



NORWEGIAN MINISTRY OF FINANCE

Summary

The National Budget 2011

Summary



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National Budget 2011

1 Introduction

The main aim of economic policy in 2009 and 2010 has been to sustain employment and keep unemployment down. So far, Norway has weathered the financial crisis and the ensuing global economic downturn better than many other countries. The fall in Norwegian mainland GDP in 2009 has been estimated at 1.4 per cent and unemployment seems to be levelling out at about 3½ per cent. Both the decline in production and the rise in unemployment have been relatively mild by international standards. The Mainland economy is forecast to grow by 1.7 per cent in 2010 and by 3.1 per cent in 2011, the latter about half a percentage point above trend growth.

In order to mitigate the effects of the financial crisis on the Norwegian economy, strong policy measures were introduced. Through the autumn of 2008 and until the summer of 2009 Norges Bank (the Central Bank) reduced its key policy rate by 4½ percentage points to 1.25 per cent - the lowest level ever. In addition, the Government and Norges Bank carried out extensive measures to improve conditions in the financial markets and facilitate lending to households, enterprises and local governments. Norges Bank has since then increased the key policy rate by 0.75 percentage point, and signalled further rises to come. Most measures directed towards the financial markets have been withdrawn or will be phased out according to plan.

Fiscal policy also took a sharp turn in an expansionary direction in 2009 and 2010, contributing to stabilizing the economy. However, this policy has also pushed the structural non-oil deficit substantially above the four per cent path for spending of oil revenues. Expansionary budgetary measures in economic downturns should be followed by a more contractionary policy once the economy returns to normal.

With the prospect of growth above trend in the mainland economy in 2011 and stabilization of unemployment, it will be in line with the fiscal

policy guidelines to tighten the budget and reduce the gap to the four per cent path. The Government propose to keep the use of oil revenues unchanged in real terms from 2010 to 2011, measured by the structural non-oil budget deficit. This corresponds to a fiscal tightening of 0.2 per cent of trend GDP for Mainland Norway, after two years of strong fiscal stimulus. Considerations relating to long-term fiscal sustainability, the stability of the exchange rate and the prospects of the internationally exposed sectors all call for such a focus in the 2011 budget.

The Government proposes a budget for 2011 with a structural non-oil budget deficit of NOK 128.1 billion, which is NOK 7.4 billion above the four per cent path.

2 Economic outlook

The recovery of the Norwegian economy since summer 2009 has continued throughout this year, although at a somewhat slower pace. Compared with developments in some other industrial countries, growth in the Norwegian economy has been moderate in recent quarters. However, this must be viewed in light of the fact that the downturn in the wake of the financial crisis was less severe in Norway than among our trading partners. Lacklustre growth in household consumption was primarily responsible for dampening Mainland Norway GDP growth in the first quarter of this year. In the second quarter growth has rebounded somewhat, mainly driven by investments in Mainland Norway and in the petroleum sector.

In the quarters ahead, growth is expected to continue to rise, supported by low interest rates, greater optimism among households, an upswing in petroleum investments and demand from export markets. Mainland Norway GDP growth is estimated at 1.7 per cent this year and 3.1 per cent next year.

The marked upturn in *private consumption* over the last three quarters of last year has been succeeded by lower consumption growth this year. In the second quarter household

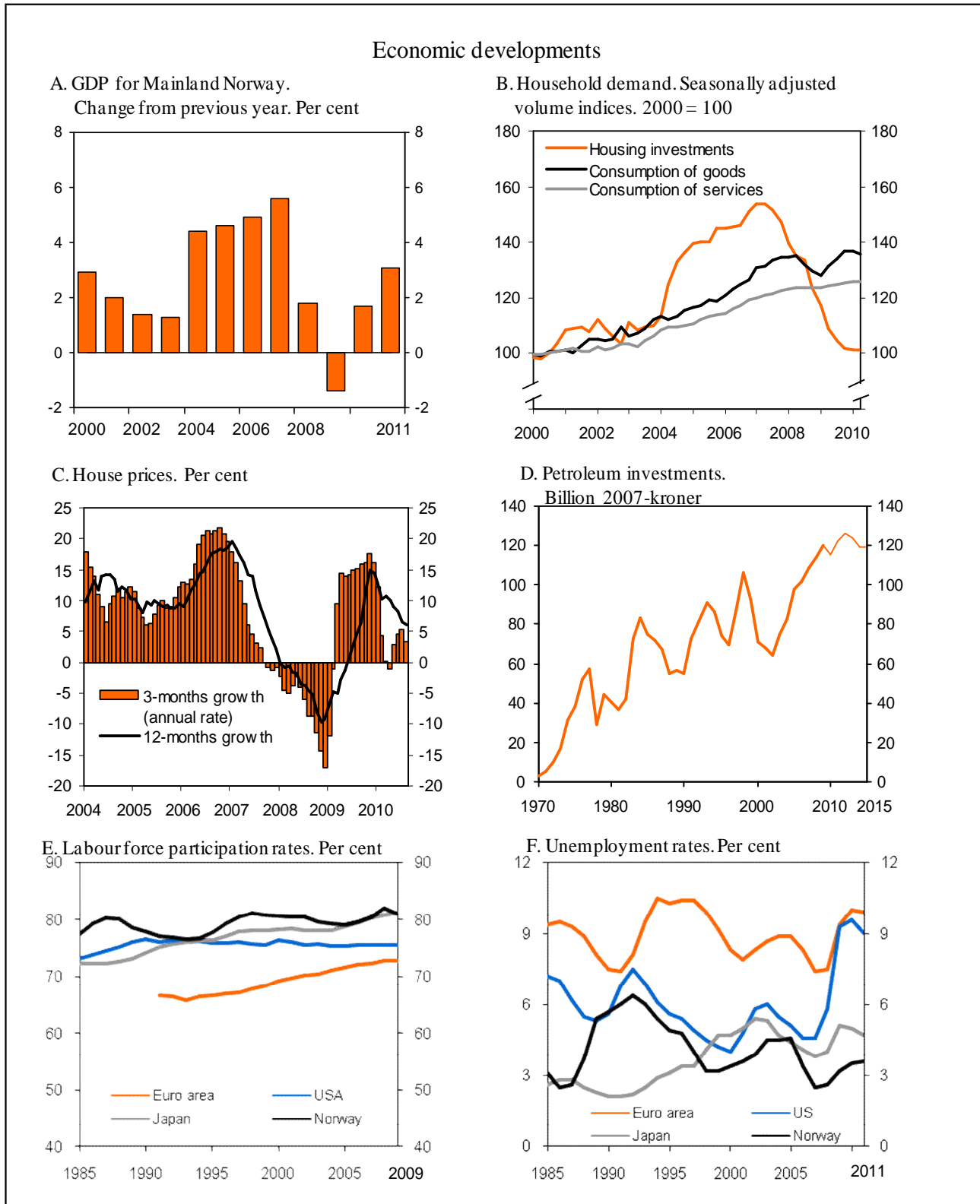


Figure 2.1 Economic developments

Sources: Statistics Norway, Norges Eiendomsmeidlerforbund – Econ Pöyry, Ministry of Petroleum and Energy, OECD and Ministry of Finance.

Table 2.1 Key figures for the Norwegian economy. Percentage change from previous year¹

	NOK billion ²			
	2009	2009	2010	2011
Private consumption	1 015,3	0,2	2,8	3,5
Public consumption	533,1	4,7	2,7	2,1
Gross fixed investments	510,0	-9,1	-3,4	4,6
Petroleum extraction and pipeline transportation	134,4	5,7	-3,8	6,0
Businesses in Mainland Norway	190,1	-15,4	-4,0	3,3
Housing investments	77,5	-18,9	-4,8	6,0
Public sector.....	85,9	7,0	3,3	5,1
Demand from Mainland Norway ³	1 901,8	-1,1	1,8	3,3
Exports	1 008,8	-4,0	0,8	1,8
Of which: Crude oil and natural gas	465,1	-1,2	-3,6	-2,8
Traditional goods	278,1	-8,2	5,1	4,9
Imports	656,3	-11,4	4,2	5,6
Of which: Traditional goods	409,1	-13,1	5,7	5,1
Gross domestic product	2 380,7	-1,4	0,5	2,1
Of which: Mainland Norway	1 846,4	-1,4	1,7	3,1
Other key figures:				
Employment (persons)		-0,4	-0,2	0,6
Unemployment rate. LFS (level)		3,2	3,5	3,6
Annual wage		4,2	3¼	3¼
Consumer price index (CPI)		2,1	2,5	1,8
CPI adjusted for tax changes and excluding energy products (CPI-ATE).....		2,6	1,5	1,9
Oil price. NOK per barrel ⁴		388	475	485
Current account balance (pct. of GDP)		13,1	16,3	15,3

¹ Calculated in constant 2007 prices unless otherwise indicated.

