



FINANSDEPARTEMENTET

# Fiscal Policy

*23 March 2006*

*State Secretary Geir Axelsen*

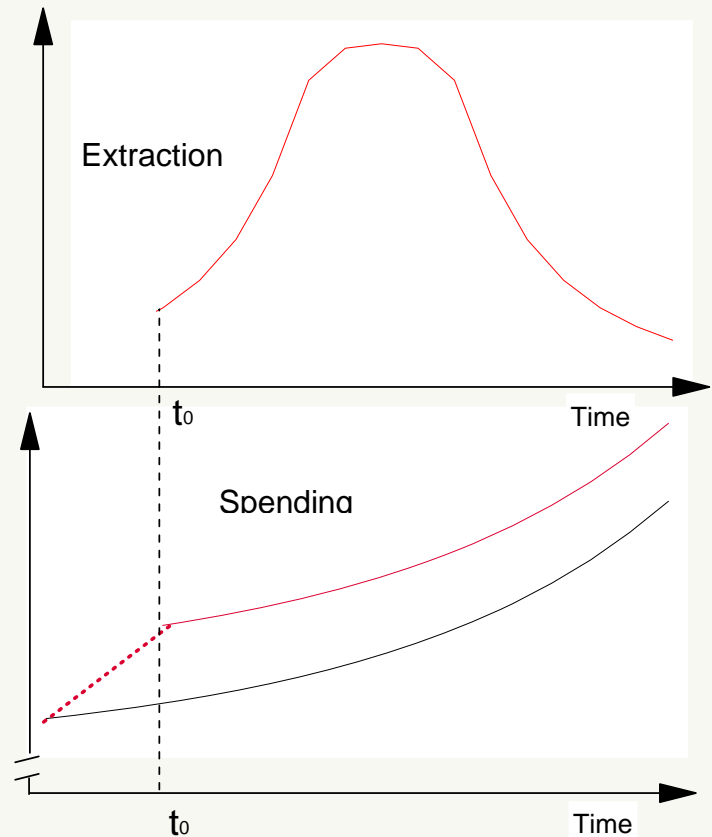
## Outline

- Fiscal policy guidelines
  - Fiscal leeway
  - Economic outlook and the fiscal stance
- Medium and long-term prospects

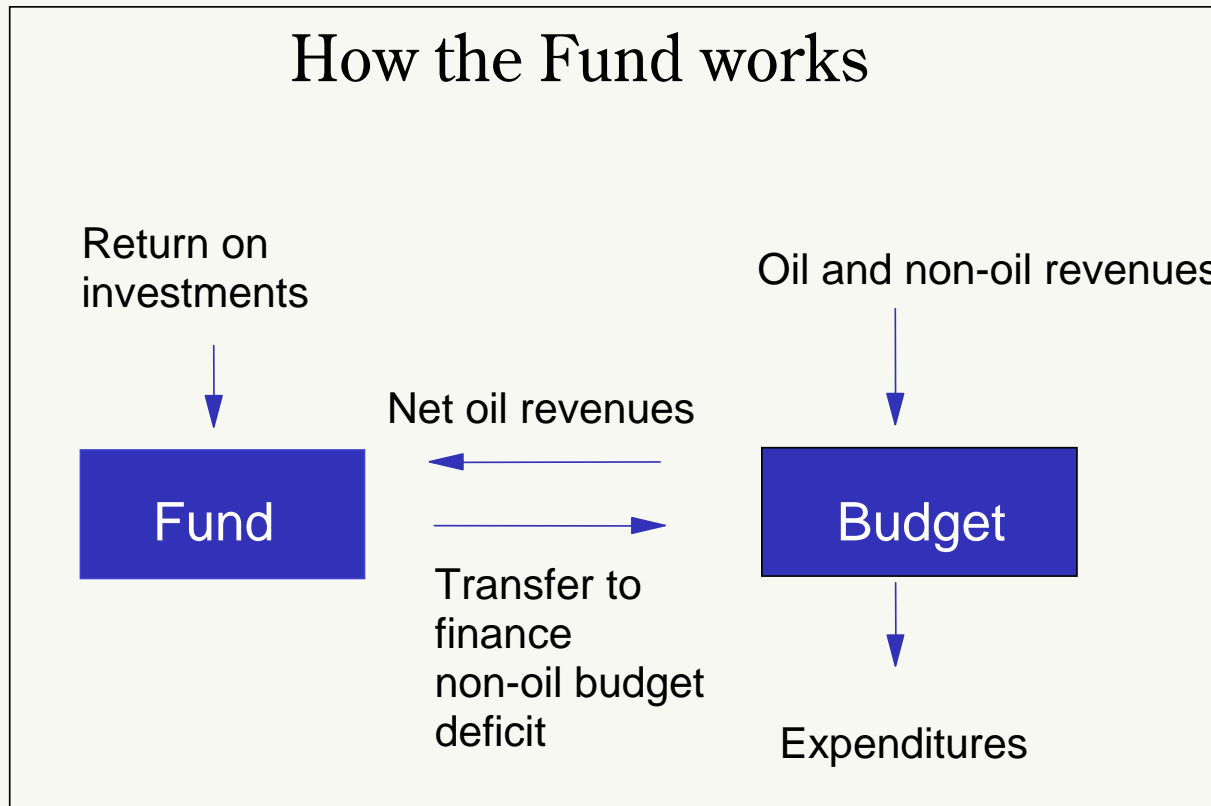
## The petroleum wealth

### - basis for a permanent increase in welfare

- Use of oil wealth must be separated from the current income from oil activities
- *Extraction* shows a typical bell-shaped pattern
- *Spending* should be a more permanent increase
- The Government Pension Fund - Global plays the separating role
- Elevated spending causes high adaption costs and reduces welfare



