Norwegian Ministry
of Finance

Meld. St. 14 (2020–2021) Report to the Storting (white paper)

Long-term Perspectives on the Norwegian Economy 2021

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Chapter 1

Recommendations of the Ministry of Finance of 12 February 2021, approved by the Council of State on the same day. (Government Solberg)

1 A new reality requires a long-term perspective and the right priorities

1.1 The Government's strategy for sustainable economic development

1.1.1 Poised for sustainability

Norway will face both new and known challenges in coming years. There will be fewer economically active persons behind each retired person in the decades to come. Government expenditure will increase, without a matching increase in revenues. At the same time, the green shift will be implemented. Preserving and safeguarding the sustainability of the welfare society – in social, climate and economic terms – are therefore key priorities to ensure that Norway remains a great place to live.

Norway is well poised to address the challenges and bring about the necessary restructuring. Public finances are extremely robust. Norway has successfully converted a major natural resource – in the form of oil and gas – into one of the world's largest sovereign wealth funds. This represents a considerable responsibility, but also offers opportunities available to few other countries. By international standards, Norway has high employment, low unemployment and a high education level. Opportunities for living a life of one's choosing are more equally distributed than in most other countries, while inequality is low, and less prone to be passed down through the generations. Besides, the Norwegian population enjoys a high degree of liberty and a high level of mutual trust. Public welfare schemes provide security, thereby strengthening our capacity to restructure the economy. The high income level in Norway permits a high standard of living and a high level of welfare.

In order to address the challenges ahead, the Government will pursue a policy to create more private sector jobs, increase employment and improve resource use. Key priorities will be education, integration, inclusion, innovation, and efficiency improvement. All in all, this will lay the foundations for the Government's development of Norway into a more sustainable welfare society.

Preparing society for the future is about holding on to what works well, while at the same time making gradual modifications to change society for the better. To change in order to preserve is a key principle. The alternative to change may otherwise be decay. Development and innovation have delivered progress and made Norway a modern welfare society. Moving forward, the focus must be on ensuring that change is well-founded, financially sustainable and in conformity with the Paris Agreement and the Sustainable Development Goals.

Norway's robust position is the result of prudent choices. Tax reforms, the EEA Agreement, the fiscal rule on petroleum revenue spending, broad access to education, the pension reform and long-term investments are notably recent examples, but the strong development performance has a long pedigree; see Box 1.1. This largely reflects the creation of robust institutions and prudent management of available resources and opportunities.

That people exhibit mutual trust, show compassion, volunteer, and involve themselves in various ways are all of major importance to society, as well as to individual lives and opportunities. Norwegian society is characterised by both high interpersonal trust and a high level of trust in government institutions. The handling of the coronavirus pandemic illustrates the importance of trust, and international experience reminds us that trust should not be taken for granted. Trust is a prerequisite for a well-functioning society and needs to be preserved.

Continued social sustainability requires renewed commitment to a society characterised by low inequality, interpersonal trust, and scope for private initiative. Exclusion deprives people of opportunities for living good lives. Having a job is an antidote to exclusion, inequality, and poverty. Quality schooling and knowledge are key to enable everyone to participate and have more opportunities. Building stronger communities also requires improved integration and inclusion of immigrants, as well as the creation of an open, safe and inclusive society in which people can live free and independent lives with a good standard of living and a high quality of life. The objective is a society that affords opportunities for all.

Box 1.1 The roots of modern welfare society

Norwegian welfare society has deep roots. In the early 19th century, Norway was a medium-income country by European standards, with an outward-looking economy. It was a leading shipping nation, with timber and fish as its key exports. The foundations for Norwegian prosperity were put in place early, through the establishment of key institutions. Power, property and knowledge have been distributed relatively equally across the Norwegian population.

Already in 1024 did Norway see the enactment of the first part of the Gulating Code of Law; the so-called Christian Law, which marked a transition from a society based on the rule of power to a society based on the rule of law. Bondservants were to be bought free and slavery was eventually abolished, people became entitled to rest on Sundays and public holidays, and children could no longer be put out to die. Polygamy was prohibited, and marriage would eventually require the consent of the woman. Another institutional milestone involved property rights. More farmers owned their own farm in Norway than in other countries, and tenant farmers had a fairly high level of independence by European standards. Norwegian farmers thus enjoyed more liberty than farmers in other countries. A third key institutional development was that large groups of the population; both boys and girls, learned to read and write after the Reformation in the 16th century. This was initiated through increasingly strict religious instruction requirements, and subsequently evolved through compulsory confirmation preparations and national schools for commoners; the precursor to elementary schools.

When the industrial revolution got going for real in Norway just after the middle of the 19th century, Scandinavia was ready for development, with a literate population, strong universities, political stability, liberty, equality, property rights and hard work. Basic social institutions like these are of decisive importance to a country's prosperity development.[1]

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[1] Acemoglu, D. & J. A. Robinson (2012). *Why Nations Fail: The Origins of Power, Prosperity and Poverty.* New York: Crown Publishers.

The Norwegian and Nordic model was thereafter developed through the creation of a welfare state, with equal opportunities and a good standard of living for all attained via a comprehensive public education system and health service as key features. The period from World War I onwards, in particular, saw the gradual development of institutions for the sick, the old, the infirm, the children and others in need through collaboration between local government, central government and non-governmental organisations (the so-called welfare triangle). The institutions were often run through collaboration between non-governmental organisations or parishioners and the public sector. Non-governmental organisations were development pioneers. The public sector assumed more responsibility for the funding over time, and public sector responsibilities were also increased through legislative developments.[2]

Development of the welfare state accelerated further after World War II, with the establishment of the national insurance scheme in 1967 as an important milestone. The expansion of kindergartens and social care institutions was stepped up when women became increasingly involved in paid work, especially from the 1970s. This has left Norway with both a large labour force and a higher degree of gender equality. Labour is the largest national wealth component and thus Norway's most important productive resource.

A wealth of natural resources; initially hydropower and subsequently the discovery of oil and gas deposits on the Norwegian continental shelf, has undoubtedly increased the level of prosperity in Norway. However, natural resources offer no guarantee of prosperity. Other countries have indeed seen resource revenues impede economic growth, rather than boosting it. Norway has managed to put the resources to good use as the result of having well-functioning institutions, an effective tax system and a robust fiscal policy framework. In subsequent decades, the EEA Agreement and freer global trade have benefited Norway and added to its economic growth.

[End of box]

1.1.2 The long-term challenges

Norway is now facing demanding challenges such as *changing international conditions*, *climate change*, *demographic change, changes in the labour market* and *changing economic circumstances*.