² Current prices.

³ Excluding inventory changes.

⁴ Current prices

Sources: Statistics Norway and Ministry of Finance.

consumption actually declined, even if spending on services increased slightly. However, increased consumer confidence, relatively high income growth, low interest rates and low unemployment, provide reason to expect that consumption growth will gather speed going forward.

The counterpart of the household consumption development has been high *saving*. Household savings as a percentage of disposable income – the savings rate – has gone up markedly in the wake of the financial crisis and is now well above its historical average. Increased uncertainty about international economic development may have prompted greater caution among Norwegian households, helping to sustain the high savings rate. The high savings rate may also reflect a need for financial consolidation. Overall, the gross debt of households is now

more than two times their disposable income, which is high in both a historical and international context.

The slowdown in household demand is also reflected in the housing market, where *house prices* have levelled off this year following robust growth last year. Seen from a historical perspective, house prices have reached a high level. Seasonally adjusted, nominal prices are now almost 5 per cent higher than they were at the previous peak in June 2007. However, adjusted for inflation, prices are still slightly below the previous peak.

Unemployment has increased substantially less in Norway than in most other industrialized countries. In the first half of this year unemployment has remained rather stable at around 3½ per cent of the labour force. This is moderately higher than the 2009 average of 3.2

per cent, but still quite low in both a historical and an international context. For 2011, unemployment is estimated at 3.6 per cent of the labour force, clearly below the average of 4¼ per cent for the past 20 years.

Overall *wage growth* this year is estimated at 3¼ per cent. High costs in Norway and substantial uncertainty about future development in demand and prices for internationally exposed sectors could indicate that the settlements will be moderate also next year. In this report, a wage growth rate of 3¼ per cent is estimated for 2011.

The strengthening of the krone throughout 2009 and low international inflation are now evident in lower prices for imported consumer goods. Core inflation (measured by the 12 month change in the CPI-ATE) fell from 2.3 per cent in January to 1.4 per cent in August. Developments in electricity prices have meant that growth in the all-items consumer price index (CPI) so far this year has been above CPI-ATE inflation. CPI inflation is now estimated at 2.5 per cent this year and 1.8 per cent next year, while CPI-ATE inflation is estimated at 1.5 per cent this year and 1.9 per cent next year.

Petroleum investment has provided a considerable stimulus to growth in the mainland economy in recent years. From 2002 to 2009, investment in petroleum activities surged by 87 per cent in real terms. However, preliminary statistics point in the direction of a decline in these investments from 2009 to 2010, followed by a sharp upturn in 2011.

The *oil price* increased through the first four months this year and was at the beginning of May just over NOK 520 per barrel (USD 88). With the increasing turmoil in international financial markets the upswing came to a halt, and recent months have seen major fluctuations in the oil price. So far this year the average price of oil has been just under NOK 470 per barrel (USD 77). The oil price is estimated at NOK 485 in both 2010 and 2011 (2011-prices).

3 Economic policy

3.1 The fiscal policy guidelines

The Norwegian fiscal policy guideline was introduced in 2001 and is a plan for a smooth, gradual increase in expenditure of petroleum revenues to a level that can be sustained over time. The rule states that the use of petroleum revenues, measured by the structural non-oil budget deficit, should over time be in line with the expected real return on the Government Pension Fund Global (GPF), estimated at four

per cent, cf. Box 3.1. At the same time, the spending of petroleum revenues for a particular year must be adjusted to the economic situation. The framework thus facilitates using the budget to stabilize developments in the Norwegian economy, in both the short and long term.

The flexibility provided by the fiscal rule has been capitalized on. When the Norwegian economy was in a slump the first years after the fiscal rule was introduced, the use of petroleum revenues, measured by the structural non-oil budget deficit, was brought above the four per cent path for spending these revenues. From 2006 to 2008 it was the reverse. To dampen the effects of the financial crisis and the global downturn on the Norwegian economy, petroleum revenue spending was raised once again in 2009 and 2010 to a level considerably above the four per cent path.

As the situation in the Norwegian economy normalizes, the spending of petroleum revenues must be brought back to the four per cent path, as the Government has announced. Such a focus in budgetary policy will facilitate a balanced development of the Norwegian economy by easing the pressure on interest rates, the krone exchange rate and industries exposed to international competition.

Indeed, the objective of long-term sustainability in state finances also calls for a quick return of petroleum revenue spending back to the four per cent path. In the years ahead an ageing population will put steadily increasing pressure on public finances through higher expenditure on pensions and health care. The longer petroleum revenue spending remains above expected fund returns, the lower the future contribution the Pension Fund will be able to provide to cover these expenditures.

3.2 Budgetary policy in 2010 and 2011

After the budget for 2010 was presented in the autumn of last year, new information has emerged about the performance of budget revenues and expenditures. This information has provided the basis for a substantial reduction in the estimated gap between the structural deficit and the four per cent path both in 2009 and 2010, cf. also The revised national budget 2010. For 2010 this reduction in the gap is due to higher estimates for structural taxes, higher than expected dividends from state-owned companies, and lower expenditures, inter alia, on sick leave benefits in the National Insurance Scheme.

For 2010 the structural non-oil budget deficit is now estimated at NOK 124.8 billion, NOK 23.7 billion lower than in the original budget for 2010.

Box 3.1 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 take due account of uncertainty and aim at a gradual increase in the spending of oil revenues up to a sustainable level, both in the short and long run.

- 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, spending will increase.
- An important point with respect to stabilization is that the guidelines allow 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. Rather, 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 the four per cent path are also justified when there are large changes in the fund value. The consequences 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.

Nonetheless, estimated at a little above NOK 19 billion, the deviation from the four per cent path in 2010 is still considerable.

The proposed 2011 budget implies an unchanged spending of petroleum revenues in real terms. Measured as a share of the trend GDP for Mainland Norway, the structural non-oil deficit is reduced by 0.2 percentage point from 2010 to 2011. This indicates a mild fiscal tightening. More detailed calculations based on macroeconomic model simulations that also take into account how the fiscal budget's revenues and expenditures affect the activity level of the Norwegian economy, support the above conclusion and shows that the Government's proposed budget entails a tightening of domestic demand equivalent to ¼ per cent of GDP for Mainland Norway.

The main features of the proposed budget for 2011 are as follows (all amounts are stated in 2011 prices):

- *The structural non-oil budget deficit is estimated at NOK 128.1 billion, which is NOK 7.4 billion higher than the expected real return on the Fund in 2011.*
- *The structural non-oil deficit is estimated at the same level in 2011 as in 2010 measured in fixed prices. This corresponds to a tightening of the budget by just under 0.2 per cent of the trend GDP for Mainland Norway.*
- *Taxes are kept at the same level as in 2010.*
- *The real, underlying growth in the fiscal budget's expenditure is estimated at 2¼ per cent, slightly below the average for the last 25 years.*
- *Local governments' total revenues are increased by 1.5 per cent in real terms from 2010 to 2011, equalling NOK 5.1 billion, calculated relative to an updated income estimate for 2010.*
- *A non-oil budget deficit in 2011 of NOK 135 billion, an increase of NOK 13.5 billion from 2010,*

Box 3.2 The structural, non-oil budget surplus. NOK million

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.

- Adjustments are made to the non-oil budget balance to address the effects of cyclical discrepancies from a normal situation by estimating the budgetary effects of various tax revenues deviating from their trend levels. Furthermore, it is taken into consideration that payments of unemployment benefits depend on the stage of the business cycle. The calculated activity adjustments for 2011 in Table 3.1 reflects the fact that the Norwegian economy operates below trend, but also that the decline started from a very high level of activity.
- Adjustments are made to address the difference between the estimated normal levels of central government interest income 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 have been transferred from the

Bank to the Fiscal Budget since 2002.