## The Fund is an integrated part of fiscal policy



# Fiscal and monetary policy guidelines for Norway

## - Overview

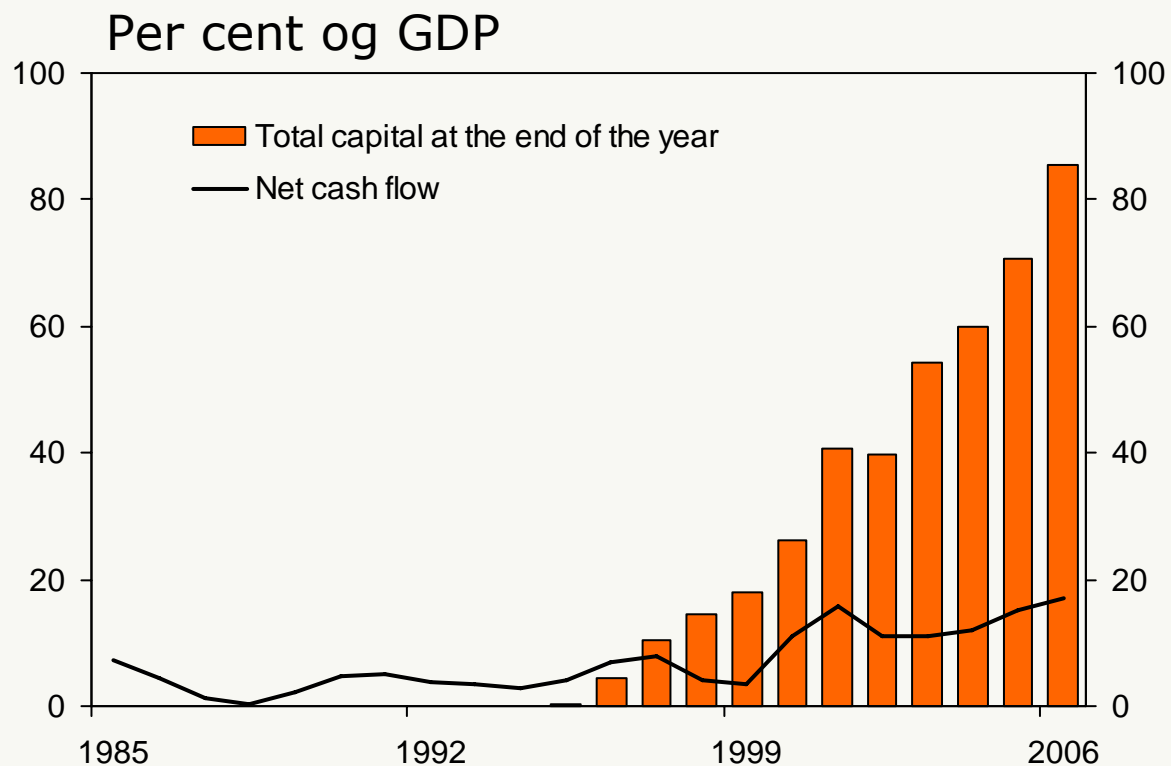
### **Fiscal Policy:**

- Petroleum income should be phased gradually into the economy on par with the development in expected real return on the Government Pension Fund - Global (estimated at 4 per cent)
- Medium term orientation
  - Automatic stabilizers should be allowed to operate
  - Discretionary fiscal policy is not ruled out

### **Monetary Policy:**

- The introduction of a flexible inflation target regime has given monetary policy a clear role in stabilizing the economy
- Norges Bank's operational target is 2.5 pct. inflation over time
- Long run aim is to give the economy a nominal anchor
- In the shorter run, developments in the real economy should be taken into account

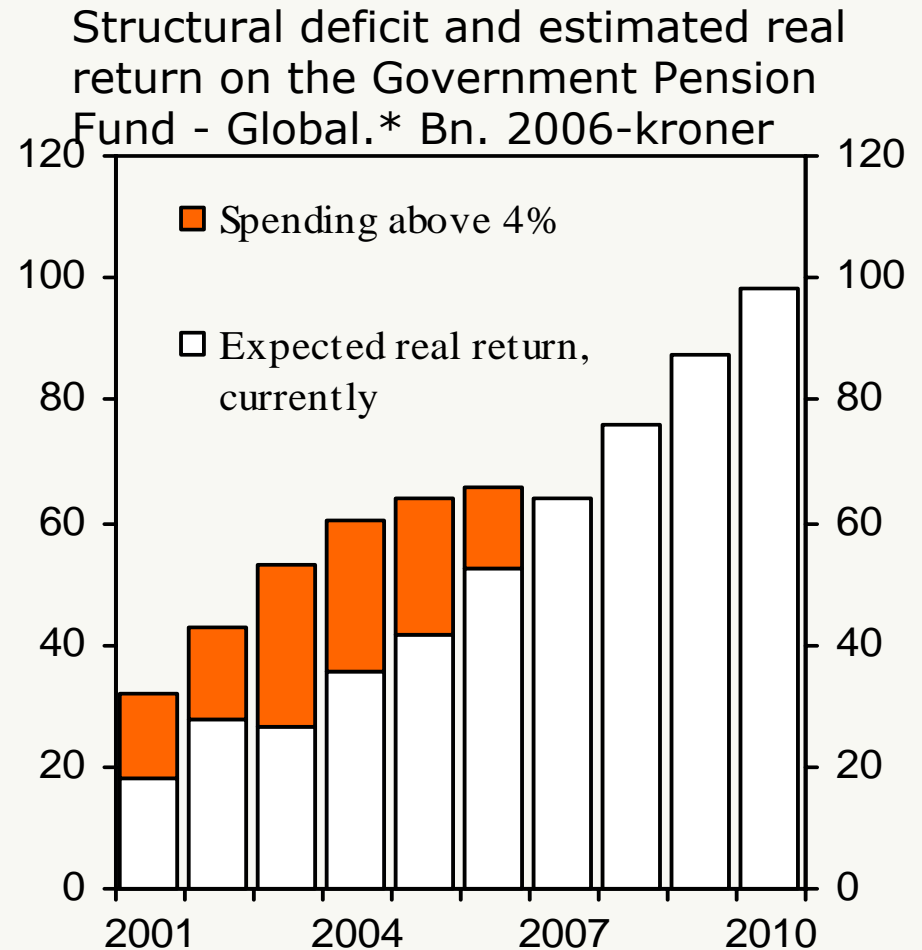
## Significant capital accumulation in the Government Pension Fund – Global