A change in international relations towards more rivalry and less cooperation between countries is cause for concern in a time when it is more important than ever for the world to stand united in solving joint challenges. Recent decades have demonstrated that international trade and cooperation can lift the standard of living internationally and defuse tensions between countries. More issues require a joint approach in an internationalised and digitalised world, and shared challenges make it clear that we are all in the same boat. We all stand to lose if the belief in a joint effort withers away.

Global society is facing the momentous shared challenge of reducing greenhouse gas emissions. The Government has introduced important measures and ramped up the level of climate policy ambition. In parallel, it is necessary to prepare for the consequences of a changing climate, with increased risk in many regards. The transition to a greener society and the prevention of climate risk

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[2] Seip, A. L. (1994). *Veiene til Velferdsstaten: Norsk Sosialpolitikk 1920-1975* ["Pathways to the Welfare State: Norwegian Social Policy 1920-1975"]. Oslo: Gyldendal.

will entail costs in the short run. This is why it is so important for the measures adopted to be effective. The transition to a greener society will impact on Norwegian oil and gas activities, but this white paper notes that such impact may be less than feared.

People live longer lives. This indicates that Norway has succeeded in creating healthy and safe living conditions. Yet, going forward there will be relatively fewer people of working age to look after the elderly and people who need nursing care. Also, there will be fewer people to generate the revenues to pay the increasing expenditure under the national insurance scheme and on health and care services. We see an increase in the Norwegian immigrant population from countries with less access to education, who therefore have lower labour force participation. A large number of people on various health-related benefits are also outside the labour force. It is of particular concern when young people are permanently excluded from the labour market. This has serious implications for both society and the individuals concerned. Several decades of productive labour force participation may be lost. Sustainable welfare schemes require a certain balance between those who provide and those who receive. Much needs to be done to prevent exclusion and maintain a large and skilled labour force.

Weak productivity growth in the last few decades is a challenge Norway shares with most other Western countries. In addition, the petroleum industry will lose much of its importance as a growth engine for the Norwegian economy in the years to come. The restructuring is already underway. Initial adaptations in the wake of the oil price slump in 2014 were challenging, but the Norwegian economy weathered them well.

The petroleum revenues will decline over time, and the Government Pension Fund Global (GPFG) will shift from growing faster to growing more slowly than the rest of the economy. Uncertainty and volatility in global stock markets affect the value of the Fund, which has funded an ever-increasing share of fiscal budgets. This suggests that caution should be exercised in the spending of petroleum revenues within the limits defined by the fiscal rule. Lower growth in tax revenue and higher pension, health and care expenditure in coming years, imply that there will be less budgetary room for manoeuvre. In a few years' time, growth in government expenditure will outpace revenue growth. The projections in this white paper indicate that there will towards 2060 be a fiscal budget funding shortfall of about NOK 5 billion per year.

These challenges are not potential developments in a distant future, but current realities. The choices we make today will affect the scope for ourselves and our descendants to lead flourishing lives in future. Challenges in coming years will in many respects require further adaptation and a continuation of the Government's necessary reform efforts.

1.1.3 The impact of the pandemic on the Norwegian economy and the road to recovery

In the spring of 2020, the Norwegian economy suffered its most severe setback since World War II. Strict infection control measures curtailed activity in many industries, demand contracted steeply, and the number of people registered as unemployed quadrupled within a short period of time. The crisis hit large parts of the world simultaneously, and the oil price slumped. Norges Bank put the key policy rate at nil, and fiscal policy stimulation without any historical precedent was launched.

After improvement in the spring and summer, the infection situation deteriorated again in the autumn and winter, and the infection control measures were tightened again.

The long-term consequences of the coronavirus pandemic are not yet known. It is nonetheless likely that the pandemic will exacerbate certain well-known long-term challenges and bring these to the top of the agenda.

That unemployment is more easily increased than reduced is known from past crises. The pandemic had a major impact on the labour market. Groups that were already facing difficulties in finding a job were hit especially hard. Periods without a job weaken a person's involvement in working life and increase the risk of permanent exclusion. Norway has thus far been fairly successful at bringing unemployment back down in the wake of economic setbacks, while quite a few other countries have had a less positive experience. Strong economic policy measures are used to bring unemployment back down to a lower level.

Greenhouse gas emissions and local pollution have declined during the crisis, in line with the lower level of activity. When the economy rebounds, emissions are likely to gradually revert towards earlier levels. More remote working and internet-based cross-border contacts may nonetheless reduce long-distance flights and other travel somewhat, also beyond the period of strict infection control measures. This will not in itself create a lasting trend towards zero emissions, but such behavioural changes may form part of the solution to the global climate challenge.

The first phase of the pandemic triggered a steep oil price decline. The price has subsequently rebounded, and the pandemic therefore has little impact on the outlook for the Norwegian oil and gas industry. A reduction in investment activity is in any event anticipated in this decade, and it is estimated that oil and gas production will be more than halved towards 2050.

It is uncertain what effect the pandemic will have on productivity growth in the years to come. On the one hand, infection control measures and infection fears do restrict resource use in the economy, which may inhibit productivity growth. To the extent that the pandemic has impaired the education of today's youth and causes more people to be excluded from the labour market, this may also have negative economic growth and productivity implications. On the other hand, the crisis has accelerated the adoption of efficiency-enhancing digital tools, and may therefore have provided an impetus for better utilisation of the potential offered by new technology.

Fiscal policy has been used actively to counter the economic consequences of the pandemic, and the Government Pension Fund Global has provided Norway with financial freedom of action. The fiscal rule allows for higher spending in a downturn, and this is mirrored by a requirement for lower spending when the economy has rebounded. In the absence of the economic measures taken, it is likely that the costs incurred as a result of the crisis would have been much higher, in the form of lower economic activity, more bankruptcies and more persistently high unemployment. The Government is committed to ensuring that the large increase in net transfers from the Government Pension Fund Global shall not result in any permanent increase in public expenditure but be temporary and targeted to the various phases of the crisis. Larger budget deficits today will add to the longer-term challenges with regard to the sustainability of public finances. Public expenditure was already before the crisis at a high level measured as a proportion of total economic activity. In 2020, the expenditure increased to a level equivalent to 66 percent of mainland GDP. This is a high level compared to other countries. Although the Government believes that the crisis response has been appropriate and well calibrated, the spending will have to be scaled back again once the economy is on the mend. This will enable us to also use fiscal policy actively in future crises. It is especially important to discontinue, as soon as possible, any grant schemes that may hold back activity and restructuring of the economy. New growth shall be based on creativity and innovation, and economic policy shall support restructuring. We thereby ensure that labour and other resources can be transferred to those industries in which these generate the highest return. The road to recovery is focused on getting people back to work, building skills, generating green growth, diversifying the economy, making society more inclusive and preserving security and trust in Norwegian society. This is summarised in Box 1.2.