- Adjustments are made for accounting changes and for changes in the division of labour between central and local government that do not affect underlying developments in the budget balance. For 2010 an accounting adjustment was included relating to the transfer of responsibility for parts of the national highway network from the central government to the county authorities. In the central government, expenses enter the books as they are paid out, whereas in the local governments they are posted when incurred. The accounting effects of the change are adjusted for in the calculation of the structural non-oil deficit for 2010. Accounting adjustments for 2008, 2009 and 2010 have also been incorporated as the result of the Supreme Court judgment on the settlement of latent tax liabilities in the tax scheme for shipping companies. To provide the most accurate picture of developments over time, the tax loss of about NOK 1¼ billion in 2008 and 2009, plus the estimated refund to the shipping companies of NOK 2½ billion 2010, have been incorporated as accounting adjustments.

Table 3.1 The structural, non-oil budget surplus. NOK million

	2008	2009	2010	2011
Non-oil fiscal budget surplus	-11 797	-96 561	-121 484	-134 971
- Net interest revenues and transfers from Norges Bank.				
Deviations from estimated trend level.....	3 219	-1 195	-1 592	98
- Accounting technicalities	1 156	-6 058	-3 000	0
- Cyclical adjustments	49 756	18 577	7 861	-6 954
= Structural, non-oil budget surplus.....	-65 929	-107 885	-124 753	-128 116
Measured in per cent of Mainland Norway trend GDP	-3,8	-5,9	-6,4	-6,3
Change from previous year in percentage points ¹	-0,5	-2,1	-0,6	0,2

¹ The change in the structural, non-oil surplus as a percentage of Mainland Norway trend GDP is used as a summary indicator of the impact of the budget on the economy. Positive figures indicate that the budget has an expansionary impact. Unlike the model computations presented in the National Budget, this indicator does not take account of the fact that different revenue and expenditure items may have differing impacts on economic activity.

Sources: Statistics Norway and Ministry of Finance.

measured in current prices. Automatic stabilizers, i.e. the effects of changed economic activity on taxes and expenditure on unemployment benefits, account for almost all of the increase.

The State's net cash flow from petroleum activities is estimated at NOK 288 billion in 2011. The net allocation to the Government Pension Fund Global, from which the transfer to the fiscal budget to cover the non-oil deficit is deducted, is estimated at NOK 153 billion in 2011. The actual withdrawal from the Fund is equal to the non-oil budget deficit, which is estimated at about NOK 135 billion in 2011.

The combined surplus in the fiscal budget and the Government Pension Fund, which also includes interest and the return on the capital in the Fund, is estimated at about NOK 266 billion in 2011. Total capital in the Government Pension Fund at the end of 2011 is estimated at NOK 3,481 billion, of which NOK 3 360 billion is in the Government Pension Fund Global.

3.3 The Government's tax profile in 2011

Total accrued tax revenues in Norway will amount to about NOK 1 057 billion in 2010. Of this, about 86 per cent is paid to the central government, while local government (municipalities and counties) receives 14 per cent. The Norwegian tax system is characterised by a relatively high share of indirect taxes. Value-added tax (VAT) and excise duties represent about 32 per cent of total tax revenue. Personal income tax and the tax on net wealth levied on individuals represent about 24 per cent of the total tax revenue. Corporate tax, including employers' social security contributions, amounts to approximately 21 per cent. Taxes levied on petroleum activities represent about 20 per cent of total tax revenue.

The Government's objectives for its tax and fiscal policies are to ensure public revenue, contribute to a fair income distribution and a

Table 3.2 Key figures for the fiscal budget and the Government Pension Fund. NOK billion

	Accounts		Budget	
	2008	2009	2010	2011
Total revenues	1 182,6	1 051,9	1 041,8	1 113,1
1 Revenues from petroleum activities	437,7	304,5	287,9	313,0
1.1 Direct and indirect taxes	245,2	169,0	156,1	173,9
1.2 Other petroleum revenues	192,5	135,5	131,8	139,1
2 Revenues other than petroleum revenues	744,9	747,4	753,9	800,1
2.1 Direct and indirect taxes from Mainland Norway	680,4	684,7	699,3	737,6
2.2 Other revenues	64,5	62,6	54,7	62,5
Total expenditures	778,6	868,7	898,6	960,1
1 Expenditures on petroleum activities	21,8	24,7	23,2	25,0
2 Expenditures other than petroleum activities	756,7	843,9	875,4	935,1
Fiscal budget surplus before transfers to the Government Pension Fund – Global	404,1	183,2	143,2	153,0
- Net cash flow from petroleum activities	415,9	279,8	264,7	288,0
= Non-oil surplus	-11,8	-96,6	-121,5	-135,0
+ Transfers from the Government Pension Fund – Global	8,4	107,2	121,5	135,0
= Fiscal budget surplus	-3,4	10,7	0,0	0,0
+ Net allocation to the Government Pension Fund Global	407,5	172,6	143,2	153,0
+ Interest and dividend revenues to the Government Pension Fund	103,1	91,3	84,4	113,1
= Consolidated fiscal budget surplus and Government Pension Fund surplus	507,2	274,5	227,6	266,1
Memo:				
Market value of the Government Pension Fund Global ¹	2 279,6	2 642,0	3 018,3	3 359,5
Market value of the Government Pension Fund ¹	2 367,4	2 759,1	3 132,7	3 481,3
National Insurance Scheme – old-age pension liabilities ^{1,2}	4 300	4 577	4 843	5 087

¹ At year-end. In addition to total surplus in the fiscal budget and the Government Pension Fund, the performance of the Fund capital is affected by changes in foreign exchange rate and asset valuations.

² Present value of accrued rights to future National Insurance Scheme old-age pensions. Calculations are based on an average annual real wage growth of 2 per cent and a real interest rate of 4 per cent. Higher real wage growth or lower real interest rate will imply increases in old-age pension liabilities. Estimates do not include pensioners living abroad or National Insurance Scheme liabilities to disability and surviving relative pensions.

Sources: Statistics Norway and Ministry of Finance.

better environment, promote economic growth and employment in the entire country and improve the functioning of the economy. The Government has stated that the level of taxation should be kept stable to ensure a good economic foundation for maintaining the welfare system.

The Government has strengthened the redistributive aspect of the tax system through more stringent taxes on dividends and gains on equity investments, a fairer net wealth tax and inheritance tax and higher minimum deductions in both of these taxes. In addition, the tax system more clearly promotes environmental concerns. By continuing the systemic changes in the tax

reform within confines of a stable tax level, the Government is ensuring a predictable tax system, making it attractive to invest and do business in Norway. The 2006 tax reform resulted in a fairer tax system by largely equalizing the wide difference in the highest marginal tax rates for earned and unearned income.

The tax system must also encourage people to work. A large labour force is crucial for maintaining the level of welfare services. Participation in working life is also the best insurance against low income and poor living conditions.

