct. Moreover, Norges Bank also provided F-loans to a far greater extent and with longer maturities than normal. Furthermore, Norges Bank eased its collateral requirements for loans from the Bank with the aim of increasing the banks' ability to borrow. Norges Bank also provided the market with foreign currency loans.
- In February 2009 the Government proposed to establish two new funds, the Norwegian State Finance Fund and the Norwegian State Bond Fund, each with NOK 50 billion in capital. The Norwegian State Finance Fund was established on 6 March and provides tier 1 capital to Norwegian banks for a limited period. The deadline for applying to the Fund for a capital injection was 30 September 2009, and applications were received from 34 banks. Administered by Folketrygdfondet, the Norwegian Government Bond fund began investing on 18 March. The Fund provides the Norwegian bond market with liquidity and capital. At 17 August 2009, when the Fund published its report for the first six months, NOK 6.2 billion of the NOK 50 billion available had been invested in the bond market.
- The Government has also implemented a number of other measures to contribute financing to export-oriented industries and

local governments. To ensure loans to local governments, the equity in Kommunalbanken Norway was increased, while higher budget allocations to GIEK and Innovation Norway help to ensure that business and industry can borrow. To remedy the situation for export-oriented industry the Government has concluded an agreement for state loans to Eksportfinans, estimated at NOK 50 billion over the years 2009 and 2010.

The actions taken by the Government and Norges Bank have helped to stabilise the Norwegian financial market and improved the banks' access to financing. Interbank interest rates have fallen substantially, thanks to lower policy rates as well as a narrowed spread between money market rates and the policy rate. Also the banks' lending rates have fallen. Since around 90 pct. of all home mortgages in Norway have floating rates, changes in the interest rate have a relatively rapid impact on the purchasing power of Norwegian households. The access to home mortgage financing now appears to be approaching normal. At the same time, the risk premium for long-term credit for business and industry has fallen. Information from Norges Bank's Survey of Bank Lending indicates that the banks expect generally unchanged credit standards for both enterprises and households in the third quarter this year, after a marked tightening the previous four quarters, particularly with regard to enterprises.

The special actions taken to counteract the effects of the financial crisis are temporary. As the situation in the Norwegian economy normalises, the measures will gradually be withdrawn. In line with this, Norges Bank has begun to raise the minimum price in the swap arrangement as banks' opportunities for financing in the market have improved, and the Bank has also announced that the last auction will be held in December of this year. The need for capital injections to banks and non-financial enterprises through the Norwegian State Bond Fund and the Norwegian State Finance Fund will be reduced as financing becomes available from other sources. Interest rates, which are now at a historic low, will gradually have to be raised again. Norges Bank has signalled that interest rates have bottomed out and that the key policy rate will increase. It will also be necessary to gradually phase out the fiscal stimulus and return the spending of petroleum revenues over the Fiscal Budget to the 4 pct. trajectory, in line with the fiscal policy guidelines.

A Financial Crisis Committee was appointed on 19 June 2009. Its mandate is to examine Norwegian financial market regulation in the light of the financial crisis and the causes of the global financial crisis and its impact on the Norwegian financial market. The committee is to present its report to the Ministry of Finance by 31 December 2010.

Employment policy

Employment policy is intended to facilitate an increased supply of labour and low unemployment over time, enabling most people to participate in the labour market. The slowdown in the Norwegian economy has reduced the demand for labour in several sectors, and unemployment has risen somewhat. Adequate income support programmes for those outside the ordinary labour market are essential. At the same time, policies need to focus on preventing marginal groups from being pushed out of the labour market and into welfare dependency. Compared with the OECD average, sick leave and the percentage of persons on disability are high in Norway, and one out of five persons in the working age population is currently on various health-related schemes or early retirement.

Even though the labour market has weakened, there is still a large number of vacancies. The most important aspect of labour market policy continues to be to facilitate active job seeking. The instruments of the Norwegian Labour and Welfare Administration will focus on closely following up job seekers, providing necessary assistance. Labour market programmes are intended to help people who have a need to improve their qualifications and require special assistance to enter the job market.

The economic downturn has caused unemployment to rise this past year, but forecasts for the labour market are now more positive than when the Revised National Budget was presented in May. The higher unemployment made it necessary for the Government to increase the number of places in active labour market programmes; by 6,000 in the amended budget in January and by a further 1,000 in the Revised National Budget 2009. The appropriation for 2009 allows for a total of 75,200 places in active labour market programmes. This includes programmes for the unemployed as well as for those with impaired work capacity. Somewhat higher unemployment in 2010 than in 2009 suggests that programmes should be stepped up further. The Government's proposed budget accommodates a total of 78,200 places in active labour market programmes in 2010, 3,000 more than in 2009.

In view of the increased unemployment, several changes were made in 2009 to the rules for temporary lay-offs. The maximum period for receiving unemployment benefits was extended, while the number of days companies are obliged to pay wages during layoffs was reduced. The required reduction in working hours entitling a person to benefits was also lowered from 50 to 40 pct. The rules for temporary lay offs will be evaluated in the Revised National Budget 2010.

The Government wishes to encourage older workers to participate longer in the labour force. The Government eliminated the income testing of pensions for 67-year-olds and 68-year-olds, from 1 January 2008 and 1 January 2009, respectively. Under the current rules, however, old-age pensions for 69-year-olds will be reduced by 40 pct. of earned income above 2G (G = NOK 72 881), the National Insurance Schemes basic pension. In the budget for 2010 the Government is following up the previous changes by repealing the deduction rules for 69-year-olds from 1 January 2010. This is in keeping with the principles emphasised in the pension reform, which introduces flexible retirement from the age of 62 without deduction for any earned income.