## High oil prices improve the fiscal leeway...

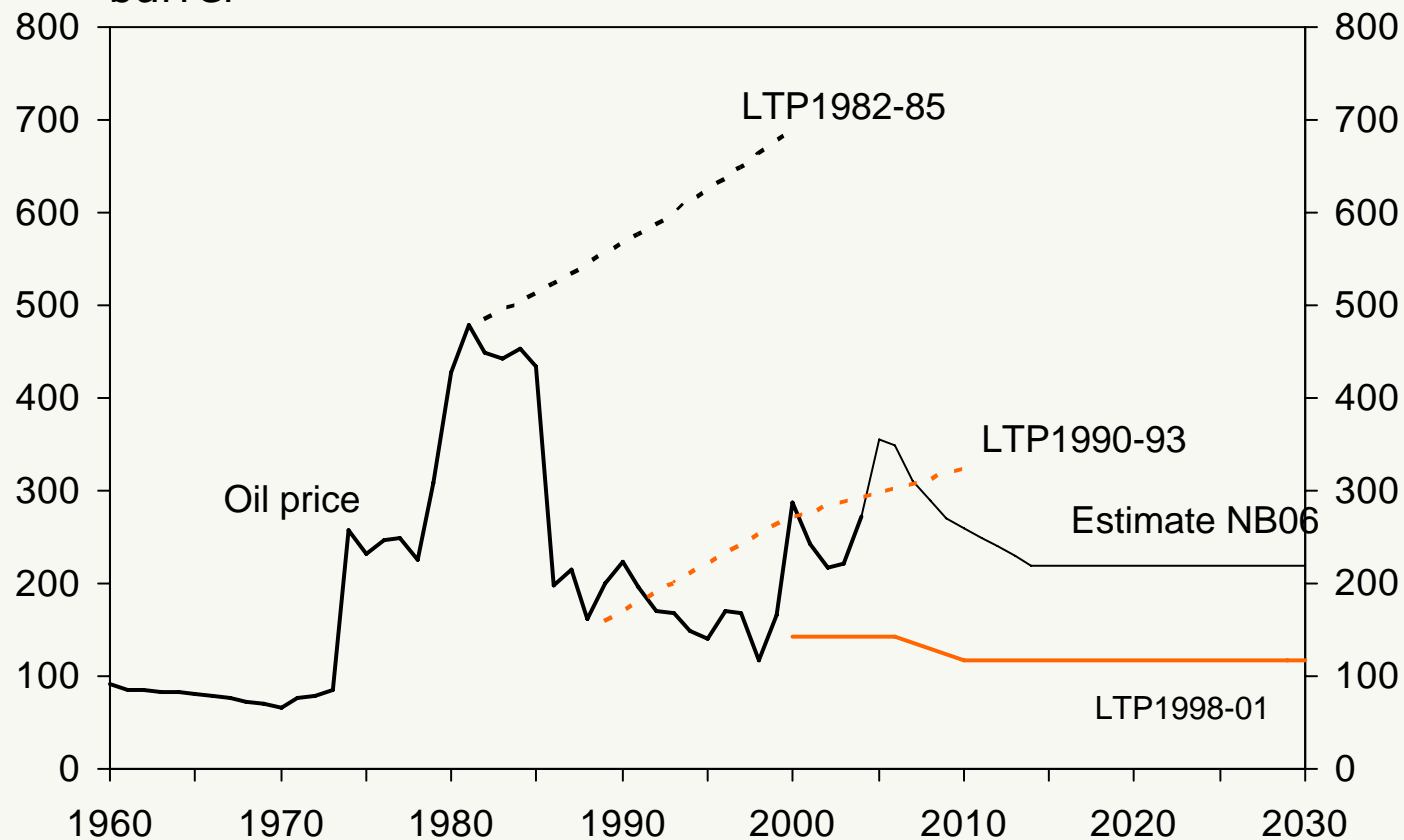
- Structural deficit at 65,9 bn. kroner i 2006
- Estimated real return in 2010:
  - AB06: 98 bn. kr.
  - NB05: 73 bn. kr.