The Government believes that this policy will both facilitate recovery from the crisis and serve to address the longer-term challenges facing Norway. The Government's response to the coronavirus crisis points in the same direction as the long-term strategies: We need to lift production while making society more inclusive.

Box 1.2 The road to recovery from the coronavirus crisis

The coronavirus pandemic has had a major impact on Norway over the last year. The Government's roadmap for the next phase; *Norway's Coronavirus Crisis Exit Strategy – Producing More and Making Working Life More Inclusive,* was published in the spring of 2020. The Government has taken this strategy further in the budget for 2021 and in other propositions submitted to the Storting. The intention is to boost activity and at the same time address the long-term challenges facing the Norwegian economy. Economic policy shall serve to:

- *Get people back to work*: Help businesses get going again all over the country and get as many people as possible back to work.
- *Diversify the economy*: We need to create more jobs, in more industries, all over the country. This growth must come in the private sector. We invest in road and rail transport and improve operating conditions for business.
- *Create a green future*: Enable businesses to create green jobs and a more sustainable future.
- *Build skills*: We shall ensure that more people complete upper secondary education and acquire the skills needed to thrive in the labour market and the business sector of the future. We shall evolve the Education Initiative 2020.
- *Make society more inclusive*: Everyone shall have the opportunity to participate, in both working life and society in general.
- *Preserve security and trust in Norwegian society and maintain a strong international involvement.*

[End of box]

1.1.4 Long-term strategies for a sustainable society

Continued economic growth is a priority. Most people want and expect future improvements, either in personal welfare or in the services and welfare schemes managed by society. People want public services that evolve in step with new technological and medical possibilities and help that is available when needed. It is the sum of everyone's effort that creates the welfare enjoyed by all.

The Government seeks to create a sustainable welfare society. A basic premise is therefore to hold on to what works well today, while at the same time effecting gradual change. A predictable regulatory framework, well-functioning institutions and prudent management of oil and gas resources have created the existing Norwegian welfare society. Much will be at stake if we tamper with these foundations. A robust and sustainable economy provides the best basis for everyone to live life to the full.

The Government's main strategy in response to existing challenges may be summarised as follows:

1. *Create more jobs*

A strong and diverse business sector with a high restructuring capacity is of decisive importance for Norway's growth capacity and for a high level of welfare in the future. It is necessary to diversify the Norwegian economy to maintain welfare growth. More jobs need to be created, in more industries, all over the country. Private businesses need to grow. Growth requires restructuring capacity, innovation, and creativity on the part of both businesses and individual employees. A highly skilled labour force is of decisive importance for taking onboard international innovations and for creating own innovations. It will be especially important to succeed with the transfer of skills from petroleum activities to other industries. A high-quality education system and a focus on research and development will support innovation and creativity.

Restructuring and technological development are also facilitated by trade and investment. An open economy has been of decisive importance for prosperity development in Norway. International protectionism tendencies highlight the importance of promoting free global trade. An industrial policy to maximise economic growth is focused on well-functioning competition, effective regulation, and more targeted use of policy measures.

An effective tax system and a responsible economic policy are conducive to economic growth. Norway needs to make future-oriented investment, restructure the economy and tailor petroleum revenue spending to business cycle fluctuations, within the limits defined by the fiscal rule. Fiscal rectitude is required, and government expenditure increases need to reflect revenue increases. New initiatives via the fiscal budget must increasingly be accompanied by improved resource use and reordering of priorities. This will enable the continued development of modern high-quality welfare services while maintaining fiscal rectitude.

2. *Economic growth and equal distribution are ensured by getting as many as possible into work*

It is important for both individuals and the country to get as many people as possible into work. Labour is Norway's most important resource. Making good use of labour is of key importance for continued economic growth – and for ensuring budgetary room for manoeuvre. Labour force participation is also the best insurance against poverty. This will enable Norway to remain a society characterised by small differences. This requires the environment in which children and youth grow up to be conducive to their development, as well as high-quality education, anti-exclusion measures and improved integration. A diverse labour market with room for all will further these goals.

The Norwegian labour market is skill-intensive. To enable as many people as possible to join the labour force, it is necessary to invest in children and youth. Key priorities are preventing youth from dropping out of upper secondary education and enabling adults to engage in lifelong learning. Better skills and education are both key elements in integration policy. In order to facilitate longer working life, it is important to ensure that youth complete and progress more swiftly through their education and into the labour force, as well as to evolve and protect the pension reform to enable older people to continue working for longer. Average working hours must also be kept at a sustainable level. It is of decisive importance that Norway succeeds in reducing the number of people on health-related benefits. Sick leave needs to be reduced, and more people must have the opportunity to join the labour force.

The Government is committed to high labour force participation. It shall be profitable to work. Work will improve health for many people, and labour force participation is of major importance for individuals. Benefit schemes shall provide a social security network, while at the same time not deterring labour force participation. The tax system shall also encourage work.

3. *An efficient, effective, and future-oriented public sector*

Most welfare services in Norway fall under the auspices of the public sector. The public sector employs one third of employees in Norway and controls more than 60 percent of mainland GDP. How these resources are used is of decisive importance to the performance of the Norwegian economy. Productivity growth and restructuring of the public sector is an altogether necessary aspect of productivity growth and restructuring of Norwegian society. An efficient and effective public sector is conducive to private sector economic activity, by providing legal safeguards, education, and infrastructure without an excessive tax burden. An efficient, effective, and future-oriented public sector is also important to maintain trust between the population and government bodies.

Public services need to evolve in line with changes in society. Public sector entities need to make use of new technology and work in a smarter way. This requires appropriate organisation, professional management and leadership, cross-sectoral cooperation, and active efforts to reap the gains from innovation and new technology. This means that the public sector must have the courage and ability to transfer resources to where these generate the highest return, including the introduction of smarter work processes and freeing up labour for other sectors where appropriate.

Local government has a key role in the Norwegian welfare state through responsibility for important welfare services such as basic education and care of the elderly. An ever-increasing proportion of children grow up in densely-populated areas. The challenge of more people who need nursing care will therefore be greatest in small municipalities, with fewer people of working age relative to the number of retired persons. An appropriate local government structure, cooperation on key services and the right division of responsibilities between central and local government are important to meet the growing need for care services. A continued merging of municipal needs to be facilitated.