3. Sustainable development

Sustainable development involves meeting the needs of the present generation without compromising the ability of future generations to meet their own needs. According to the UN, the primary challenges to a sustainable development are global poverty, loss of biodiversity, anthropogenic climate change and the spread of hazardous chemicals. To meet the environmental and poverty challenges, the environmental impact of economic activity needs to be reduced.

The Government's aim is for Norway to be a pioneer in the work towards sustainable development. In the 2008 National Budget the Government presented a new national strategy for sustainable development. The follow-up of the strategy is reported each year in a separate chapter in the National Budget.

Eighteen indicators have been developed for monitoring progress in a systematic manner. Statistics Norway points out that the indicators show that economic performance has been sustainable during the period 1986-2008 as a whole. National wealth per inhabitant increased over the entire period, with human capital accounting for about 73 pct. of national wealth. In 2009 the Government will meet its target that official Norwegian development assistance should equal 1 pct. of gross national income (GNI). In the proposed Budget for 2010 the level of assistance is estimated at 1.09 pct. of GNI. Imports from developing countries have more than doubled since 2003. China and Brazil are our biggest trading partners among developing countries, but imports from the least developed countries in Africa are increasing as well.

Norway is set to meeting its Gothenburg Protocol commitments with regard to reducing emissions of three of four long range transboundary air pollutants. The Government has made an agreement with industry organisations to cut emissions of nitrogen oxides (NO_X).

It is the Government's objective to exceed Norway's commitments under the Kyoto Protocol. More than 70 pct. of Norwegian greenhouse gas emissions have since 2008 been covered by economic policy instruments. Norwegian greenhouse gas emissions declined in 2008, as a consequence of measures as well as lower activity in some emission-intensive industries.

After the Government began its reorientation of motor vehicle taxes on 1 January 2007, CO_2 emissions from first-time registered motor vehicles on average were reduced from 177 g/km in 2006 to 152 g/km in the period January-August 2009.

The Government is contributing actively to an ambitious climate agreement in Copenhagen in December 2009 that will include as many countries and sectors as possible. The new agreement should be structured to limit global warming to 2°C and include measures against deforestation, technological collaboration and adaptation to climate change. A substantial portion of the costs should be borne by the industrial countries.

The Government is increasing the efforts to develop reliable carbon capture and storage technology. Construction at the technology centre for carbon capture at the Mongstad power plant is under way, and there is an ongoing effort to plan full-scale carbon sequestration.

The Government is following up its commitment to reduce greenhouse gas emissions from deforestation and forest degradation in developing countries. The Government proposes to increase appropriations for these purposes by NOK 650 million, from NOK 1.5 billion in the approved budget for 2009 to more than NOK 2.1 billion in the Fiscal Budget for 2010. In addition, a grant authorisation of NOK 1.4 billion is proposed.

For the period 2006-2009 the Government has set aside NOK 2.4 billion for renewable energy and energy efficiency measures through Enova. This is more than 3 times as much as in the 2002-05 period. The escalation continues in the 2010 budget. The Government's strong commitment to railways also continues.

4. The Government Pension Fund

4.1. Introduction

The Government Pension Fund comprises the Government Pension Fund – Global and the Government Pension Fund – Norway. Under the Act relating to the Government Pension Fund, the Ministry of Finance has been charged with managing the Fund. The Ministry determines the guidelines for the management of the two parts of the Fund and follows up its operational management. Norges Bank and Folketrygfondet have been given the task of operational management of the Government Pension Fund – Global and Government Pension Fund – Norway, respectively, based on guidelines from the Ministry of Finance.

The Government's ambition is for the Government Pension Fund to be the best managed fund in the world, entailing that international best practice must be sought for in all aspects of the management. The goal for the management of the Government Pension Fund is to achieve maximum financial return with moderate risk.

By virtue of our long-term investments in a large number of the world's companies, we have a responsibility for and an interest in promoting good corporate governance and safeguarding environmental and social concerns. Therefore the Government gives priority to being a responsible investor in its management of the Fund.

Openness regarding the management of the Government Pension Fund helps to build confidence in the Fund and the fund structure. Operational management performance is also reported by Norges Bank and Folketrygdfondet on a regular basis. The Ministry reports on the management of the Fund in an annual report to the spring session of the Storting, cf. Report No. 20 (2008 – 2009) to the Storting, On the management of the Government Pension Fund in 2008.

The fund performed very well in the first half of 2009 as a whole, which must be viewed in the context of a sharp improvement in equity markets. At the same time this underscores the need to be prepared for market volatility from time to time, and that in the future as well there will be considerable fluctuations in the return on the Fund. As the Government Pension Fund has a strong risk-bearing capacity, it is well able to live with the considerable volatility that the Fund has experienced recently.

Section 4.2 provides a detailed discussion of the management performance of the Government Pension Fund, while 4.3 reports on a number of current issues related to the management of the Fund. Section 4.4 reports on the status for the implementation of already approved changes to the management of the Fund.

4.2 Management performance

Financial markets

In the first half of 2009 financial markets trended upward, with liquidity improving in most segments. Contributing to this were greater confidence that the financial system had stabilised, powerful fiscal and monetary stimuli as well as signs of stabilisation in the real economy. At the end of the first half of 2009, financial market volatility was substantially lower than in 2008. Even so, there are still relatively large short-term price movements in the markets.

In the first half of 2009 there was also a marked improvement in the credit markets. The risk premium on interbank loans continued to drop, improving the banks' access to short-term borrowing. It also became easier for the banks to raise capital via the equity market. In the corporate bond market there was as marked increase in new issues.

Equity markets saw a solid gain in the first half of 2009 and the rate of return on the equity benchmark for the Fund was 7.9 pct., measured in foreign currency. The development was particularly good for cyclical equities such as technology and basic industries. Equities within sectors with more stable earnings, such as infrastructure, health and telecommunications, showed a weaker performance. Emerging markets and investments in small and medium sized companies performed relatively well.