\*As estimated in the Amendment to the 2006 Budget



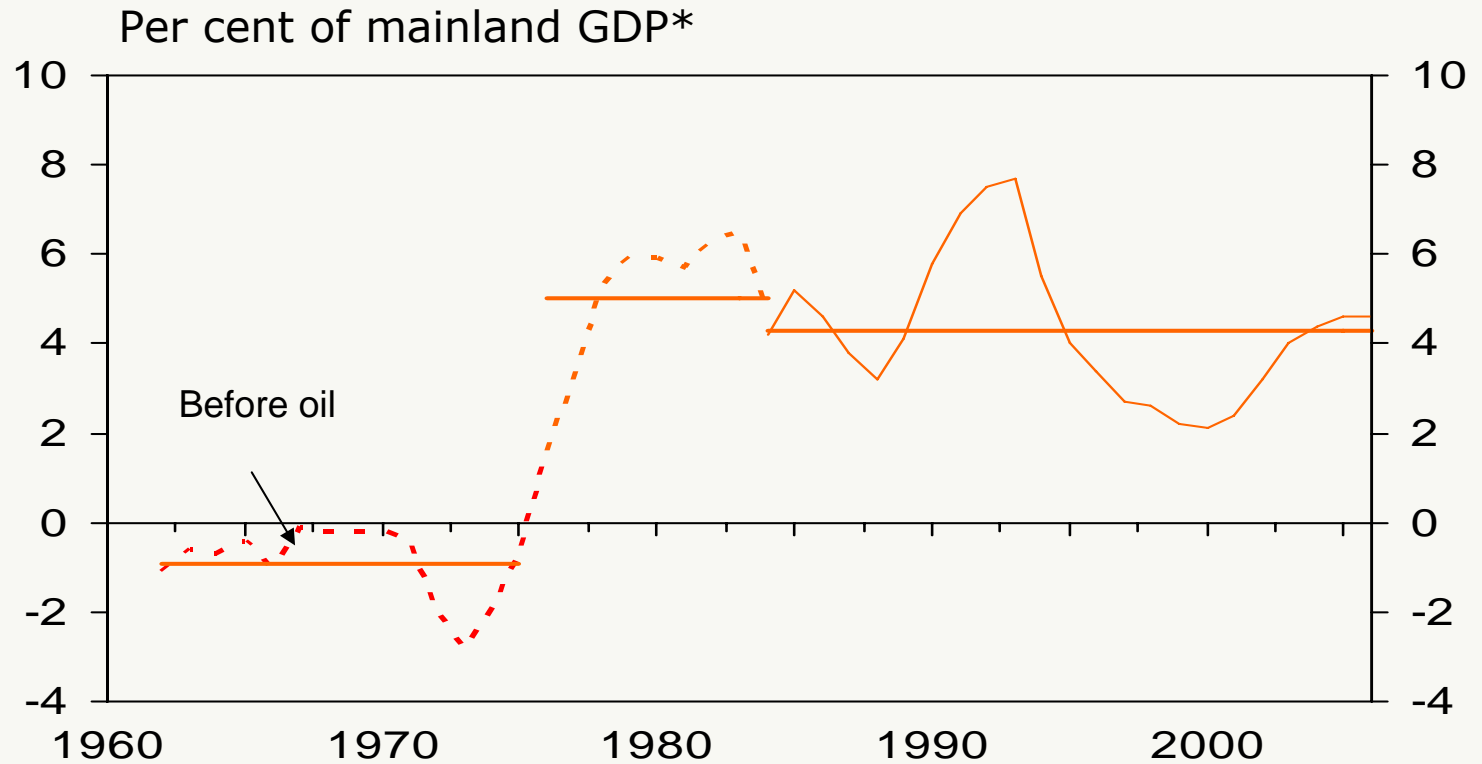
## ...but they are very uncertain

The price of crude oil and the price development estimated at different points in time. 2006-kroner per barrel





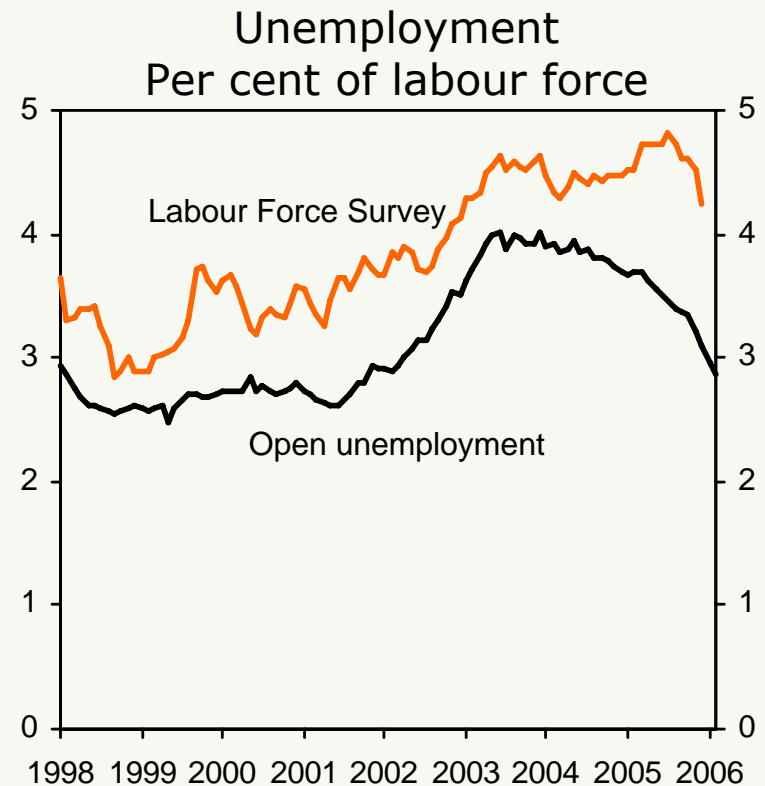
## Consumption of petroleum income



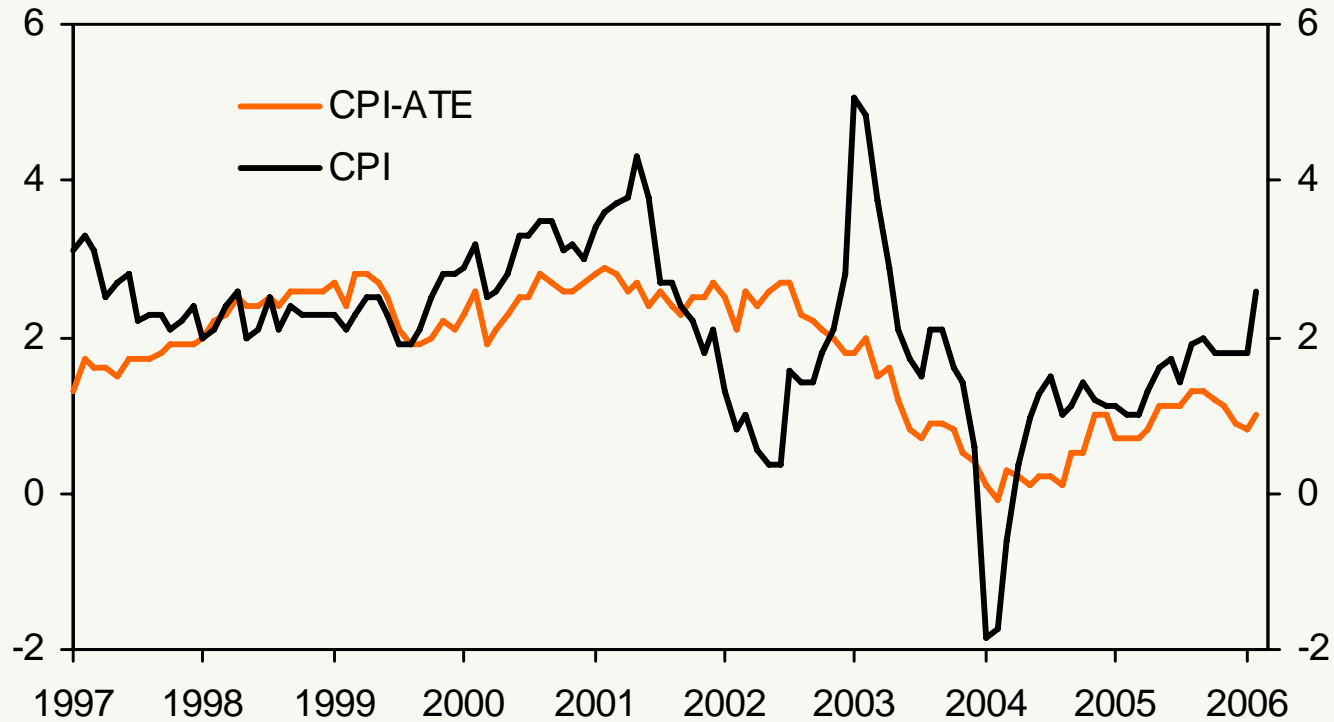
\* Non-oil deficit. Structural deficit from 1984.