Sustainable welfare schemes require preventive efforts, prioritisation systems and knowledge-based services. Public health improvement measures and an emphasis on enabling people to remain longer in their own home, may increase the quality of life of the elderly and reduce the need for nursing home places. Technological progress may offer new resource-saving and more user-friendly opportunities for solving welfare obligations. Priorities in the enhancement of public services need to be clear and knowledge-based. It must be demonstrated that the services and treatments that are given priority are those that deliver the most health and welfare benefits. User payment may in some instances serve to identify the appropriate priorities and choices between various measures.

The level of public investment is high in Norway compared to most other countries, with special priority given to transport infrastructure. Road and rail investments integrate the country and may increase the growth capacity of the economy. Government investment needs to focus on maximising benefits for the population at the minimum cost. This will enable important public services to be provided as efficiently and effectively as possible. The best projects shall be given the highest priority.

4. *Climate and environmental challenges need to be addressed through proactive policy*

Climate change is one of the principal challenges of our time, which needs to be tackled through both national measures and global cooperation. A proactive climate policy is required to create sustainable development, affording future generations at least the same opportunities as current ones. Norway needs to meet its climate commitments and assume its part of the responsibility for solving global climate challenges.

The long-term growth capacity of the economy depends on the ability of Norway to shift production and consumption in a more sustainable direction. This requires economic decisions to take the climate and the environment into account. The Government has submitted an enhanced climate commitment for 2030 under the Paris Agreement, and the Government aims for Norway to become a low-emissions society with efficient resource use and competitive businesses. New green jobs will emerge in step with such restructuring and may contribute to Norway developing new businesses that can thrive internationally. Norway's efforts to meet the Sustainable Development Goals may also contribute to Norway developing new businesses that can thrive, both nationally and internationally.

The key policy measures in the Government's climate policy are focused on consistent emission pricing in the form of greenhouse gas taxes and participation in the EU ETS.

The policy measures need to be structured to meet the climate and environmental goals at the minimum possible cost to society. The 'polluter pays' principle plays a prominent role. The key climate policy features are outlined in the Meld St 13 (2020-2021) white paper, which includes the Government's climate plan for 2021-2030. The white paper sets out the Government's policy for reducing EU ETS and non-EU ETS emissions, as well as its policy for increasing CO_2 sequestration and reducing emissions from forestry and other land use. A key element of the plan is specific policies for cutting non-EU ETS emissions by 45 percent. The policy outlined by the Government in the climate plan will cut Norwegian non-EU ETS emissions.

The Government's objective – a sustainable welfare society

The Government's objective is that we by joint efforts ensure a safe and secure society premised on economic, social, and environmental sustainability, for both current and future generations.

The white paper on Long-term Perspectives on the Norwegian Economy describes key developments in the world and in Norway that will influence the opportunities available to Norway, and the challenges facing Norway, in coming years. The white paper outlines the Government's strategies for making Norway optimally prepared for the future.

The UN Sustainable Development Goals (the 2030 Agenda) apply to all countries, and all countries are responsible for furthering the goals. The 17 Sustainable Development Goals constitute the world's joint working plan for eradicating poverty, promoting decent work and economic growth, combatting inequality, and stopping climate change by 2030. The goals shall further a better standard of living and improved quality of life for people all over the world. In Norway, follow-up of the goals is integrated in the Government's ordinary policy and budget processes. The Government will submit a white paper setting out a national action plan on the Sustainable Development Goals in the spring of 2021. The goals are consistent with the Government's ambitions.

The remainder of this chapter is a summary of the other chapters of the white paper.

1.2 International developments

A world order based on international trade and support for joint solutions has over many decades brought prosperity, health, and education to a rapidly growing global population. International trade and cooperation have caused the world to be more peaceful and fewer people to live in extreme poverty; see Figure 1.1.

International cooperation and common rules of international trade have served Norway well. This world order is now under pressure. Belief in international cooperation appears to be waning in many countries. The same applies to support for international agreements that have taken a long time to get into place. There is currently renewed superpower rivalry and uncertainty about international commitments. Basic democratic rights, liberal values and human rights have also come under pressure in many places around the world.

The world is facing a number of challenges that require countries to get together around joint solutions. Both the challenges and the solutions adopted globally will have implications for the Norwegian economy.

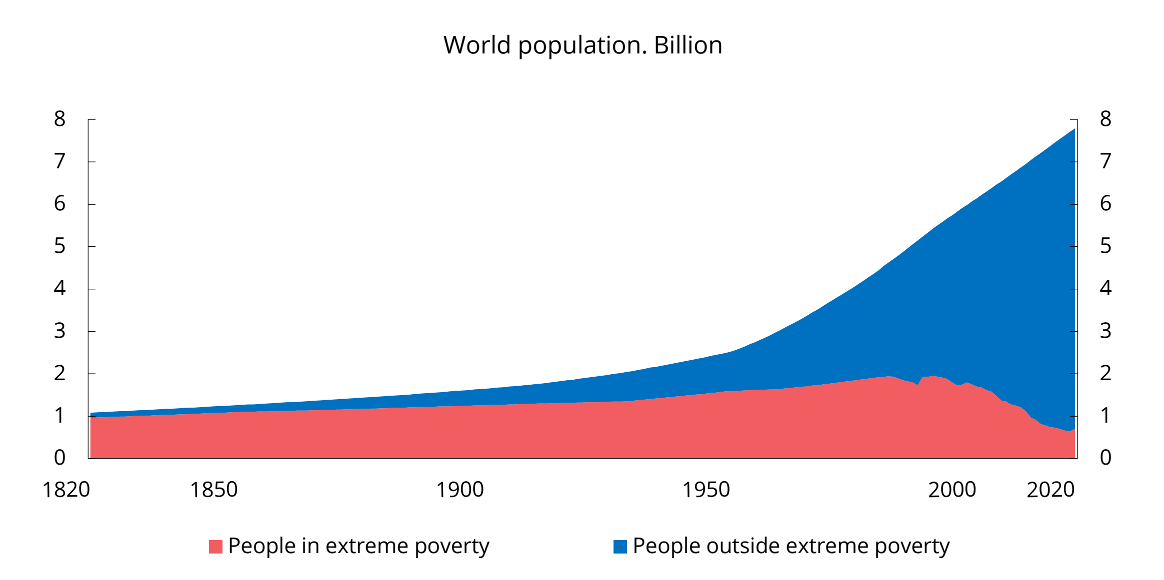

Figure 1.1 World population by economic status, in billion people. 1820-2020

Sources: Our world in data, World Bank, UN, and Ministry of Finance.

The centre of gravity in the world economy is shifting. China, India, and other emerging economies are becoming more important. This also results in Norway getting new trading partners. China's economic and technological positioning affects how the rest of the world relates to the new superpower. In a world characterised by a clash of interests between major powers, undermining of democracy and waning international trust, support for trade and cooperation may lose further momentum. Openness may be confused with vulnerability. Trade barriers that purport to attend to national interests may gain increased support.