In the 2011 budget, the Government is

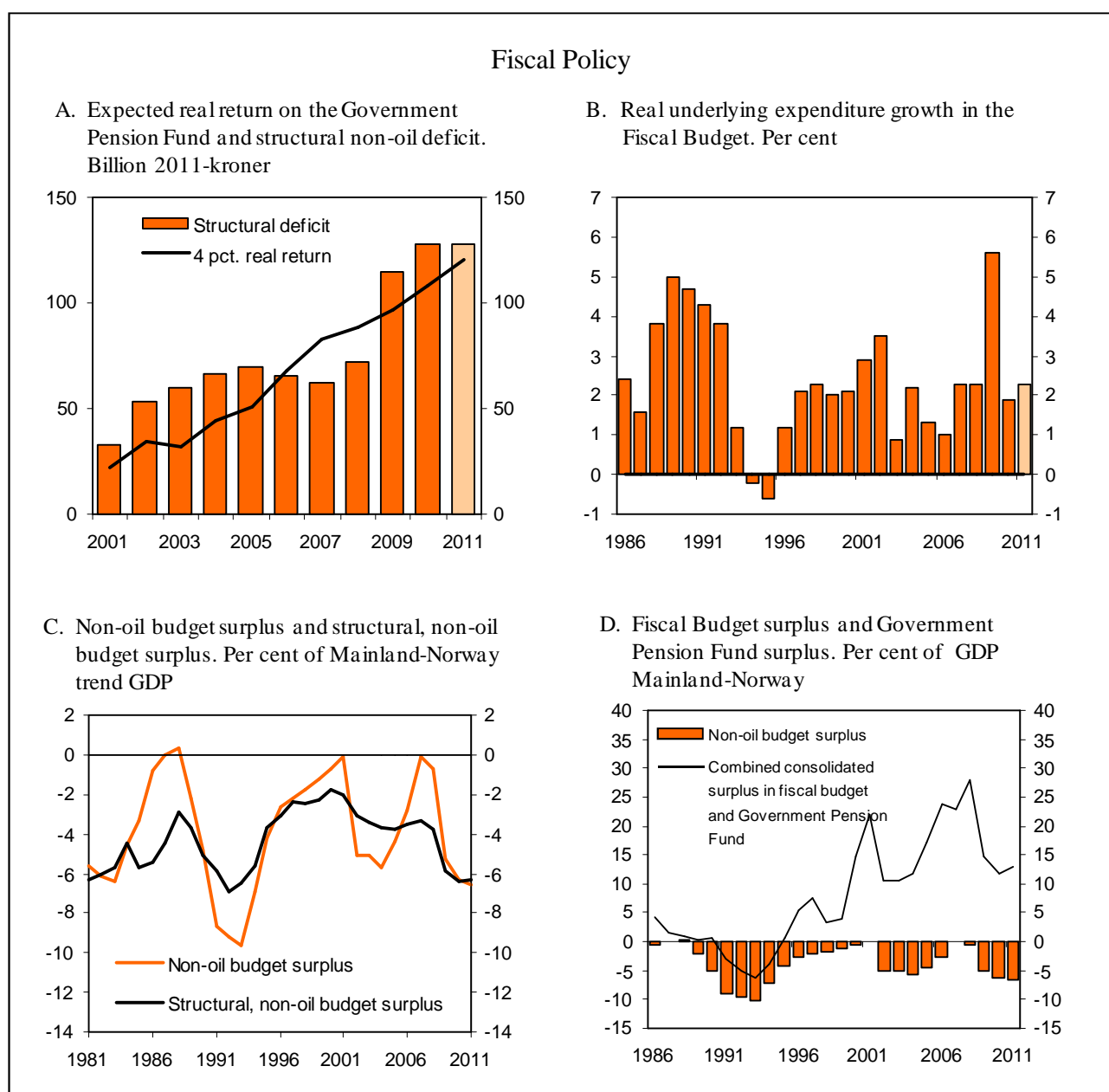


Figure 3.1 Fiscal Policy

Sources: Statistics Norway and Ministry of Finance.

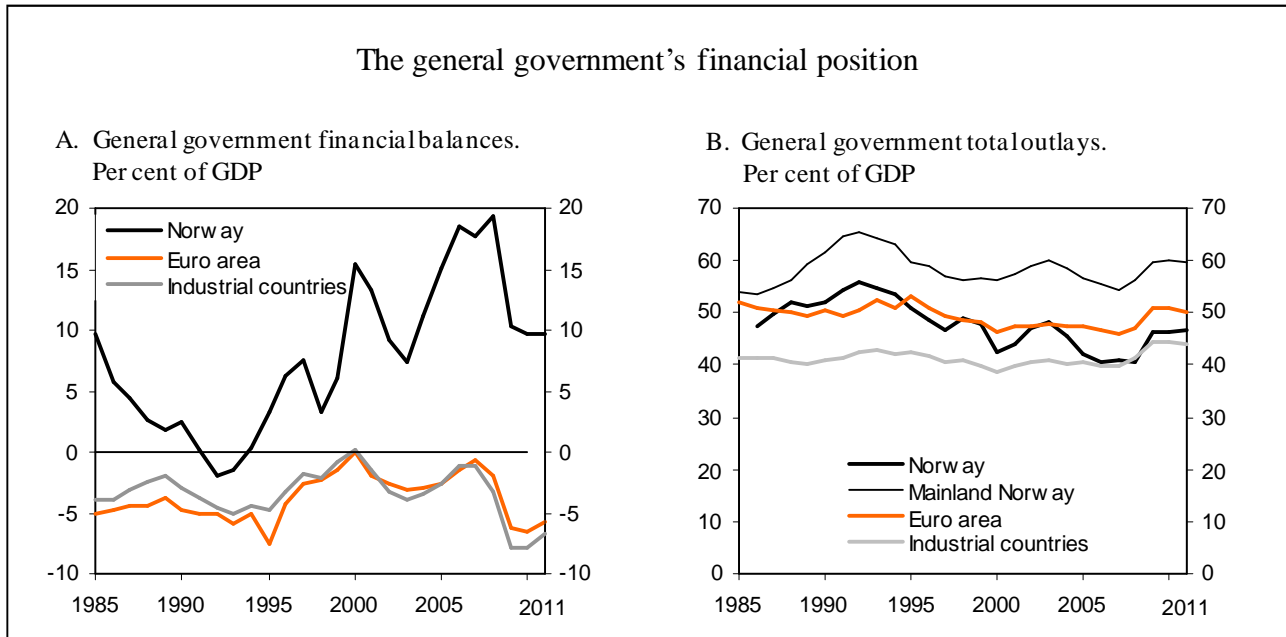


Figure 3.2 The general government's financial position
Sources: OECD, Statistics Norway and Ministry of Finance.

proposing changes in the tax system to provide elderly with better incentives to work when receiving pension. Under the proposal, the current tax limitation rule for early retirement and old-age pensioners will be replaced by a new tax allowance for pension income. The allowance will ensure that those who only receive the minimum pension will continue not to pay income tax. The allowance will be scaled down only against pension income so that the marginal tax on earned income will be reduced to the same level as for wage earners. The marginal tax on capital for low and middle income pensioners will also be reduced to the same level as for other taxpayers.

Access to the new tax allowance will be independent of the income of the spouse, and married early retirement and old-age pensioners will each have their own allowance. In addition, the Government proposes to increase the social security contribution from pension income and abolish the special allowance for age. Altogether, the proposals will provide pensioners with NOK 1.35 billion in tax relief accrued in 2011, and have beneficial redistributive effects.

3.4 The fiscal position of the general government

In addition to the fiscal budget and the Government Pension Fund, general government includes other central government and national insurance accounts and local government administration. General government net lending

is the surplus concept of the national accounts and is computed in a way that makes possible meaningful comparisons of public sector figures for different countries. Since the mid-1990s huge oil revenues have contributed a substantial surplus to public finances in Norway, whereas the euro area and industrial countries as a group have generally posted deficits, cf. figure 3.2A. In the last couple of years, general government net lending has decreased by a substantial amount in both the euro area and in Norway. This must be viewed in the context of lower tax revenues in the wake of the global downturn, along with extensive fiscal policy measures to dampen the rise in unemployment. For Norway, the decline in the price of oil from the high level in 2008 also plays a part.

For 2011 general government net lending in Norway is estimated at just under NOK 250 billion, equivalent to 9.6 per cent of GDP. This is about the same level as in 2009 and 2010, but is clearly lower than in 2006-2008. The general government surpluses can primarily be linked to developments in central government net lending, cf. table 3.3.

For Norway, gross government debt is estimated at NOK 1,125 billion at the end of 2010, equivalent to about 45 per cent of GDP. The level of the gross debt must be viewed in light of the use of repurchase and reverse repurchase agreements (repos and reverse repos) in the management of the Government Pension Fund Global. These transactions do not change the government's net financial position, but in line

Table 3.3 General government net lending. NOK million and per cent of GDP

	2009	2010	2011
A. Central government net lending, accrued value	268 298	267 771	277 558
Consolidated surplus in fiscal budget surplus and Government Pension Fund.....	274 487	227 607	266 136
Non-oil fiscal budget surplus	-96 561	-121 484	-134 971
Net cash flow from petroleum activities	279 794	264 691	288 007
Dividends on the Government Pension Fund.....	91 254	84 400	113 100
Surplus in other government and public pension accounts	2 439	2 810	2 763
Definitional discrepancies, central government accounts/national account ¹	-8 627	37 354	8 659
B. Local government net lending, accrued value.....	-23 005	-26 336	-27 821
C. General government net lending (=A+B)	245 293	241 435	249 737
Measured as a percentage of GDP	10,3	9,7	9,6

¹ Includes central government accrued, but not recorded taxes. Adjustments are made to address that capital contributed to state-run enterprises, including central government petroleum activities, are classified as financial investments in the national accounts.