## Economic activity is now high...

- The labour market has turned around:
  - Employment is increasing
  - Unemployment is falling
  - Vacancies is increasing rapidly

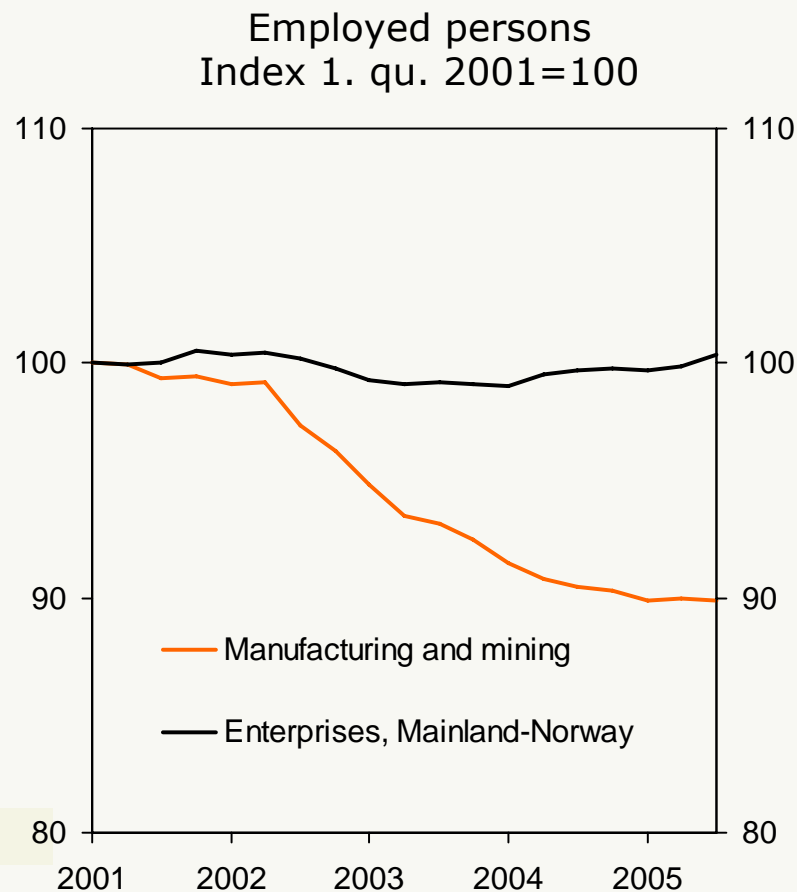


...and CPI growth is gradually picking up



## Industrial activity is vulnerable to shocks...

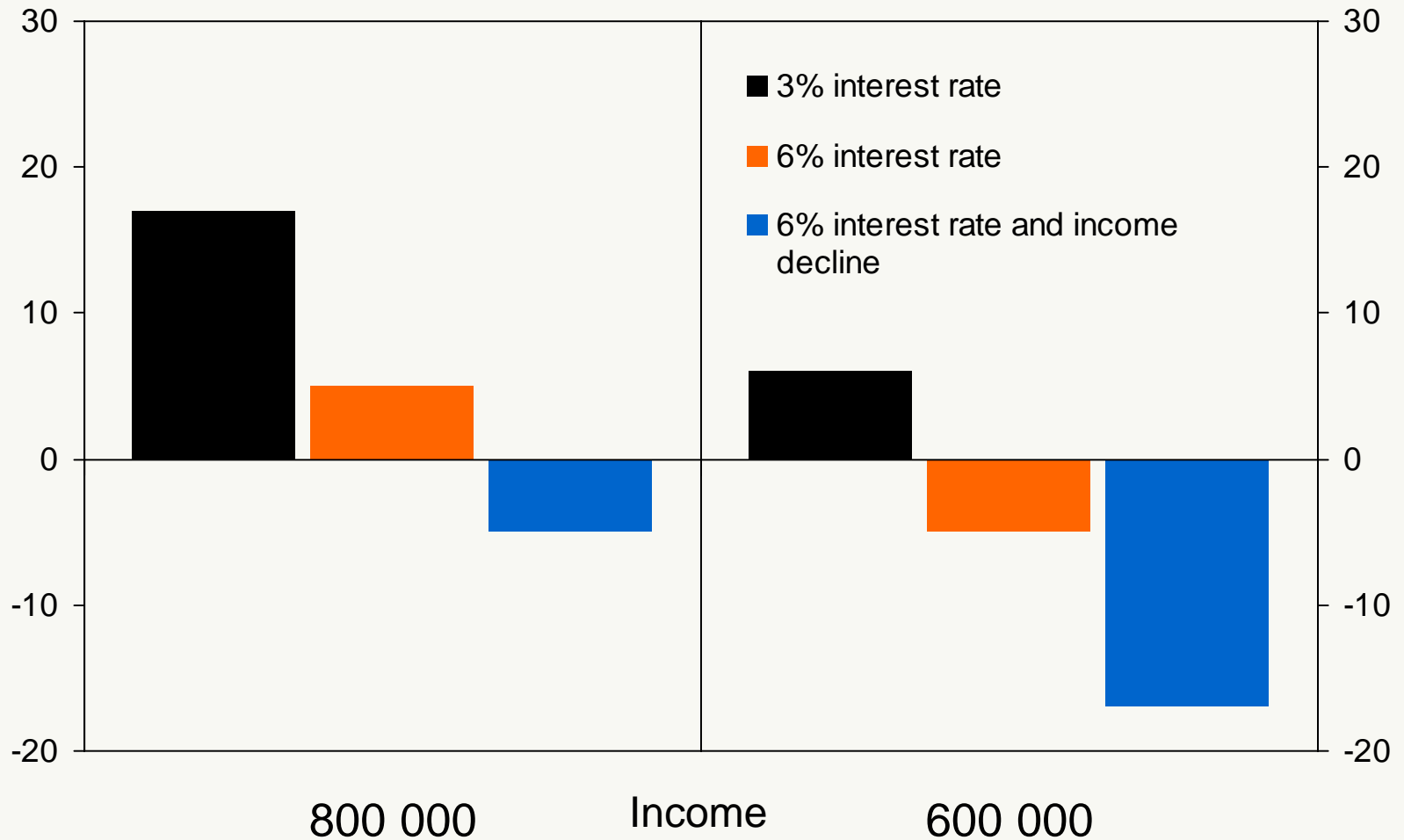
- The combination of high wage growth and stronger currency contributed to a significant fall in industrial employment
- Every tenth job in engineering industry and ship building was shredded