The pandemic has served to put the spotlight on vulnerabilities that result from the close integration of the world. It has demonstrated that global value chains may cause increased uncertainty, although this was primarily of concern for a short period after the virus outbreak. The need for emergency preparedness has also been highlighted. Moreover, weaker earnings in strategically important businesses gave rise to concern about foreign takeovers. If the response to such vulnerabilities is taken too far, it may cause markets to become more closed. Several countries are now tightening restrictions on foreign takeovers. For Norway, the pandemic provided an important reminder of how dependent we are on deep links with close trading partners. The vaccine cooperation with the EU offers an illustration of this. In the further development of emergency preparedness for future international crises, Norway as a small country will stand to gain much from a strong affiliation with the EU.

Protectionism and less cooperative relations are bad news for the world economy and for Norway. As a small country with extensive trade and considerable assets invested abroad, Norway is especially dependent on free global trade, open capital markets and a stable international regulatory framework. The United Kingdom's decision to leave the EU is unfortunate for Norway. The United Kingdom has in its EU involvement had many interests in common with Norway.

Despite setbacks, there are nonetheless forces pulling in the direction of ever-increasing integration, both economically and technologically. Internationally, the EU is the cooperation framework that has gone furthest in forging deep cross-border integration. The pandemic appears to have intensified such cooperation, with joint borrowing and transfers to the hardest hit EU member states. The single market illustrates that gains can be reaped on trade and investment. A driver for further integration may be trade in services that have traditionally required proximity between the provider and the customer, and which can now be provided by means of digital communications and thereby be traded between countries to a greater extent.

Technological developments that increase digitalisation are giving rise to far-reaching changes in the economy and in society. These bring market change and create new services and business models, but also open up new security and data protection vulnerabilities. Many of these changes may over time reduce the ability of the nation state to meet challenges on its own. International entities may operate outside the scope of national regulations and policy measures. Multinational companies may for example adapt to tax rules by shifting costs and profits between countries. This reduces the scope for maintaining tax-funded welfare schemes. Moreover, there are indications that increasing market power on the part of large multinational companies mean that profits are concentrated on fewer hands. This represents a competitive disadvantage for companies that do not have corresponding opportunities for circumventing regulations. Cooperation on tax and regulation of economic activity is therefore high on the agenda in international fora and a key priority for Norway.

At present, climate change and loss of natural diversity are among the main challenges facing the world. Prosperity developments over the last 200 years are the result of tremendous productivity growth, but also lead to increased resource use, and part of the increased use is not sustainable. It is of particular concern that increased economic activity has been accompanied by higher greenhouse gas emissions, which threaten the global climate.

It will require major restructuring and global cooperation to shift development onto a more sustainable path. If we succeed in safeguarding the basis of our existence, we will all benefit. If we do not succeed, we will move ever closer to the planetary boundaries of the Earth, with risk of severe repercussions for economic and social conditions as well. At worst, resource base depletion and temperature change may result in densely populated parts of the world becoming uninhabitable. This will add to the already high migration pressure and give rise to conflicts over land and resources internationally.

Differences in economic and social conditions mean that ever more people want to move and settle down in other countries. Acts of war and persecution also drive people to flee. Cooperation with the transit countries is currently curtailing the influx of migrants to Europe. Such cooperation may turn out to be fragile. The underlying reasons why people want to come to Europe and other wealthy regions are no less pressing now than before such cooperation was established.

Sustainable development for the climate and natural resources, stable and peaceful international development and an international trading framework are global public goods of benefit to all countries. Such public goods are, by their very nature, more than any individual country can bring about on its own. Open and well-functioning international markets are especially important prerequisites for growth and prosperity. The climate challenge and the depletion of nature need to be addressed through cooperation and the use of market mechanisms. A closely integrated world economy has over time also turned out to offer the best basis for peaceful coexistence.

1.3 Changing growth prospects

The Norwegian economy has undergone a significant increase in prosperity over the last 75 years. Income growth has been driven by productivity growth and favourable developments in the terms of trade. Higher national income enables a higher level of welfare in society, but the gains need to be redistributed in order to benefit all. By global standards, Norway is a country characterised by small differences. The wage-setting system and high employment have made key contributions to reducing differences.

Extensive restructuring capacity, a high skill level and an open economy largely explain the high growth in the post-war period. For Norway, it has been especially profitable to export raw materials that have simultaneously experienced a price increase, and to import manufactured products whose prices have fallen due to efficiency improvements and the mounting global exchange of goods. In addition, trading with new countries has enabled Norway to shift its imports to low-cost countries and at the same time reap large gains from shifting its production from less profitable to more profitable industries – in particular to the petroleum industry. Spillover effects from petroleum activities have probably served to increase productivity in the rest of the mainland economy.

Productivity growth has been weak in the last 15 years, both in Norway and internationally. The causes have not been unequivocally identified and may be complex. Potential explanations may be unequal distribution of technology between businesses and an extended period of historically low interest rates that have increased the survival prospects of low-productivity businesses. Protracted recession in many countries may have eroded the skill level of the labour force. There is also uncertainty as to whether productivity is measured in a reliable manner. The absence of efficiency-enhancing reforms in many countries has also been highlighted, but reform activity has increased in Norway in the last few years according to the OECD.

The growth capacity of the Norwegian economy will continue to face headwinds. Labour-intensive industries that have traditionally been characterised by low productivity will grow, while less of a growth impetus can be expected from the petroleum industry. The working age population will stop growing, and lower access to labour will reduce growth capacity. Increased international protectionism may also inhibit growth. The handling and consequences of the pandemic will have an impact on development in the short run. On the other hand, growth may increase as the result of higher digitalisation. The changes to production processes brought by automation, followed by an increase in the digital skills of the population, may offer growth potential.

Facilitating a less petroleum-dependent economy in mainland Norway is important for the growth outlook. Restructuring is on the cards both because the resources are being exhausted and because global consumption needs to be refocused on cleaner energy sources. The baseline scenario of the white paper on Long-term Perspectives on the Norwegian Economy assumes petroleum prices that are consistent with realisation of the ambitions under the Paris Agreement. It is expected that Norwegian petroleum production will decline towards 2050, and it is anticipated that the decline will be steeper than what is required on a global basis to limit the temperature increase to 1.5 ˚C. Although the petroleum sector will remain an important industry for Norway for many decades to come, less development activity will significantly reduce the employment and growth impetus. This will have repercussions throughout the economy. The transition to a less petroleum-dependent economy is already underway. The oil price slump in 2014 caused restructuring to commence sooner than had been anticipated, and the Norwegian economy exhibited high restructuring capacity. Facilitation of further restructuring is needed to maintain economic growth. Other profitable industries will have to take on the role of growth engines in the Norwegian economy.