The rate of return on the fixed income benchmark in the first half of 2009 was 1.4 pct., measured in foreign currency. Government bonds with long maturities performed poorly.

Management performance of the Government Pension Fund – Global

Norges Bank manages the Government Pension Fund – Global on behalf of the Ministry of Finance. The Fund's market value was NOK 2,385 billion at the end of the first half of 2009. In summer 2007 the Government decided to increase the equity portion from 40 pct. to 60 pct. The phasing-in of the increased equity portion began in the second quarter of 2007 and was completed in the first half of 2009. Total inflow to the Fund was NOK 84 billion during the first six months of the year.

Gains in the equities and credit markets contributed to the estimated 7.3 pct. return on the Government Pension Fund – Global in the first half of 2009, measured in foreign currency. Chart 4 shows performance since 1998 for both the equity and fixed income portfolios. Measured in Norwegian kroner, the return in the first half of the year was 0.8 pct. The difference between the two rates of return reflects the period's strengthening of the Norwegian krone against the Fund's basket of currencies. However, it is the rate of return in international currency that is relevant when measuring the changes in the Fund's international purchasing power. The annual real rate of return in foreign currency – i.e. the return less management costs and adjusted for inflation – provides a good picture of the changes in international purchasing power over time. Since 1998 the Government Pension Fund – Global has had an average annual net real rate of return of 1.5 pct., cf. Table 5.

In the first half of 2009 Norges Bank achieved a rate of return of 1.6 pct. in excess of the benchmark portfolio defined by the Ministry of Finance. Equity management had an excess return of 1.0 pct., whereas fixed income management had an excess return of 2.8 pct. in the period. Measured in Norwegian kroner, the excess return for the Fund was 1.5 pct., and 1.0 pct. and 2.6 pct. for the equity portfolio and fixed income portfolio respectively. The Ministry of Finance stated in Report No. 20 (2008-2009) that it will consider the reporting principles for the rates of excess return. The Ministry will address this in the annual report on the management of the Fund in spring 2010. The rate of excess returns has not been adjusted for costs connected with active management.

The very good performance for fixed income management must be viewed in the context of the negative excess return of 6.6 pct. in 2008, when credit and liquidity premiums soared in the fixed income markets. In the second quarter of 2009 the fixed income markets showed signs of returning to normal, and the large liquidity premiums characterising some of the markets fell. The excess return from fixed income

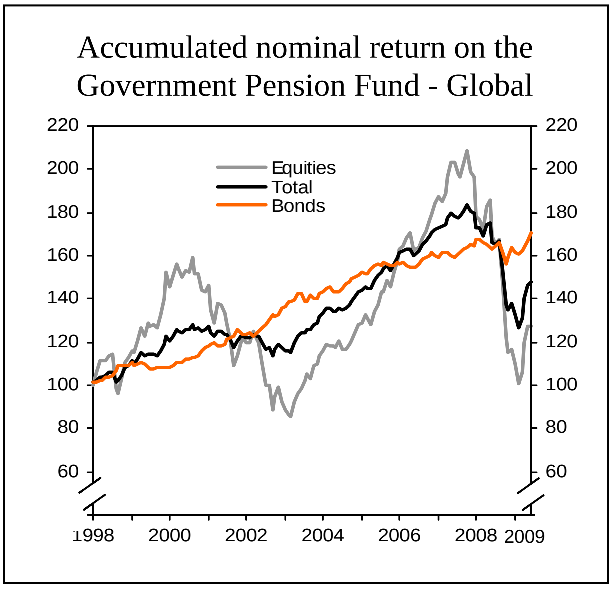


Figure 3 Nominal performance of the portfolios of the Government Pension Fund – Global measured in international currency. Index at year-end 1997 = 100

Source: Norges Bank.

Table 5 Key figures for the Government Pension Fund – Global 1998 – Q2 2009. Annual figures. Per cent.

Government Pension Fund - Global	Last year	Last three years	Last five years	Last ten years	Since 1.1.1998
Nominal return	-11.17	-2.75	1.74	2.55	3.44
Inflation	-0.3	1.9	2.1	2.0	1.8
Management costs	0.13	0.11	0.11	0.10	0.10
Net real return	-11.01	-4.70	-0.47	0.48	1.49
Excess return (percentage points)[1]	-1.95	-0.98	-0.35	0.08	0.10

[1] Before deduction for costs related to active management.
Source: Norges Bank.

management is primarily due to positions that have been relatively illiquid, where there has been considerable uncertainty as to pricing them. The contribution from European bank bonds with the status of core or supplementary capital was especially strong, as well as from US mortgage-backed securities. Over the past three years active management has generated an overall annual excess return of -1.0 pct., whereas since it began the Fund has had an annual excess return of 0.1 pct., before deductions for management costs related to active management.

Management performance of the Government Pension Fund – Norway

Folketrygdfondet manages the Government Pension Fund – Norway on behalf of the Ministry of Finance. The market value of the Government Pension Fund – Norway was NOK 98.9 billion at 30 June 2009, which is NOK 11.2 billion higher than the value at the beginning of the year. In all, 65 pct. was invested in equities and 35 pct. in bonds.

The rate of return on the Government Pension Fund – Norway in the first half of the year was 12.8 pct. The Norwegian stock market (measured by the OSEBX-index) rose 25.2 pct., whereas the bond market had a more moderate gain of 3.6 pct.

In the first half of 2009 Folketrygdfondet achieved an excess return of -1.8 pct. against the benchmark defined by the Ministry of Finance. In Norwegian equity management the excess return was -3.9 pct., while the Norwegian fixed income portfolio yielded an excess return of 1.2 pct. In the past ten years, active management has produced an average annual excess return of 0.5 pct., before deduction of management costs related to active management.