...as many households are

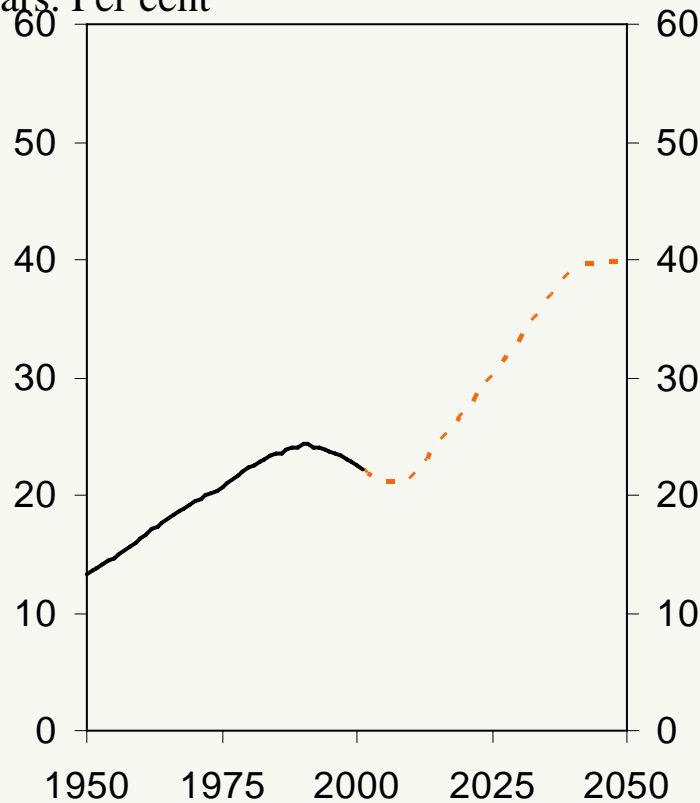
Left after basic outlays, interest rates and installments

Per cent of income

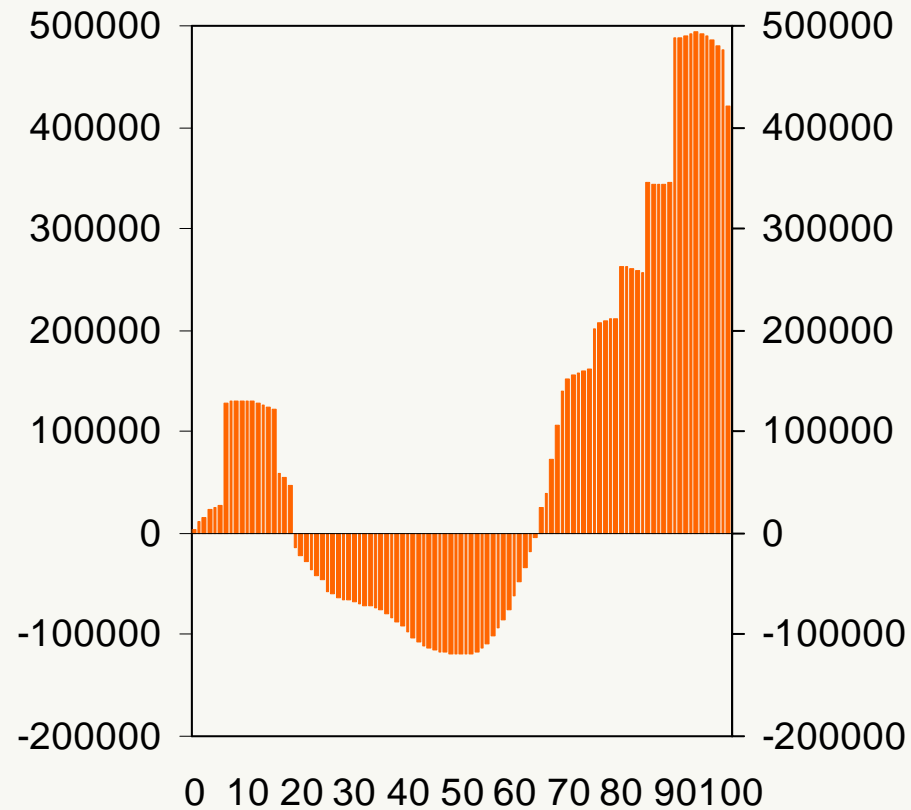


# Public finances face significant long-term challenges

The ratio between number of persons 67 years and older and number of persons at age 20-66 years. Per cent