In the long run, welfare development will depend on productivity and employment. Norway has relatively high real capital per employee compared to other countries. This enables a high level of productivity, but also makes it challenging to further increase productivity. How much productivity affects future level of prosperity is illustrated in Figure 1.2.

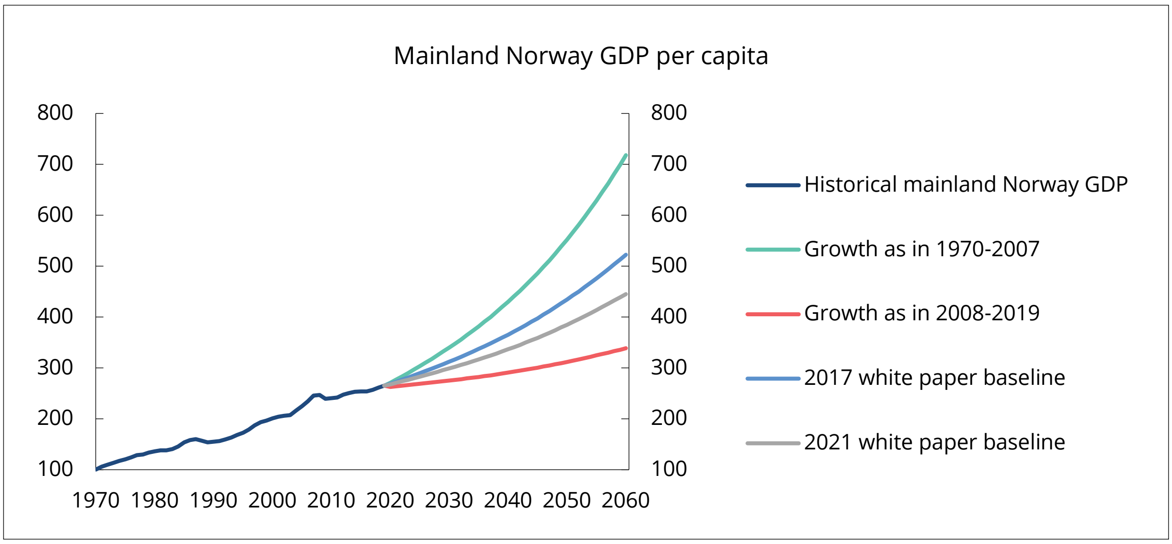

Figure 1.2 Development in mainland Norway GDP per capita at different levels of productivity growth in coming years. Index, 1970=100

Sources: Statistics Norway and the Ministry of Finance.

The transition to a low-emissions society and adaptation to a stronger climate policy may entail adjustment costs in both the short and long run, but a proactive climate policy now is the only way of averting much higher costs later on. By promoting climate-friendly choices on the part of businesses and households, the growth capacity of the economy will be strengthened over time.

Growth-promoting policies are about providing a business-friendly regulatory framework that facilitates innovation and competition. Education and knowledge are key elements. Competition creates incentives to become more efficient, innovate and take onboard technology developed by others. Competition will over time result in resources being transferred from low-productivity businesses to high-productivity businesses and activities. A number of Norwegian businesses have developed technology that is world-leading in its field. Nonetheless, a small open economy like that of Norway cannot be alone at the front in all fields. It is therefore especially important to accumulate sufficient abilities and skills in making use of innovations developed in other countries. It will be of decisive importance for future growth capacity to succeed in reaping gains from new technology and getting the most from labour and real capital.

1.4 High labour participation ensures economic growth and welfare

A large and skilled labour force brings economic growth and makes it easier to fund welfare schemes. Investing in people is therefore profitable for society. Increasing labour force participation is the Government's principal strategy for meeting long-term challenges. High employment is a prerequisite for meeting the Sustainable Development Goals of reduced income inequality and for promoting permanent, inclusive and sustainable economic growth.

High employment and low unemployment are promoted by stable and sound economic development with sufficiently high demand for labour. Economic policy shall serve to smoothen fluctuations, thereby preventing temporary setbacks in the economy from having negative long-term effects. The pandemic has caused a major short-term labour market setback. The Government's strategy for recovering from the crisis is focused on preventing unemployment from becoming entrenched at a high level. This will also serve to prevent people from dropping permanently out of the labour force. The pandemic has had an asymmetric impact on the labour market, with youth and people with little or no formal education most likely to be furloughed or made redundant. If they do not get quickly back to work, the pandemic will exacerbate the existing problem of inadequate labour force inclusion. A policy for swift economic recovery and an active labour market policy are therefore especially important.

Fundamental demographic changes make it challenging to keep up the employment rate. Declining birth rates over the last century and higher life expectancy have changed the age distribution of the population. The population has been gradually aging, and the proportion who are people of working age is falling. People remain in education for longer, and the period spent in retirement has increased significantly since the national insurance scheme was introduced. On the other hand, the pension reform and a higher education level have resulted in older people now continuing to work for longer than they did a couple of decades ago, although this has not been sufficient to make up for the shift in population composition and the higher life expectancy.

Employment in Norway is relatively high by international standards. Before the pandemic, the employment rate was increasing, but developments have in the last decade been weaker than in neighbouring countries. This includes weak employment rate performance for core labour market groups compared to other European countries – the employment rate for men during their most economically active years (25-54) was below the OECD average in 2019. Norwegian women's employment rate remains very high by international standards, but the increase in employment among women has levelled off. Youth have reduced their labour force participation over time, but this is mirrored by them getting more education. Working hours are less than in many other countries, because of a somewhat shorter standard working day, more generous leave of absence provisions, longer holidays, higher sick leave and a larger proportion of part-time employees. Among OECD countries, Norway has the largest proportion of the population on health-related benefits and underperforms other countries when it comes to including people with functional impairments in the labour force. Functional impairments do not necessarily mean a reduced fitness for work. There should thus be a potential for increasing the labour input of several groups.

A policy for mobilising more labour may entail expanded use of part-time employment. It is nonetheless important to oppose involuntary part-time employment and foster a full-time employment culture where part-time employment is extensively used at present. This will serve to make the most of the labour force potential. Keeping up total working hours is of major significance for economic growth and the sustainability of public finances. Projections in this white paper show that a reduction in working hours in line with a six-hour working day would result in mainland GDP being reduced by 20 percent towards 2060, compared to the baseline scenario, while the fiscal gap will increase to a full 14 percent of GDP; two and a half times as much as in the baseline scenario.