4.3 Current issues in management of the Fund

Evaluation of active management in the Government Pension Fund – Global

In Report No. 20 (2008-2009) to the Storting, the Ministry announced that it will undertake an external review of the experiences with active management in the Government Pension Fund – Global. It was also indicated that Norges Bank will be asked to prepare a plan for active management going forward. The external review and Norges Bank's input are to form part of a broad decision-making basis to be presented to the Storting in spring 2010, with an assessment of whether and to what extent active management of the Government Pension Fund – Global ought to be continued.

On 31 August 2009 the Government announced the plans for a broadly based process related to the evaluation of the active management in the Government Pension Fund – Global (see www.government.no/fin). A group was appointed consisting of three internationally recognised experts (Professor Andrew Ang, Columbia Business School, Professor William N. Goetzmann, Yale School of Management, and Professor Stephen Schaefer, London Business School) who will analyse *inter alia* Norges Bank's performance in active management and the basis for active management going forward. Furthermore, the consultancy Mercer has been asked to report on the status of active management in other large funds internationally. In addition, Norges Bank has been asked to present a plan for active management going forward. The terms of reference and the letter of the Ministry of Finance to Norges Bank are available on the Ministry's website.

The reports from the external review and the letter from Norges Bank will be made publicly available in December 2009. The Ministry plans to arrange an open seminar in January 2010 to which Norwegian and international experts will be invited to review and comment on the written input received. The purpose of this consultation process is to ensure a broad anchoring of this part of the investment strategy as well.

The research project on climate

According to the Stern Review report, global warming can have a serious impact on global economic growth. For a major universal investor like the Government Pension Fund – Global it makes sense to ask what impact this may have on financial markets and how investors ought to react.

To study these issues the Ministry of Finance has signed an agreement with the consultancy Mercer to report on the impacts climate change may have on global capital markets in general, and specifically for the portfolio of the Government Pension Fund – Global. This is a joint project between Mercer and a number of major international pension funds from Europe, North America and Asia. As external consultant on the project Mercer has chosen the Grantham Research Institute on Climate Change and the Environment at the London School of Economics and Political Science. The institute, which is headed by Professor Sir Nicholas Stern, author of the Stern Review, will contribute with economic analyses and scenarios for climate change and international climate policy.

The project has a time frame of around one year and will result in two reports. The first report, which will be publicly available, will show the consequences the various scenarios can have for capital markets, primarily up until 2030. It will differentiate among various asset classes and regions. The second report will be adapted to the particular participating fund and will analyse the fund's vulnerability to climate risks and identify possible changes in investment strategies that may reduce this risk and/or increase returns (new investment opportunities).

This is the first time major international pension funds are joining forces to evaluate a global risk factor that may be important for their long-term returns and risk.

New regulations on the management of the Government Pension Fund

The current regulations for the Government Pension Fund – Global reflect that they have continuously been added to and amended over time, as the Fund has grown in value and complexity. The Ministry of Finance has therefore initiated a review of the regulations with the aim of further developing them. Real estate as a new asset class and the evaluation of the ethical guidelines also imply a need to change the regulations. For that reason, the Ministry announced in Report No. 20 (2008-2009) to the Storting that the framework of the Government Pension Fund – Global will be reviewed with the aim of new regulations on managing the Fund entering into force on 1 January 2010. On 31 August 2009 the Ministry circulated a draft of the new regulations for the Government Pension Fund – Global for comment. The draft is available on the Ministry website (www.regjeringen.no/nb/dep/fin/dok/hoeringer). The time limit for the consultation has been set at 15 October 2009. The new regulations are intended to combine as much as possible the Ministry's regulation of Norges Bank's management tasks in a single document. Management tasks are currently governed by regulations, supplementary guidelines to the regulations and a separate management agreement. A single set of rules will help to make the regulation more user-friendly and more easily accessible.

Review of the status of risk management at Norges Bank

In Report No. 20 (2008-2009) to the Storting, the Ministry of Finance indicated that external consultants with specialist expertise will be used to review the status of risk management.

In line with the discussion in Report No. 20 (2008-2009) to the Storting the Ministry of Finance believes that it is appropriate for such an external review of the risk assessment within the Bank's asset management be conducted as a certification assignment given by Norges Banks Supervisory Council to the bank's external auditor. Reference is also made in this connection to Proposition No. 58 (2008-2009) to the Odelsting, in which it is pointed out that the Supervisory Board as the body responsible for auditing the Bank and supervising its operations determines a programme for auditing.

In spring 2009 the Ministry of Finance initiated a dialogue with the Supervisory Board on such an arrangement with certification assignments. In a letter dated 8 September 2009 to the Supervisory Board the Ministry pointed out that it has a need to have certification assignments carried out that cover the areas mentioned in the Executive Board's letter of 12 February 2009 to the Ministry of Finance. The Supervisory Board replied in a letter to the Ministry of 17 September 2009, where it presented plans for specific projects related to a certification assignment to be carried out during a two year period.

The Ministry of Finance believes that the certification assignment adequately meets the Ministry's need for an external review of the Bank's risk management and will report on the results of the project in the report to the Storting on the management of the Government Pension Fund in 2009 and 2010.

4.4 Implementation of approved changes to management

Increased equity portion

The increase in the strategic portion of equities in the Government Pension Fund – Global from 40 pct. to 60 pct. was completed at the end of June 2009.

Report No. 24 (2006–2007) to the Storting, On the management of the Government Pension Fund in 2006, gave an account of the expected return and risk from an increased equity portion in the short and long terms. The analysis was based on extensive historical figures, as well as simulations of the future return and risk based on given expectations for future equity premium and risk in the equity and bond markets. A significantly lower equity premium than the historically observed premium was used in the simulations. The Ministry concluded that an increase in the equity portion of the benchmark portfolio for the Government Pension Fund – Global from 40 to 60 pct. represented a good balance between the expected rate of return and risk in the long term for investments in the Fund.