Sources: Statistics Norway and Ministry of Finance.

with international guidelines for national accounts repurchase agreements shall be treated as liabilities and reverse repurchase agreements shall be treated as assets. Outside the Government Pension Fund Global public gross debt at the end of 2010 was estimated at about 33 per cent of GDP. This is an increase of just over 13 percentage points from the end of 2008, which can be primarily attributed to the crisis related scheme under which the banks may swap covered bonds for government securities. The Government's net asset position is not affected by these swaps.

Public expenditure as a share of GDP is used as an indicator of the size of public administration. Measured as a share of mainland GDP, public expenditure in Norway is estimated to remain close to 60 per cent in 2010 and 2011, after rising significantly from 2008 to 2009. The level of public expenditure in 2011 is slightly higher than the average for the past 25 years, but lower than during the economic downturns in the early 1990s and in 2002-2003, cf. Figure 3.2B. As with other industrial countries and countries in the euro area, the increase must be viewed in light of cyclical developments and fiscal policy measures to dampen the effects of the global financial crisis.

3.5 Fiscal policy in the medium and long term

Over time, the leeway in budgetary policy is primarily determined by the growth of the tax bases of the mainland economy, by expenditure and revenue commitments from previous decisions and by the path of expected real returns on the capital in the Government Pension Fund Global. At the moment, the leeway is also

constrained by the fact that the use of petroleum revenues is above the four per cent path.

Tax bases trend upward over time. For a given structure of the tax system this provides increasing tax revenues to the public sector. For the coming years, it is estimated that the underlying growth of the tax bases will strengthen the budget by around NOK 12 billion per year. The estimate takes into account that rising real wages implies a higher average price growth for budget items than the average price growth for the tax bases.

Even without further expansion of the publicly funded welfare programmes, fiscal budget expenditure is set to increase substantially in the years to come. This is largely due to the interplay between National Insurance Scheme rules and a demographic shift towards an older population. Eventually, the need for health and care services will also increase sharply. Expenditure increases in the National Insurance Scheme are estimated, on average, at nearly NOK 9 billion 2011-prices per year for 2012-2014. In comparison, expenditure rose by just under NOK 5 billion 2011-prices on average per year from 2005 to 2010 (measured in fixed 2011-prices). In the longer term, the growth in expenditure on pensions, health and care services is estimated to be clearly stronger than the underlying growth in tax revenues.

The estimated petroleum revenue spending in 2011 is approximately in line with the expected real return on the Fund in 2012, cf. table 3.4, indicating that there is room for some increased petroleum revenue spending both from 2012 to 2013 and in the next couple of years, estimated on the order of NOK 7-8 billion on average per year. It is emphasized that these numbers are

uncertain, and that the use of petroleum revenues in the next few years also will have to be adjusted to the performance of the economy.

The use of oil revenues in 2011 is equivalent to 6.3 per cent of the trend GDP for Mainland Norway. Based on estimates for the performance of the Fund capital in the coming years, the use of petroleum revenues may increase to a peak equal to just below 8 per cent of value added in the mainland economy around 2025. Most of the scope for increased spending of oil revenues is thus behind us. At the same time age-related expenditures will rise steeply in years ahead. For the period up to 2025 expenditure on old-age and

disability pension in the National Insurance Scheme is estimated to increase from 9.7 to 12.4 per cent measured as a share of mainland GDP, equal to about 0.2 percentage point on average per year.

Population projections from Statistics Norway show a persistent increase in the share of the elderly in the population, from just over 20 per 100 persons of working age now to just over 40 per 100 persons in 2060, cf. Figure 3.3A. At the same time Figure 3.3B shows how public welfare programmes are primarily financed by the working age population, while children, young people and the elderly are net recipients of

Table 3.4 Government Pension Fund Global, expected real rate of return and structural, non-oil budget deficit. NOK billion and per cent

	Current prices			Constant 2011 prices			Structural deficit	
	Government Pension Fund Global at the beginning of the year ¹	Expected return (4 pct. on the Fund capital)	Structural, non-oil budget deficit	Expected return (4 pct. on 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	15,5	22,8	22,4	33,1	-	2,0	-
2002	619,3	24,8	38,1	34,4	52,9	18,5	3,1	6,2
2003	604,6	24,2	44,6	32,3	59,6	27,3	3,4	7,4
2004	847,1	33,9	51,1	43,9	66,2	22,3	3,7	6,0
2005	1 011,5	40,5	55,3	50,9	69,6	18,7	3,8	5,5
2006	1 390,1	55,6	53,9	67,7	65,5	-2,1	3,5	3,9
2007	1 782,8	71,3	53,6	83,1	62,5	-20,6	3,3	3,0
2008	2 018,5	80,7	65,9	88,8	72,5	-16,3	3,8	3,3
2009	2 279,6	91,2	107,9	96,7	114,4	17,7	5,9	4,7
2010	2 642,0	105,7	124,8	108,6	128,1	19,6	6,4	4,7
2011	3 018,3	120,7	128,1	120,7	128,1	7,4	6,3	4,2
2012	3 359,5	134,4	-	130,2	-	-	-	-
2013	3 688,7	147,5	-	138,5	-	-	-	-
2014	4 005,5	160,2	-	145,7	-	-	-	-
2015	4 334,3	173,4	-	152,7	-	-	-	-
2016	4 656,5	186,3	-	158,7	-	-	-	-
2017	4 995,3	199,8	-	164,6	-	-	-	-
2018	5 340,7	213,6	-	170,2	-	-	-	-
2019	5 701,9	228,1	-	175,7	-	-	-	-
2020	6 065,7	242,6	-	180,8	-	-	-	-

¹ When projecting the Fund capital, it is technically assumed that the structural deficit remains constant in 2011 kroner until a return to the four per cent path.

Source: Ministry of Finance.

publicly funded benefits. Calculations of generational accounts couple net expenditure statistics for the different groups with detailed population projections from Statistics Norway. The calculations indicate that today's public budgets must be correspondingly bolstered by 9½ per cent of mainland GDP so future generations will not have to face a heavier tax burden.

The generational accounts are based on relatively simple assumptions. As a result, price growth of public purchases is overestimated and calculations do not take the savings contained in the pension reform into account. However, the

conclusion that public budgets must be bolstered so that current welfare programmes can be continued is supported by more extensive model projections of public finances.

The more extensive model projections are based on some important assumptions, including the continuation of current welfare programmes and current labour force participation among different demographic groups. It is also assumed that the spending of oil revenue follows the four per cent path. The calculations show a financial gap gradually increasing to an amount equivalent to about 7 ¼ per cent of value added in the