Education is of high importance for individual opportunities in the labour market. For the economy, more education and a higher skill level mean that the labour force is more productive, thereby enabling higher growth in the economy. The education level of the Norwegian population is high, and the population over the age of 25 years have strong reading, numeracy, and ICT skills.

The Norwegian labour market is skill-intensive, with few jobs that only require compulsory education. There is a low proportion of routine jobs and high ICT intensity in both manufacturing industry and service industries; see Figure 1.3. Continued digitalisation and automation are expected for the future. New technology paves the way for growth and higher productivity. Technology may in some instances replace tasks that are performed by human labour, but also gives rise to new products and services, as well as new tasks. All in all, it would not appear that automation and digitalisation will create much unemployment in Norway. It is for example expected that the need for personnel in the health and care sector will increase significantly in coming years.

The skills needed in the labour market are likely to change over time, and it is anticipated that labour market demand will increasingly favour people with vocational skills or higher education, while people with compulsory education as their highest completed education will be less in demand. It is therefore cause for concern that completion rates in vocational upper secondary education programmes are at the bottom of the OECD league table.

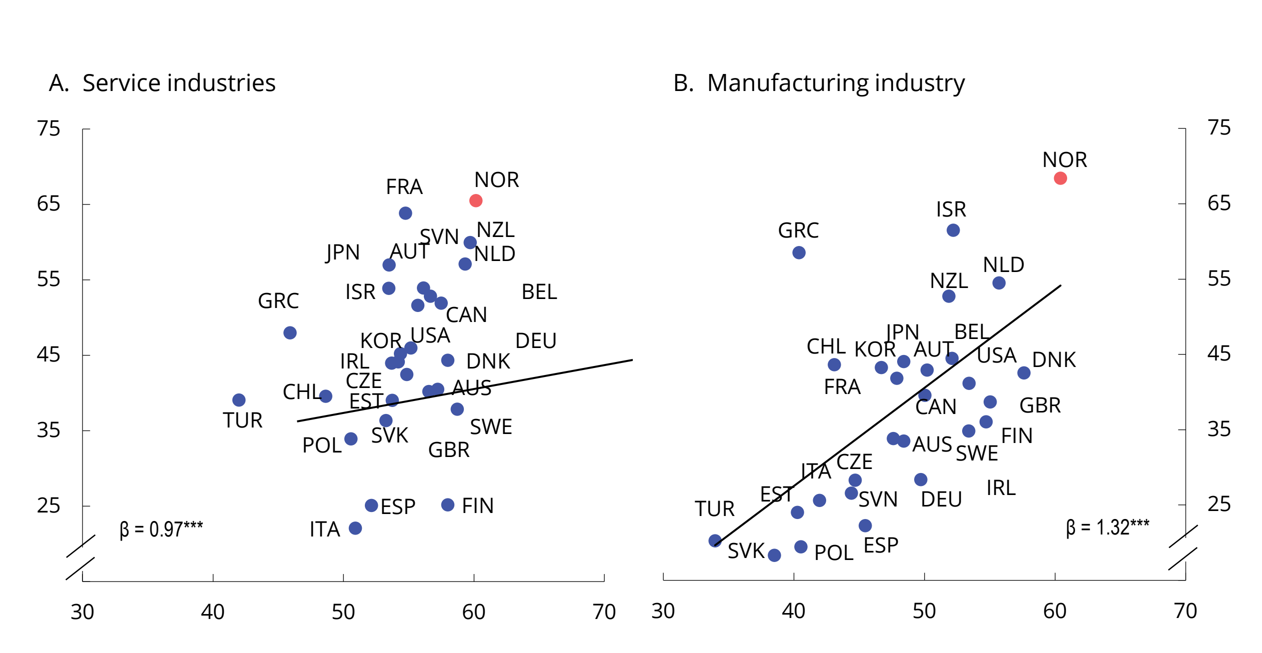

Figure 1.3 Proportion of non-routine jobs and ICT intensity in work duties, 2012 or 2015

Note: The figure shows correlations between non-routine jobs (y-axis) and jobs with a large ICT component (x-axis). β denotes the slope of the curve.

Source: OECD Economic Survey of Norway, 2019.

The Norwegian labour market has a high restructuring capacity. 10 percent of jobs are replaced each year, and extensive industrial restructuring has been carried out with high employment and low unemployment. If many people fail to get educated and readied for the labour market of the future, the situation may become more challenging than before for groups that were already struggling to gain entry to the labour market, such a people with health challenges, people with gaps in their CVs and immigrants.

1.5 Opportunities and standards of living

The Sustainable Development Goals call for the eradication of all forms of poverty and hunger, and for inequality in and between countries to be reduced. Global integration and technological development have contributed to lifting millions out of poverty and have reduced income differences between countries. At the same time intra-country inequality has increased in several countries; see Figure 1.4.

In many industrialised countries, increased income inequality is linked to globalisation and technological development. These international *megatrends* have for example increased the scope for substituting capital for labour in production, as well as for shifting labour-intensive production to countries with high access to labour. Such mechanisms mean that the gains from global integration and digitalisation will not necessarily be equitably distributed.

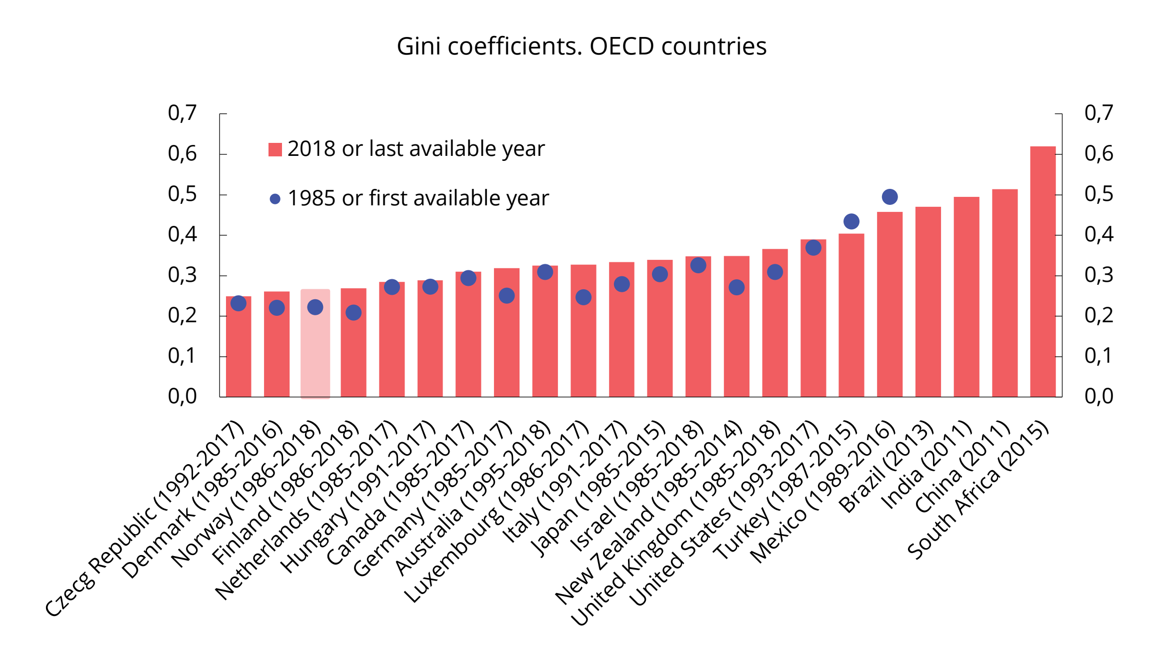

Figure 1.4 Gini coefficients for income after tax.[1] 1985 or first available year and 2018 or last available year. OECD scale