In Recommendation No. 228 (2006–2007) to the Storting the majority of the Standing Committee on Finance, all the members except the members from Fremskrittspartiet (Progress Party), noted this and supported the Government's assessment of increasing the equity portion of the benchmark portfolio for the Government Pension Fund – Global to 60 pct.

A number of considerations were emphasised in the implementation of the phase-in of the increased equity portion. The fact that in the long run, equities have a higher expected return than bonds argues in itself for a speedy changeover to an increased equity portion. At the same time, implementation over a short period, with large purchases relative to the liquidity in the market, might push prices up in the short term, making the Fund's transactions visible and predictable. This may result in high transaction costs for the Fund and give other market players an information advantage, e.g. by pricing larger individual trades. A more stable phase-in over time reduces the risk of undesirable market impact and reduces the likelihood that the adjustment takes place at a time that in retrospect appears to be unfavourable.

From the second quarter of 2007 until the fourth quarter of 2008, the inflow of new capital was used to increase the equity portion. In addition the proceeds of matured bonds and interest payments received on bonds in the Fund's portfolio were invested in equities rather than in bonds. Owing to the weak performance of equity markets throughout 2008, the equity portion nevertheless was only 50 pct. at the beginning of 2009. At the same time the transfer of new capital declined as a consequence of lower oil prices. It was therefore decided to increase the transfers of capital from the fixed income portfolio to attain the desired equity portion. This was considered to be in line with earlier pronouncements regarding a gradual adaptation to an increased equity portion, and that from now on the equity portion would be built up according to the same principles as before. Following an overall assessment a plan was approved whereby around NOK 177 billion was moved from the fixed income portfolio to the equity portfolio in the first half of 2009.

The average purchase price for equity investments during the entire period was estimated by Norges Bank to be 22 pct. lower than at the start of the phase-in. Capital withdrawals from the fixed income portfolio were made at prices that were 11 pct. higher than in summer 2007. The Bank has estimated the phase-in costs at NOK 8.7 billion, including direct transaction costs and indirect costs resulting from market effects. The estimate covers both the increase of the equity portion and the enlargement of the benchmark portfolio for equities since summer 2007 with new emerging markets and the segments for small-cap listed equities. The estimate has not been adjusted for costs that would have been incurred in any case in connection with the phase-in of new capital in the period.

The Government Pension Fund – Global has equity holdings in about 7,900 companies in 46 countries. These companies represent around 98 pct. of the global, investable equity markets. During the phase-in period, the Fund more than doubled its average stake in each company, from 0.4 pct. to 1.0 pct. This increase in the Fund's holdings means that the Fund has secured for itself the right to substantially higher portions of all future profits in the world's listed companies.

Investments in real estate

Following the Storting's deliberation of Report No. 16 (2007–2008) to the Storting, the Ministry has continued to work on the plans to invest up to 5 pct. of the Fund in real estate.

Cases where the investments are made in unlisted securities create challenges relating to, *inter alia*, measuring and evaluating returns and risk. For that reason there is a need to establish separate return requirements, risk limits and reporting requirements that address the Ministry's objectives for its real estate investments.

The rules for real estate investments will be included in the new regulations for managing the Government Pension Fund – Global planned to enter into force on 1 January 2010. On 31 August 2009 the Ministry circulated a draft of the new regulations for the Government Pension Fund – Global for comments.

The draft contains rules on how investments in real estate are to take place. The rules specify a return objective and requirements for risk diversification, leverage, valuation and reporting, among others. The Ministry is planning to require the Bank to prepare a strategic plan for the real estate portfolio before investing can begin. The Ministry will also lay down special phasing-in rules before investing in real estate can commence.

The Ministry will return to the Storting in spring 2010 with a more detailed discussion of the rules for real estate investments.

New investment programmes

In Report no. 20 (2008–2009) to the Storting, the Government outlined plans for the establishment of a new investment programme aimed at environment-related investment opportunities. Plans were also announced to continue work on considering whether it is pertinent to establish an investment programme aimed at sustainable investment opportunities in emerging markets.

Plans for the environmental programme could include both investment opportunities in private markets for infrastructure and private equity, and selections of listed equities and bonds based on environmental criteria. Segments of the infrastructure and private equity market were also mentioned as possible investment opportunities for the investment programme aimed at sustainable investment opportunities in emerging markets.

The assumption is that the total amount for these investment programmes may be around NOK 20 billion, invested over a five-year period. The investments must have a clear financial objective.

In Recommendation no. 277 (2008–2009) to the Storting, a majority of the Standing Committee on Finance and Economic Affairs (all the members except the members from Fremskrittspartiet (Progress Party) voted in favour of establishment of an environmental-related investment programme. A majority of the Committee also adopted the Ministry's preliminary assessments of a possible programme aimed at sustainable growth in emerging markets, noting that a programme of this nature would largely have to be built up through investments in private markets.

The Ministry has undertaken a preliminary examination of the investment opportunities within the environmental programme. There are a number of investment opportunities with clearly defined environmental criteria *within* the Fund's existing investment universe, for example, green bonds issued by the World Bank. These bonds target environment-friendly projects in developing countries and will thus also be suitable for an investment programme for sustainable growth in emerging markets.

The market for environment-friendly investments is most developed on the equity side, and investments within the environmental programme can be made in listed equities by overweighting companies with a good environmental profile. This can be achieved by investing according to an index where the weight ascribed to the companies is affected by environmental criteria defined by the index provider. Mandates can also be established for active management, where the Ministry asks Norges Bank as a manager to give priority to environmental criteria in the attempt to achieve excess returns compared with the rate of return of the benchmark index. A common denominator for all the strategies mentioned here is that they entail costs linked to identifying and selecting investment opportunities and companies. However, these costs will be small compared with the amount invested.