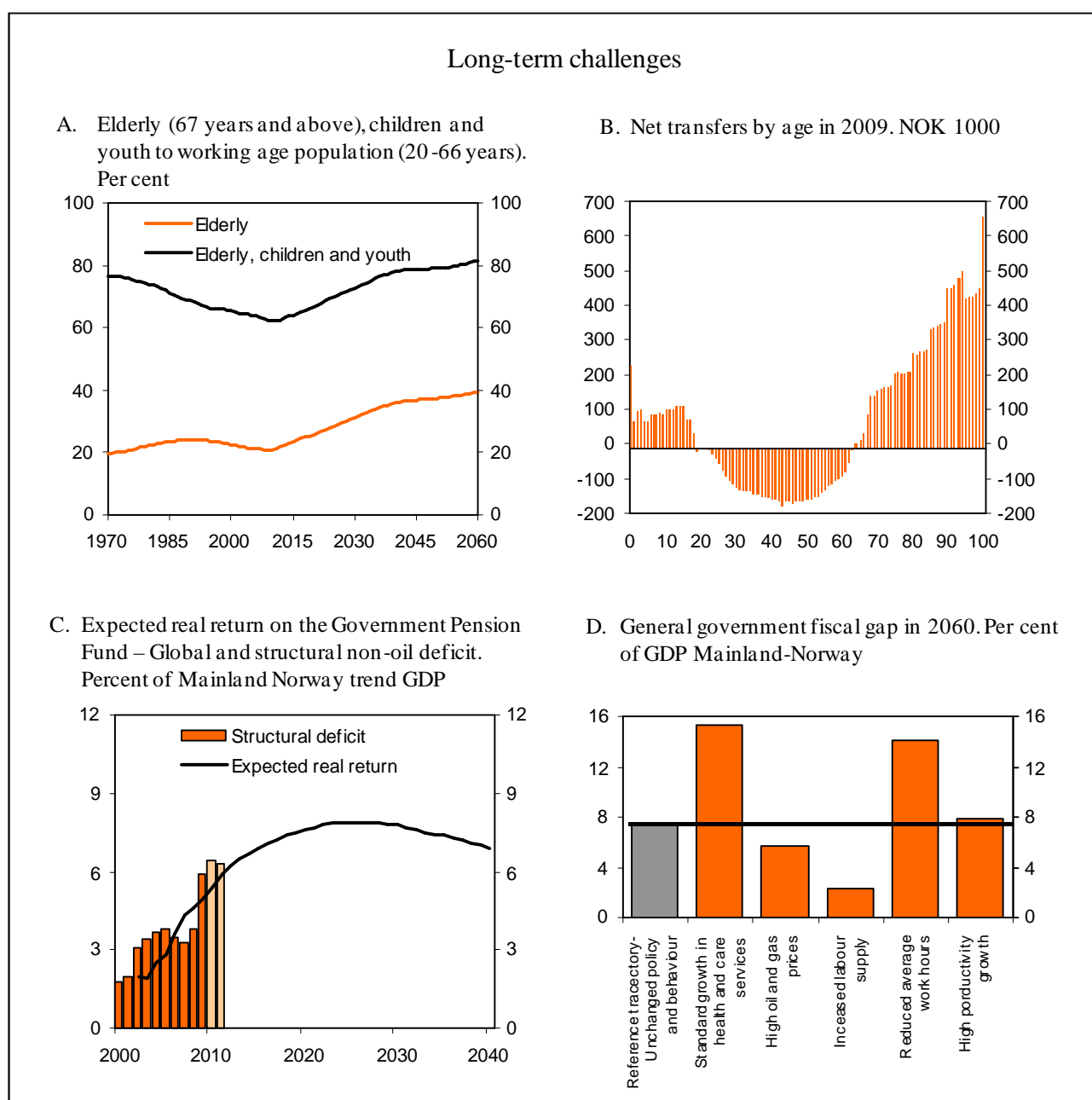


Figure 3.3 Long-term challenges

Sources: Statistics Norway and Ministry of Finance.

mainland economy in 2060. The estimates are uncertain and sensitive to changes in assumptions. The conclusion that there will be increasing pressure on public finances is still sound vis-à-vis a variety of reasonable outcomes in the underlying assumptions

Total labour effort is crucial for ensuring the sustainability of public welfare programmes. According to calculations a 10 per cent increase in the number of hours worked in 2060 compared with the benchmark nearly closes the estimated public sector financial gap in 2060. A high labour force participation rate provides a large tax base and boosts public revenues. At the same time expenditure on relevant benefits can be cut if the number of people outside the labour force is reduced. In this connection the pension reform is very important because it provides incentives for increasing labour supply.

3.6 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 stability in output and employment.

Norges Bank's operational conduct of monetary policy shall be aimed at low and stable inflation, defined as an annual increase in consumer prices that remains close to 2.5 per cent over time. 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 allow for lags between changes in policy and their effects, and it should disregard disturbances of a temporary nature that are not deemed to affect underlying price and cost increases.

To mitigate the effects of the global financial crisis on the Norwegian economy and in light of a considerably weaker economic outlook, Norges Bank cut its key policy rate substantially through the autumn of 2008 and first half of 2009. Together with extensive fiscal measures and actions aimed at stabilizing the financial markets, the expansionary monetary policy helped bring about signs of an upturn in the economy over the summer. In view of the recovery in the economy from summer 2009, Norges Bank raised its key policy rate by 0.25 percentage point at each of the interest rate meetings in October, December and May, to 2.0 per cent.

In the monetary policy report from June this year Norges Bank's interest rate forecast was adjusted slightly downward compared with the forecast in the March report. The interest rate path assumes an unchanged key policy rate until year-end 2010, followed by a gradual increase to 2.7 per cent in the fourth quarter of 2011 and 3.6 per cent in the fourth quarter of 2012. Reasons for the downward adjustment of the interest rate path include a weaker growth outlook for Europe and expectations that international interest rates may remain lower than previously assumed.

Norwegian financial institutions have generally weathered the financial crisis better than similar institutions in many other countries. Targeted measures were implemented to mitigate the effects of the financial crisis and stabilize markets. To a large extent these are now withdrawn. Norwegian institutions had low exposure to the most exposed assets at the start of the financial crisis. Furthermore, the supervisory authority and regulatory set up in Norway facilitate consistent regulation and common standards for different types of financial institutions, based on the principle of "same risk, same regulation".

3.7 Employment policy

Seen from an international perspective, labour force participation in Norway is high, particularly among women and elderly. Moreover, the labour force is well qualified and unemployment is low. At the same time, the number of recipients of health-related benefits has grown substantially over many years. At the end of 2009, one out of five persons in working age received various health-related benefits, including sick pay, disability benefit and early retirement.

The Government is committed to continuing the key features of the Norwegian welfare model. Cooperation and joint effort, as exemplified by income policy cooperation, have been a key factor in the development of the welfare model. Universal income insurance schemes and a broad range of public services that include health care, child care and education are other key factors. This way of organizing society has enabled us to combine income equality with sound economic growth, high labour force participation and macroeconomic stability.

Adequate programmes for ensuring incomes for those outside the ordinary labour market are important. At the same time, policies need to focus on facilitating employment and preventing marginal groups from being pushed out of the labour market into welfare dependency. The sick leave fell by about 10 per cent from the first half of last year to this year. Still, the level is too high and

it is considered particularly worrying that long-term sick leave often results in permanent disability.

The new *Inclusive Workplace Agreement* agreed to this winter by the social partners and the Government includes measures aimed at reducing the sick leave. The goal of 20 per cent reduction in sick leave from the 2001 level is maintained as a key feature of the new agreement. The agreement also emphasizes closer follow-up at each workplace.

To deal with higher unemployment, the level of *labour market programmes* has been substantially boosted since 2008. The level of measures shall be adapted to the economic situation. With an expected upswing in demand for labour, it is important that labour market programmes do not slow the transition to jobs. At the same time, the labour market programmes must be designed to prevent long-term unemployment from becoming entrenched. The Government's proposed budget accommodates a total of about 71,200 programme places in 2011.

Unemployment benefit regulations contain some special rules that may reduce labour supply among older recipients of unemployment benefits. To ensure that the elderly remain an important resource in working life, the Government proposes to discontinue the special rules for elderly unemployment benefit recipients from 1 January 2011, with a transition period of one year for some groups already within the scheme. This will enable more elderly persons to work longer and is well in line with the intentions and the flexibility of the pension reform.

Income policy cooperation is a key part of economic policy in Norway. Regular Contact Committee meetings between the Government and the social partners are an important part of this cooperation. Furthermore, the Norwegian Technical Calculation Committee for Wage Settlements works to ensure a shared understanding of the statistical basis for the wage settlements.

Coordinated wage bargaining, in which the pay scale areas in internationally exposed sectors are negotiated first, will help keep wage developments within limits that ensure a sufficient scale of internationally exposed activities over time.

The wage cost level in manufacturing is clearly higher in Norway than amongst our trading partners. According to estimates in this report, the cost gap with Norway's trading partners will continue to grow both this and next year. This is due to clearly lower wage growth among our trading partners than estimated for Norway, and the strengthening of the krone compared with last

year. The objective of balanced development of the Norwegian economy must continue to guide income policy cooperation going forward. The Government emphasizes that the implementation of the wage settlements is the responsibility of the partners.