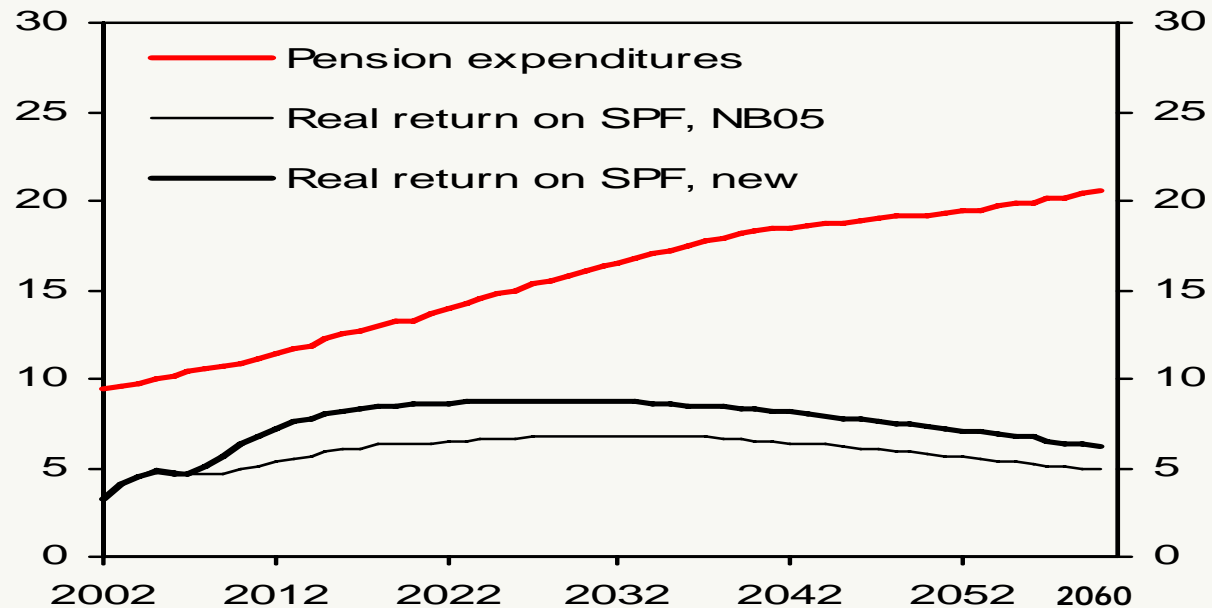


Net transfers by age. 2004. NOK



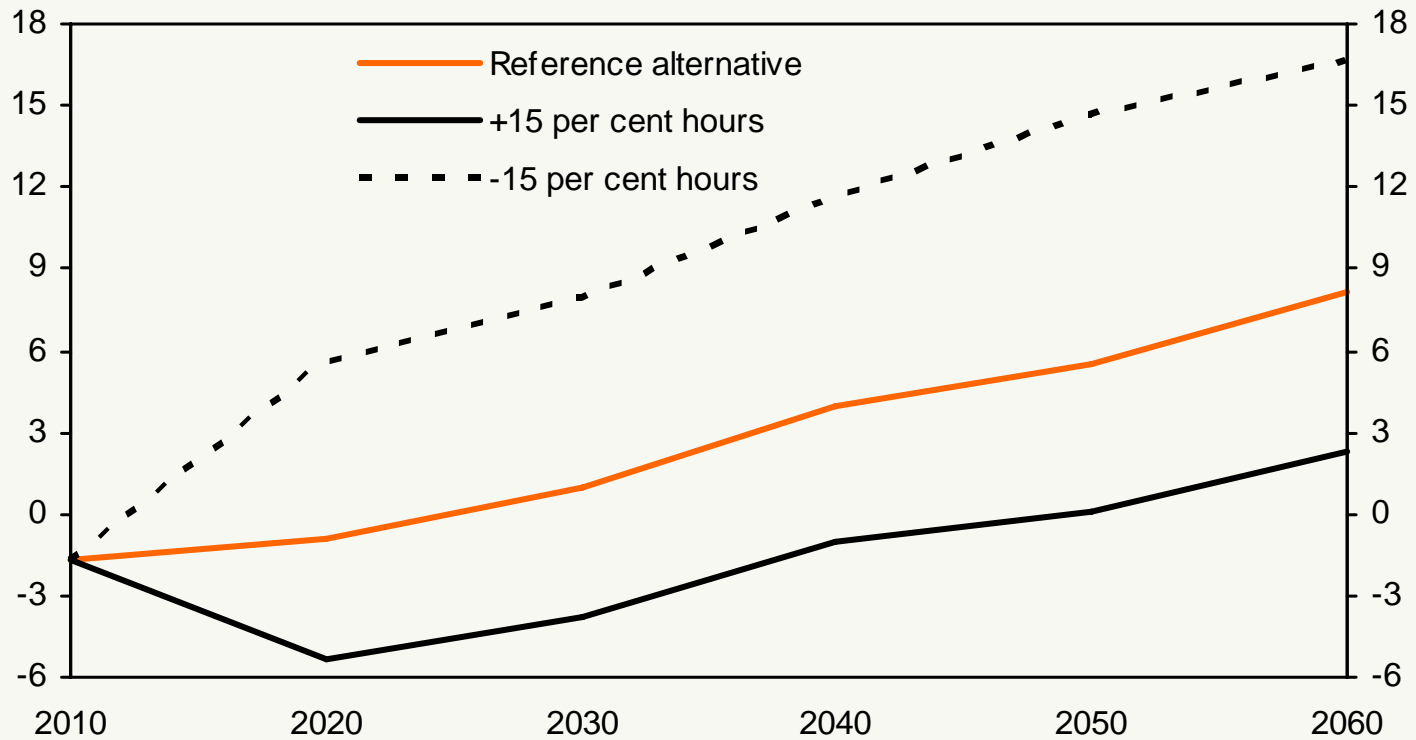
## Income from petroleum will not suffice

Pension expenditure and expected real return on the  
Government Pension Fund - Global. Per cent of mainland GDP