Examples of environmental investments *outside* the investment universe of the Fund may be investments in green infrastructure projects, such as wind farms, for example, and investments in start-up companies in eco-friendly technology. Investments of this nature may be made directly, but will often be organised through funds. Exposure to these kinds of markets will be more demanding and will entail greater financial and operational risk than listed investments. There are therefore a number of factors that must be considered more closely before these kinds of investments may be undertaken. For example, it is necessary to examine the opportunities for achieving returns that reflects the increase in risk for the Fund.

The Ministry will also continue to work on considering whether an investment programme can be established in an appropriate manner for sustainable growth in emerging markets. New investments in emerging markets will target unlisted investments in particular. The risk associated with unlisted investments will be especially large in the least developed markets. For this reason, funds with which it is appropriate to make comparisons have started out with unlisted investments in the most developed markets. Investments in less developed markets have not been made until the fund has gained experience from the more developed markets. This approach has been adopted for the listed equity portfolio of the Government Pension Fund – Global and will also be used for the unlisted investments in the real estate portfolio. In the Ministry's view, the same approach ought to be used for unlisted equity investments. The interests of adequate management also dictate the need for a thorough analysis of the investment opportunities in these markets before a programme for unlisted investments in emerging markets is established.

In a letter to Norges Bank on 25 August this year the Ministry of Finance asked the Bank to examine operational aspects of investing in environmental bonds issued by the World Bank and various environmental stock market indices. In addition the Bank was asked to assess the possibility of establishing an active management mandate with environmental criteria. The Ministry also asked Norges Bank to ascertain the unlisted investment opportunities within the two investment programmes and assess the opportunities for returns that are proportionate to the increase in risk for the Fund. Furthermore, the Bank was asked to consider whether an organisation can be established to carry out such investments and how the Bank envisages a possible investment programme.

Norges Bank replied in a letter to the Ministry of 18 September 2009. Regarding investments *within* the Fund's existing investment universe, the Bank wrote that in general such investments could be made using Norges Bank's current systems for operational management of the Government Pension Fund – Global. If the Ministry establishes a mandate for environmental-related investments within the current management framework for the Government Pension Fund – Global, Norges Bank will be able to undertake this kind of management assignment.

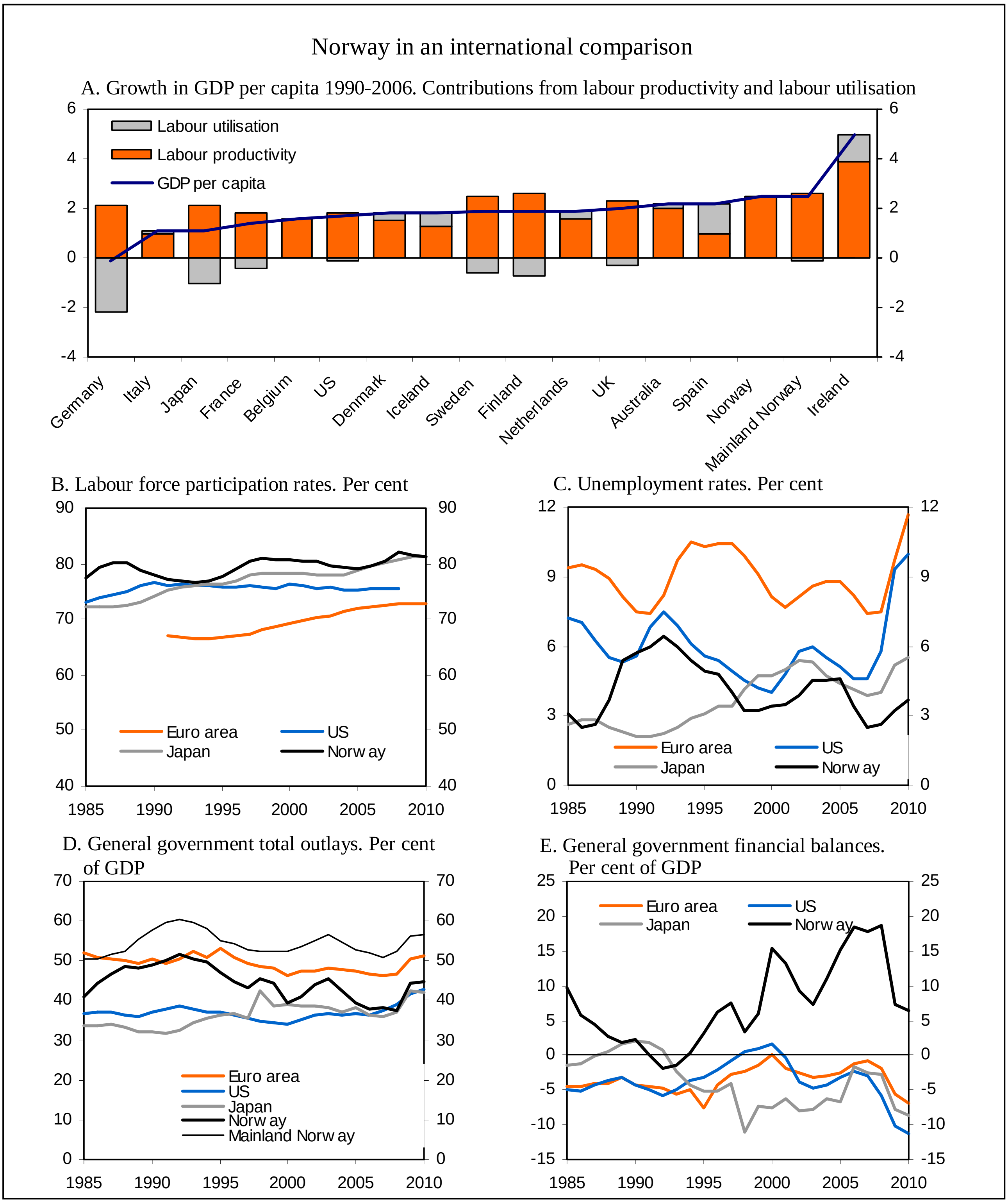
For investments *outside* the investment universe of the Fund, the Bank points out that new investment in unlisted markets within these limited areas will require an extensive examination of the investment opportunities and a thorough assessment of factors relating to expected returns and risk related to such investments. It will be equally important to assess whether Norges Bank can establish an organisation to implement this kind of management. The investments should be made in a professional and businesslike manner, while safeguarding the objectives of the investment programme. Norges Bank will undertake these evaluations and aims to present its conclusions to the Ministry in 2010.