4 Sustainable development and climate policy

Sustainable development safeguards 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 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 strategy for its work on sustainable development. The follow-up of the strategy is reported on each year in the annual national budgets. To be able to track progress in a systematic manner, 18 indicators have been developed relating to emissions to air, biodiversity, development assistance and trade with developing countries, and economic and

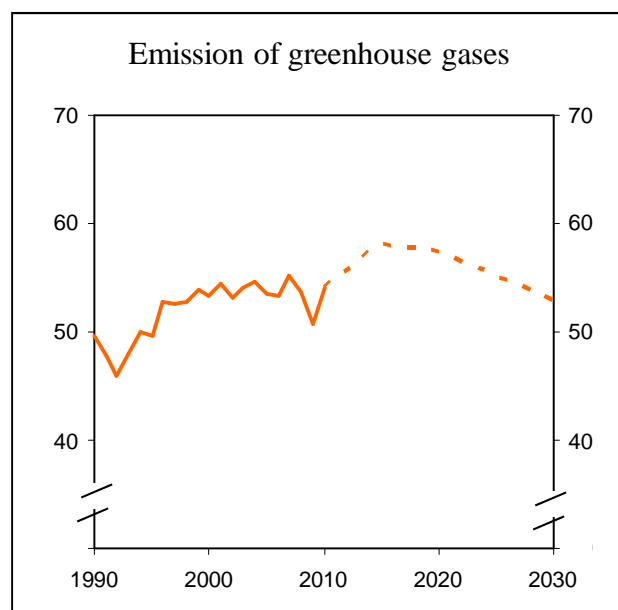


Figure 4.1 Emission of greenhouse gases.

Historical and projected. Mill. CO₂-equivalents

Sources: Statistics Norway, Climate and Pollution Agency and Ministry of Finance.

social development in Norway. The indicators are updated annually by Statistics Norway.

Since 2009 the Government has met its target that official Norwegian development assistance should stay above 1 per cent of gross national income (GNI). In the proposed budget for 2011 the level of assistance is estimated at 1.02 per cent of GNI. In practice Norwegian development assistance is even higher than the official development assistance statistics indicate, since Norway does not include bilateral debt relief in the figures. Imports from developing countries have more than doubled since 2003. China and Brazil are the countries we import the most from, but imports from the least developed countries in Africa are increasing as well.

Norway is set to meet its Gothenburg Protocol commitments with regard to reducing emissions of three of four long-range transboundary air pollutants. To help Norway meet its commitment regarding nitrogen oxides (NO_x), the Government has concluded an agreement with industry organizations to cut emissions. The organizations have also been invited to negotiate a continuation of the agreement.

Norway's Assigned Amount Units (emission quotas) under the Kyoto Protocol are on average 50.1 million tonnes CO₂-equivalents annually in the Kyoto period 2008-2012. In addition, 1.5 million tonnes may be added for sinks (LULUCF), but the Government has decided to add less. It is the Government's objective to exceed Norway's commitments under the Kyoto Protocol by 10 per cent. New emission projections indicate that we will have to purchase 15-20 million emission credits under the Kyoto Protocol Flexible Mechanism during the Kyoto period and that we are close to reaching this target (1 ton of CO₂ = 1 credit). Norwegian greenhouse gas emissions declined by 5.4 per cent in 2009, largely due to the downturn in the wake of the financial crisis. Based on current policy and use of policy instruments, emissions are expected to increase going forward, partly as a result of the expected normalization of economic development, and partly as a result of higher emissions from petroleum activities. After 2020 petroleum activities are expected to contribute to decreasing emissions, cf. Figure 4.1.

The main policy instruments in Norway's climate policy are taxes and tradable emission allowances and credits. The Norwegian permit system is an integrated part of the EU Emissions Trading System (EU ETS). More than 70 per cent of Norwegian greenhouse gas emissions are now covered by economic policy instruments.

After the process of restructuring motor vehicle taxes began on 1 January 2007, CO₂ emissions from first-time registered cars were reduced on average from 177 g/km in 2006 to 141 g/km in the period January-August 2010. The Government's strong commitment to railways also continues.

For the period 2006-2010 the Government has set aside NOK 3.3 billion for renewable energy and energy efficiency measures through Enova. The majority of these funds are returns from the Renewable Energy and Energy Efficiency Fund, which now totals NOK 25 billion.

The Government will continue and bolster its efforts to develop reliable carbon capture and storage technology. Together with building and operating the technology centre, planning and preparing the full-scale plant at Mongstad will be a key element in the Government's effort to develop and realize CO₂ capturing and storage in the years to come.

The Government is following up its commitment to reduce greenhouse gas emissions from deforestation and forest degradation in developing countries, and the appropriations of nearly NOK 2.2 billion for climate and forest initiatives will be continued in 2011.

The Government is actively contributing to bring an ambitious international climate agreement to fruition. The endorsement in the Copenhagen Accord of the goal to limit global warming to two degrees (Celsius) was a welcome step. The Accord also represented a breakthrough with respect to funding for climate measures in poor countries. Prime Minister Jens Stoltenberg and Ethiopian Prime Minister Meles Zenawi are the co-chairs of the UN High-level Advisory Group on Climate Change Financing, which seek to draw up practical proposals for reaching the long-term financial goals in the Copenhagen Accord. The group, which will evaluate various sources of financing from both the private and public sectors, will present its final report by November this year.

5 The Government Pension Fund

5.1 Introduction

The purpose of the Government Pension Fund is to support government saving to finance the pension expenditure of the National Insurance Scheme and long-term considerations in the spending of government petroleum revenues. Sound, long-term management of the Government Pension Fund will help ensure that

Norway's oil wealth can benefit both today's and future generations.

The Government Pension Fund comprises the Government Pension Fund Global (GPFG) and the Government Pension Fund Norway (GPFN). The operational management of the two parts of the Government Pension Fund is conducted by Norges Bank and Folketrygdfondet respectively, within guidelines laid down by the Ministry of Finance. The Government Pension Fund is not a separate legal entity and does not have its own executive board or administrative staff.

Through the investment strategy, the Ministry of Finance seeks to take advantage of the characteristics of the Fund. The Fund's investments have a very long time horizon. The strategy is therefore based on assessments of expected long-term returns and risks. Importance is also attached to broad diversification of investments over different regions, asset classes, sectors and companies.

A good financial return over time depends on sustainable development in economic, environmental and social terms. By virtue of the Fund's long-term investments in a large number of the world's companies, it follows a responsibility and an interest in promoting good corporate governance and safeguarding environmental and social concerns.

5.2 Performance of the Government Pension Fund

Performance of the Government Pension Fund Global

At the end of the first half of 2010 the market value of the GPFG was NOK 2,792 billion, up NOK 152 billion since year-end 2009. At the half-year mark, 60 per cent of the Fund was invested in equities and 40 per cent in fixed income securities. A total of NOK 55 billion in new capital was transferred to the Fund during the first six months of the year.

With the negative performance of the stock market, the return on the Fund in the first half of 2010 is estimated at -1.7 per cent, measured by the currency composition of the benchmark index (currency basket). The return on the equity portfolio was -4.8 per cent in the first half, while the fixed income portfolio achieved a return of 3.2 per cent. Average annual net real return since 1998 is estimated at 2.4 per cent measured in the currency basket.

In the first half of 2010 Norges Bank achieved a return that was 0.35 percentage point higher than the return on the benchmark. Equity

management had a gross excess return of 0.09 percentage point, whereas fixed income management had a gross excess return of 0.84 percentage point. Around half of the excess return from fixed income management came from investments made before 2007, and which became illiquid during the financial crisis. These positions benefited from an improvement in liquidity and the prices of US fixed income securities. Since 1998 the annual gross excess return has averaged 0.27 percentage point.

Performance of the Government Pension Fund Norway

The market value of the GPFN was about NOK 113 billion at the end of the first half of 2010, down just over NOK 4 billion since the start of the year. In all, 59 per cent of the Fund's market value was invested in equities, while 41 per cent was invested in fixed income securities.

The return on the GPFN in the first half of the year was -3.5 per cent. The return on equity portfolios was -11.3 per cent in the Norwegian equity portfolio and 7.7 per cent in the Nordic equity portfolio. The Norwegian fixed-income portfolio had a return of 5.5 per cent, while the Nordic fixed income portfolio had a return of 4.8 per cent.