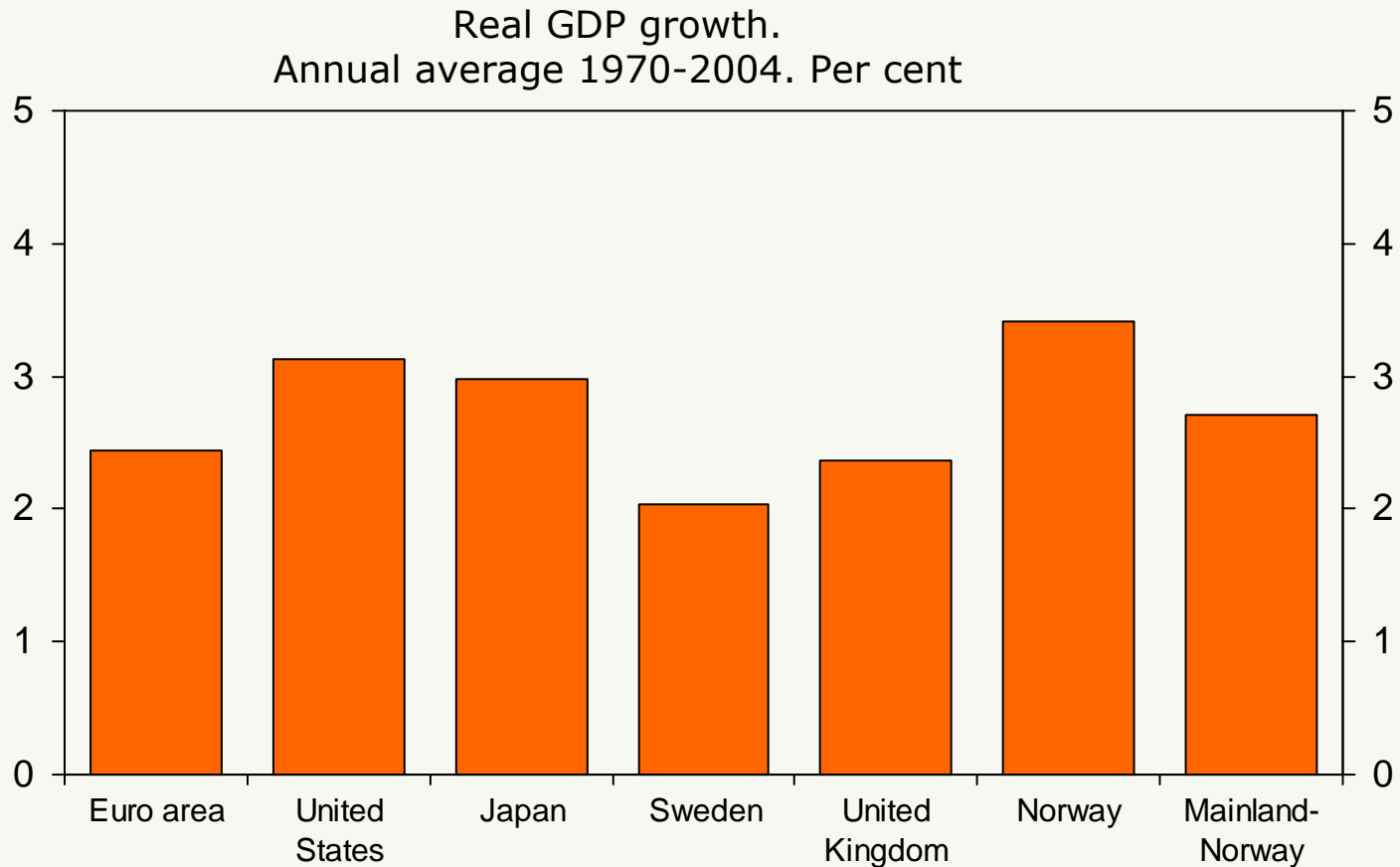
## Employment is decisive

Need for fiscal tightening, as estimated in 2004. Per cent of mainland GDP



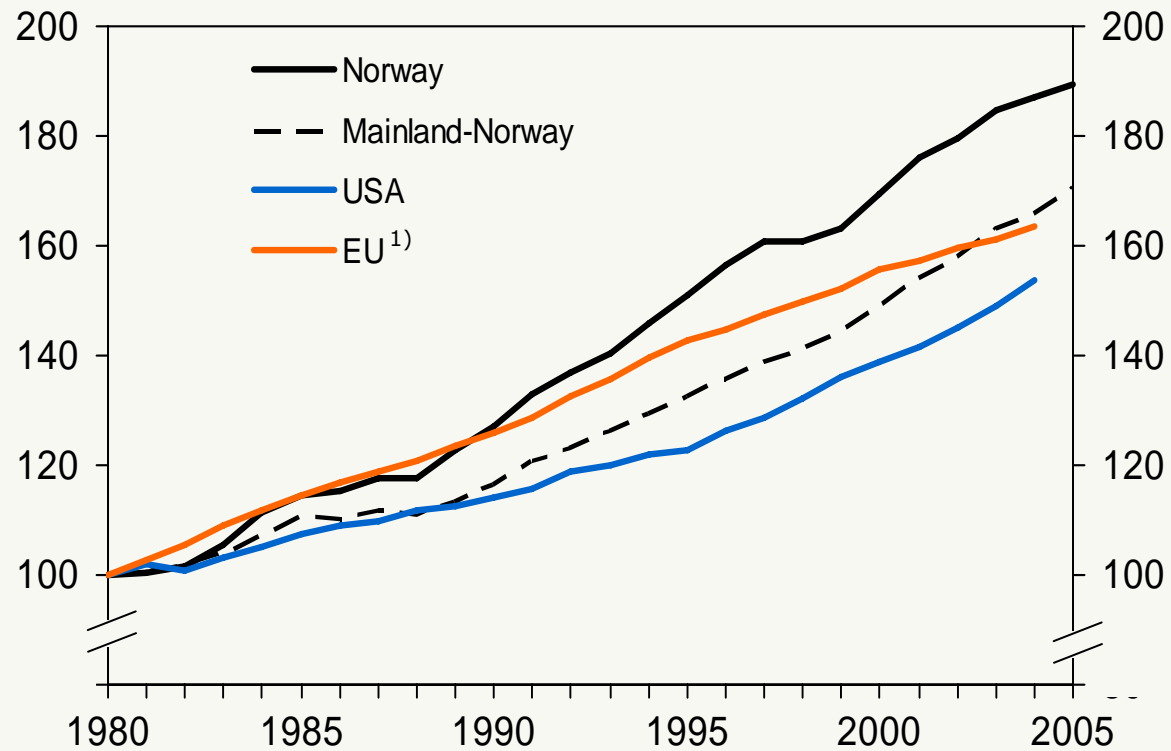


## Norway's economic performance has been solid...



## ...reflecting high productivity growth

Labour productivity (GDP per hour worked), 1980 = 100



1) EU11 (EU15 excl. Austria, Greece, Luxembourg and Portugal).

# Avoiding the pitfalls

## Gradual exploration strategy

## The Petroleum Fund

- Disentangling income generation from spending

## Fiscal discipline

- Medium term spending rule: Limit spending to the real return of the Petroleum Fund

## Structural policy

- Keep focus on this
- Success in the 90'ies - productivity growth in the non-oil economy higher than in the US

## Real exchange rate

- 15 pct. appreciation since 1995
- Nominal wage growth slowed in 2004-2005

Relative unit labour costs. Index, 1995 = 100