The Ministry will continue its assessment of unlisted investments in the environmental programme and a possible programme aimed at sustainable investment opportunities in emerging markets. Norges Bank's review will play an important role in this work. Investments of this nature also require that the Ministry prepares special guidelines for the investments. I line with the guidelines for other aspects of the management of the Fund, these guidelines will require Norges Bank to achieve the highest possible financial return. Norges Bank will have the opportunity to select external managers.

Previous plans have indicated a total investment within these two investment programmes of approx. NOK 20 billion over five years. Against this backdrop, the Ministry is planning that approx. NOK 4 billion be invested on the basis of environmental criteria in 2010. It is natural that these kinds of investments initially be made in already permitted instruments and markets, such as listed equities and bonds. These kinds of investments will not be very different from the current investments in terms of operational challenges and could therefore be made relatively quickly.

The Ministry will discuss the work linked to the investment programmes further in its annual report on the Fund to be presented in spring 2010.

Appendix 1
Norway in an international comparison



1) Based on 2006 purchasing power parities (PPPs).
2) Labour resource utilisation is measured as total number of hours worked per capita.
3) Labour productivity is measured ad GDP per hour worked.
Sources: OECD and Ministry of Finance.

Appendix 2
The Norwegian Petroleum Sector

Oil exploration started in the late 1960s and production of oil in 1971. Today, there are 60 fields in production on the Norwegian continental shelf. In 2008, these fields produced 2.5 million barrels of oil per day (including NGL and condensate) and 99.3 billion standard cubic metres (scm) of gas, for the total production of saleable petroleum of 242.2 million scm oil equivalents. Total production is expected to fall in both 2009 and 2010, to 233 million scm oil equivalents next year. Whereas gas production is expected to increase by around 8 pct. from 2008 to 2010, a decline in oil production of about 15 pct. is expected in this period. Norway is ranked as the world's fifth largest oil exporter and the third largest gas exporter.

In 2008, the petroleum sector accounted for 27 pct. of value added, and was the largest private sector, in Norway. The State's net cash flow from the petroleum sector, which amounted to approximately 34 pct. of total revenues in 2008, is estimated at NOK 265 billion in 2009 and 220 billion in 2010.

The State's revenues from petroleum activities are allocated to a separate fund, the Government Pension Fund – Global, which is invested abroad. By the end of 2008, the value of this fund was NOK 2,280 billion or some 90 pct. of GDP. Although direct revenues from the petroleum sector are channelled out of the mainland economy and employment in the sector is less than 1 pct. of total employment, petroleum investment, intermediate inputs and other linkages with the mainland economy make activity in the mainland economy dependent of the petroleum sector. In 2008 petroleum investment was over 60 pct. higher than in 2003, measured in constant prices, and corresponded to 7¾ pct. of GDP for Mainland Norway. Petroleum investments are expected to increase by a further 7 pct. this year and 3 pct. next year.

Table 6 Key figures for petroleum activities

	2008	2009	2010	2015	Effect of a NOK 10 change in the oil price in 2010
Assumptions:					
Crude oil price, NOK per barrel	536	375	425	448	
Crude oil price, 2010 NOK per barrel	540	380	425	406	
Production, million Sm^3 o.e					
- Crude oil and NGL	142.9	132.7	126.3	114.4	
- Natural gas	99.2	102.9	106.7	115.3	
NOK billion:					
Export value[1)]	634	422	439	485	8.5
Accrued taxes and excise duties[2)]	246	120	128	153	5.5
Taxes and excise duties paid[2)]	245	171	124	146	2.8
Net income for SDFI	154	78	81	88	2.2
The State's net cash flow[3)]	416	265	220	252	4.9
Memo items:					
Investment in petroleum activities, billion 2006 kroner	107	115	118	88	

1) Crude oil, natural gas, NGL and pipeline transport.
2) Ordinary tax on income and net wealth tax, special income tax, area-, excise- and carbon tax, as well as NO_x tax in 2008 and 2009.
3) The total of taxes and excise duties paid, net payments from the State's Direct Financial Interest (SDFI) in petroleum activities and dividends paid by StatoilHydro.
Sources: Statistics Norway, Ministry of Petroleum and Energy and Ministry of Finance.

Appendix 3
The structural, non-oil budget deficit

The fiscal policy guidelines relate the expected real return on the Government Pension Fund – Global to the structural, non-oil budget deficit. This deficit provides a measurement of the underlying use of petroleum revenues over the Fiscal Budget, which is adjusted for, inter alia, effects of changes in the business cycle. The following adjustments are made to the non-oil budget deficit:

– To address the budgetary effects of cyclical discrepancies from a normal situation the effects of tax bases deviating from their trend levels are calculated. Furthermore, it is taken into consideration that payments of unemployment benefits depend on the stage of the business cycle. The performance of the estimated activity corrections in 2009 and 2010 in Table 7 reflects the fact that the Norwegian economy is in a downturn, but got there from a situation characterised by a high level of activity.

– Adjustments are made to address the difference between the estimated normal levels of central government interest revenues and expenditures and transfers from Norges Bank on the one hand, and actual transfer and interest flows, on the other. To strengthen Norges Bank's equity, no funds has been transferred from the Bank to the Fiscal Budget since 2002.