In the first half of 2010, Folketrygdfondet achieved an excess return of 0.18 per cent against the benchmark index defined by the Ministry of Finance. Norwegian equity management had an excess return of 0.35 percentage point, while Nordic equity management had a negative excess return of 0.56 percentage point. Norwegian and Nordic fixed income management achieved excess returns of 0.11 and 0.33 percentage point, respectively. Folketrygdfondet has an investment profile that means that equity portfolios normally achieve a higher return than the market in periods of sharp price declines, and normally lower returns in periods of sharp price rises. In the last 10 years, the gross excess return on the Fund has been 0.42 percentage point.

5.3 Current issues

Benchmark review

Report No. 10 (2009-2010) to the Storting, Management of the Government Pension Fund in 2009, contained a broad review of the experiences with active management of the GPFG. In the report the Ministry concluded that there should still be a certain limit to how much the difference between return in the actual

portfolio and the benchmark is expected to vary, but it emphasized that continuing a certain degree of active management requires regular and broad reviews. The Ministry stated that it would conduct such regular reviews at the beginning of each Storting period.

The report also pointed out that there is a need to explore many of the proposals the Ministry received in connection with the evaluation process. This includes the issue of whether a greater emphasis should be placed on the Fund's exposure to systematic risk factors and whether the benchmark index for the Fund's fixed income investments should be changed.

The Ministry has therefore initiated a process to evaluate the composition of the benchmark index for the Fund. To start with, the process will focus on the Fund's benchmark index for fixed income investments. Part of this work will be carried out with the assistance of external advisers, and the Ministry will seek to work with other funds. The Ministry will provide more details on the status of this work in the report on the management of the Government Pension Fund in the spring of 2011.

New Strategy Council

In Report No. 10 (2009-2010) to the Storting, the Ministry wrote that going forward it would aim for public external evaluations of the Ministry's investment strategy work on a regular basis. Such independent and critical reviews are expected to provide useful input while contributing to greater transparency and discussion about important issues related to the long-term investment strategy of the Fund.

The Ministry has set up a Strategy Council to write a report on the Fund's long-term investment strategy and to present this no later than 1 December 2010. The composition of the Strategy Council and its mandate is available at the Ministry's home page www.regjeringen.no/spf. While such reports will be produced regularly going forward, both the composition and mandate of the group may vary from time to time. In the mandate for this first report, the Ministry has asked the Council to focus on the overriding challenges related to the work on the Fund's long-term investment strategy. The Council has also been asked to evaluate the relevance of the Fund's investment strategy analyses published in the annual reports to the Storting and give advice on how these analyses can be improved.

Advice from Norges Bank on investments in the GPF

In a letter to the Ministry of Finance dated 6 July 2010 Norges Bank discusses how the Fund's investments should be divided among different investments and regions, questions about the design of the Fund's benchmark index and questions about the outline of the assignment the Ministry of Finance gives Norges Bank for the management of the Fund.

In the work on the Fund's investment strategy Norges Bank believes that a distinction should be drawn between investments that provide protection against unexpected high inflation (real assets including equities) and investments without such protection (nominal bond investments). The Bank believes that to protect the purchasing power of the Fund in the best possible way over time consideration should be given to reducing the Fund's investments in nominal bonds and investing a share of the Fund in real assets other than equities, including unlisted investments in infrastructure and real estate. The Bank also proposed including unlisted investments in the equity portfolio.

The Fund's investment strategy has gradually evolved since 1998, the first year the Fund was invested in equities. Such a gradual process has provided scope for professionally sound studies and healthy debate about the most important policy choices on which the strategy is based. In addition, it has provided a base for the strategy, which has been a strength in periods with substantial market fluctuations. Norges Bank's letter concerning further development of the investment strategy is an overall presentation of topics to which the Bank may eventually return.

The Ministry will return to the proposals in Norges Bank's letter and the report from the Strategy Council in the annual report about the Fund in the spring of 2011.

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. Whether an investment programme could be established for investment opportunities in sustainable growth in emerging markets in an appropriate manner was also to be assessed.

A prerequisite of the new investment programmes is that it must be possible to implement them on the basis of the Fund's role as a financial investor, with the associated return and risk requirements.

Plans for the environmental programme include being able to invest in market segments in the area of infrastructure and unlisted equities and in a selection of listed equities or bonds based on environmental criteria. Investments in unlisted equities and infrastructure were deemed the most appropriate for the investment programme aimed at sustainable growth in emerging markets.

In Report No. 20 (2008-2009) to the Storting, it was assumed that the total amount for these investment programmes may be around NOK 20 billion, invested over a five-year period. In the 2010 National Budget, the Government outlined plans for investments based on environmental criteria amounting to about NOK 4 billion in 2010. It was pointed out that it is natural that such investments are initially made in already permitted instruments and markets, such as listed equities and bonds. At the end of 2009, over NOK 7 billion had already been invested under this programme, i.e. a faster escalation than originally assumed. The Ministry will return with updated figures on the extent of these investments in the annual report on the Fund in the spring of 2011.

Reference was made in the National Budget for 2010 to the Ministry's plan to continue to consider unlisted investments within the environmental programme and whether an investment programme should be established aimed at sustainable growth in emerging markets. It was pointed out that advice from Norges Bank will represent important input to this work.

Norges Bank gave its assessments in a letter dated 6 July 2010. The Bank recommends that no special limits be established for carrying out unlisted environmental investments or unlisted investments aimed at sustainable growth in emerging markets. Instead, the Bank recommends that unlisted investments aimed at the environment and sustainable growth should take place within the framework of a management mandate that permits unlisted investments on a broader basis. The Bank expects that investments that address the intention of the two investment programmes will eventually consist of substantial amounts, but emphasizes that the investments should be carried out with the same requirements as for other investment alternatives concerning returns and risk management.

In view of the letter from Norges Bank, the Ministry will continue efforts to assess new unlisted investments under the environmental programme and whether an investment programme aimed at emerging markets should be established.

The Ministry will return to the status of this work in its annual report on the Fund in the spring of 2011.

Appendix 1

The Norwegian petroleum sector

Oil exploration started in the late 1960s and production of oil in 1971. Since 2000, the production of oil has fallen significantly. At the same time, production of gas has increased and contributed to limiting the decline in total production of petroleum. In 2009 the total production of petroleum amounted to 239 billion standard cubic metres (scm) oil equivalents. Total production is expected to fall in both 2010 and 2011, to 231 billion scm oil equivalents. Whereas gas production is expected to increase by almost 7 per cent from 2009 to 2011, a decline in oil production of about 13 per cent is expected in this period. Norway is ranked as the world's sixth largest oil exporter and the second largest gas exporter.

In 2009, the petroleum sector accounted for 20 per cent of value added, and was the largest private sector industry, in Norway. The State's net cash flow from the petroleum sector, which

amounted to approximately 27 per cent of total revenues in 2009, is estimated at NOK 265 billion in 2010 and 288 billion in 2011.

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 2009, the value of this fund was NOK 2,642 billion or some 111 per cent 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 per cent 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 2009 petroleum investment was 87 per cent higher than in 2002, measured in constant prices, and corresponded to 7¼ per cent of GDP for Mainland Norway. Petroleum investments are expected to decline by 3¾ per cent this year and increase by 6 per cent next year.

Table A.1 Key figures for petroleum activities

	2009	2010	2011	2015	Effect of a NOK 10 change in the 2011 oil price in 2011
<i>Assumptions:</i>					
Crude oil price, NOK per barrel	388	475	485	451	
Crude oil price, 2011 NOK per barrel	404	485	485	416	
Production, million Sm ³ o.e.....					
- Crude oil and NGL	136	129	122	112	
- Natural gas	103	105	110	115	
<i>NOK billion:</i>					
Export value ¹	478	509	507	493	8,2
Accrued taxes and excise duties ²	153	181	166	132	5,4
Taxes and excise duties paid ²	169	156	174	132	2,7
Net income for SDFI	95	96	101	91	2,2
The State's net cash flow ³	280	265	288	230	4,9
<i>Memo items:</i>					
Investment in petroleum activities, billion 2007 kroner	120	116	123	119	

1 Crude oil, natural gas, NGL and pipeline transport.

2 Ordinary tax on income and wealth, special income tax, area and carbon tax.

3 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.

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