– Adjustments are made for accounting changes and for changes in the division of functions between central and local government that do not affect underlying developments in the budget balance. The accounting adjustment for 2009 is related to the fact that changes in working capital loans in the regional health authorities are included in the non-oil budget deficit starting in 2009. At the same time, NOK 7.3 billion was appropriated for the health authorities and health trusts to convert their working capital loans from private banks to a state working capital loan scheme. For 2010 an accounting adjustment was included that related to the fact that the responsibility for parts of the national highway network is being transferred from the central government to the county authorities. In the central government, expenses are recognised as they are paid out, whereas in the local governments they are recognised when accrued. The accounting effects of the change are not included in the calculation of the structural, non-oil deficit for 2010.

A number of other countries also use a measurement of the structural budget balance as the basis for assessing fiscal policy. In addition, the OECD and EU regularly publish standardised estimates of the structural budget deficits of member states. These estimates are based on more aggregated calculations than the Ministry of Finance's estimates for Norway. However, the methodological basis for activity-adjusted budget balances is very much like that used in Norway.

Table 7 The structural, non-oil budget deficit. NOK million.

	2007	2008	2009	2010
Non-oil deficit	1 342	11 797	118 088	153 780
- Transfers from Norges Bank Deviations from estimated trend level	5 640	6 010	6 270	6 270
- Net interest revenues. Deviations from estimated trend level	-5 083	-7 545	-3 066	-4 344
- Special accounting technicalities	-3 238	-107	7 364	500
- Business cycle adjustment	-52 975	-58 754	-22 418	2 851
= Structural non-oil budget deficit	56 998	72 194	129 938	148 503
Measured in pct. of Mainland Norway trend GDP	3.5	4.2	7.2	7.8
Change from previous year in percentage points[1]	0.1	0.7	3.0	0.6

1) The change in the structural non-oil deficit as a percentage of Mainland Norway trend GDP is used as an indicator of the effect of the Budget on the economy. Positive figures indicate that the Budget has an expansionary effect.

Sources: Statistics Norway and Ministry of Finance.

Appendix 4
Budget tables

Table 8 Fiscal budget revenues and expenditure in 2009. NOK million

	1 Adopted Budget	2 Amended Budget	3 Revised National Budget 2009	4 National Budget 2010	5=4-1 Memo: Change from Adopted Budget
A Revenues other than petroleum revenues	773 122	743 943	733 467	732 296	-40 825
Direct and indirect taxes from Mainland Norway	702 793	675 843	674 649	674 224	-28 569
Interest revenues	23 908	23 925	20 445	19 692	-4 216
Other revenues	46 420	44 174	38 372	38 381	-8 040
B Expenditures other than petroleum activities	821 772	842 311	851 029	850 384	28 612
Interest expenditures	20 468	20 468	21 210	20 857	389
Unemployment benefit	5 133	7 367	10 530	10 230	5 097
Other expenditures	796 171	814 476	819 289	819 297	23 126
C Non-oil surplus (A-B)	-48 650	-98 368	-117 562	-118 088	-69 438
D Cash flow from petroleum activities	394 840	275 940	261 367	264 717	-130 123
E Allocations to the Government Pension Fund Global (C+D)	346 190	177 572	143 805	146 629	-199 561
F Interest and dividend revenues to the Government Pension Fund	87 200	91 300	93 600	108 400	21 200
G Consolidated fiscal budget surplus and Government Pension Fund surplus (E+F)	433 390	268 872	237 405	255 029	-178 361

Source: Ministry of Finance.

Table 9 Government Pension Fund – Global, expected real rate of return and structural, non-oil budget deficit. NOK billion and per cent

	Current prices			Constant 2010 prices			Structural deficit	
	Government Pension Fund – Global at the beginning of the year [1]	Expected return (4 pct. of the Fund capital)	Structural, non-oil budget deficit	Expected return (4 pct. of the Fund capital)	Structural, non-oil budget deficit	Deviation from the 4 pct. trajectory	As pct. of Mainland Norway trend GDP	As pct. of the Fund capital
2001	386.6	-	16.4	-	23.0	-	1.4	-
2002	619.3	24.8	30.0	33.4	40.5	7.1	2.4	4.8
2003	604.6	24.2	37.8	31.3	49.0	17.7	2.9	6.3
2004	847.1	33.9	44.1	42.6	55.5	12.9	3.2	5.2
2005	1 011.5	40.5	49.0	49.4	59.8	10.4	3.4	4.8
2006	1 390.1	55.6	52.4	65.6	61.8	-3.8	3.4	3.8
2007	1 782.8	71.3	57.0	80.7	64.5	-16.2	3.5	3.2
2008	2 018.5	80.7	72.2	86.3	77.2	-9.1	4.2	3.6
2009	2 279.6	91.2	129.9	93.9	133.9	39.9	7.2	5.7
2010	2 597.3	103.9	148.5	103.9	148.5	44.6	7.8	5.7
2011	2 823.8	113.0	-	109.3	148.5	-	-	-
2012	3 063.8	122.6	-	114.8	148.5	-	-	-
2013	3 321.9	132.9	-	120.5	148.5	-	-	-
2014	3 599.1	144.0	-	126.3	148.5	-	-	-
2015	3 890.4	155.6	-	132.1	148.5	-	-	-
2016	4 203.5	168.1	-	138.0	148.5	-	-	-
2017	4 549.0	182.0	-	144.5	148.5	-	-	-
2018	4 920.7	196.8	-	151.1	151.1	-	-	-
2019	5 309.7	212.4	-	157.7	157.7	-	-	-
2020	5 716.0	228.6	-	164.2	164.2	-	-	-

1) In the projections for the Fund capital it is technically assume that the structural deficit remains constans in 2010 kroner until a return to the 4 per cent trajectory. Thereafter it is assumed that annual withdrawals from the Fund will correspond to 4 pct. of the Fund capital as at the beginning of the year.

Source: Ministry of Finance.