[1]The income definition may vary between countries and between years.

Source: OECD.

Small differences and equal opportunities are key elements of the Norwegian social model. Equal opportunities imply that own efforts, interests, and talents should have greater implications for the standard of living and social influence of a person than their social background. The degree of social mobility between generations provides an indication of how the children' social and economic background affects their living standard as adults. Standard of living data show a significant expansion of opportunities in Norway over the last 40 years, in terms of education, income, life expectancy, as well as gender equality.

Income mobility in Norway is high compared to many countries, in the sense that there is a weaker link between the income level of parents and the income level of their children as adults than in most other countries. High income mobility may to some extent be attributed to a public system of free or heavily subsidised education and an active family policy, which includes high kindergarten availability. Standard of living is nonetheless to some extent passed down through the generations in Norway as well. Children who grow up in households with persistently low income or in households without any adult who participates in the labour force have an elevated probability of themselves earning low incomes and facing other living standard challenges as adults. Such causalities highlight the importance of early efforts in kindergartens and schools, as well as other measures such as public health centres, parent support and income support, which can contribute to a better start in life.

Norwegian households have experienced considerable income growth over the last 25 years. The median real income of Norwegian households has increased by close to 70 percent since 1995. Income growth has increased the purchasing power and improved the standard of living for all groups. The vast majority of people in Norway have benefited from the increase in incomes, which is not necessarily the case in other countries. Incomes have increased slightly more for those at the top of the income distribution scale than for those at the bottom. This has caused measured income inequality to be slightly higher at present than in the mid-1980s and 1990s; see Figure 1.4. Norway is nonetheless among the countries with the lowest measured income inequality. This is caused by several national institutions that contribute to reducing inequality. Comprehensive education opportunities and a focus on the environment in which children and youth grow up provide basic skills for all, and thereby a more equal distribution of employment opportunities. The Norwegian system of coordinated wage setting serves to keep wage differences relatively low, while the tax and income redistribution system reduces income differences. Comprehensive benefit and income support schemes aim to guarantee financial security for the entire population and serve to reduce differences in income and standard of living over the course of the life of individuals and between different population groups. In addition, the extensive range of public services reduces some of the negative impact of having an income below that of the population average.[3]

High income inequality, as observed in some other countries, may make it challenging to ensure sufficient equality in opportunities. Firstly, high income dispersion means that a larger income increase is required in order for a person to move up the income distribution scale. Secondly, high income inequality may reduce human capital investment, especially in countries where kindergartens and education are expensive for individuals. Increased inequality may also reduce trust in both other people and governing institutions, and thereby reduce support for trust-based redistributive institutions such as the Norwegian welfare model. Moreover, large income differences may give some individuals power and influence that run counter to democratic ideals and undermine the confidence of individual groups that their interests will be heard and looked after by the public sector. This may make society more polarised.

There is a high level of support in Norway for having a society characterised by small differences. Reducing differences and creating equal opportunities is a continuous process. In the white paper on opportunities for all, the Government presented a strategy for countering inequality and exclusion that was based on comprehensive factual information. The Government's efforts to counter exclusion and mounting differences are focused on children and youth, education, employment, and improved integration. A sound distribution policy must at the same time protect the fundamental prerequisites for economic growth and stability. Enterprise, work, and willingness to take risk when starting new businesses and creating new jobs shall be profitable. The same shall apply to investments in, and enhancement of, human capital. These are key drivers for economic restructuring, new investment, new ideas and new development, and thereby economic growth. Norway shall remain a country characterised by small differences and opportunities for all.

1.6 Green future

Greenhouse gas emissions have caused most of the increase of about 1 °C in global mean temperature of pre-industrial times. If the current global emissions trend continues, the temperature

[3] For a more detailed description, see the Meld. St. 13 (2018-2019) white paper; *Opportunities for all. Distribution and social sustainability*.

increase may approach 4 ˚C by 2100. This may bring large-scale glacier melting, global sea level increase, more draught in arid areas and a higher incidence of extreme weather events.

The climate challenge is global. Greenhouse gas emissions have the same effect irrespective of where these happen. The industrialised countries accounted for the majority of emissions until and including the first few decades after World War II. At present, close to 70 percent of emissions are taking place in developing countries and emerging economies. The climate challenge can therefore only be resolved through broad international cooperation to which all countries contribute. In 2015, the countries of the world concluded the Paris Agreement. The ambition under the agreement is to limit the global temperature increase to well below 2 ˚C, and to pursue efforts to limit the temperature increase to 1.5 ˚C. This will require steep reductions in global emissions, as well as rapid and extensive restructuring in all countries and all sectors.

The climate challenge requires a broad set of policy tools. The most effective approach is to put a price tag on greenhouse gas emissions to make the polluter pay for negative effects. When the polluter pays, production and consumption will be reoriented in a more climate-friendly direction. In addition, it is necessary to have various forms of direct regulation and support for the development of climate-friendly technology.

Estimates of what global carbon price is compatible with the objectives of the Paris Agreement differ substantially; see the discussion in Chapter 6. It is in this white paper assumed that the global emission price on greenhouse gases will have to be increased to NOK 740 per tonne of CO_2 equivalents in 2025 and gradually onwards to NOK 1,300 in 2040 in order for the world to be able to meet the objective. The world has a long way to go in pricing emissions, but the last 15 years have seen a steep increase in the proportion of global emissions subject to pricing. There are currently more than 60 national or regional carbon pricing initiatives, across 46 countries. Including planned efforts, about 22 percent of the world's emissions carry a price tag, and the average price is about NOK 18 per tonne of CO_2.

National contributions under the Paris Agreement are far from enough to bring global emissions down to a path that is consistent with the objectives of the Paris Agreement. In 2019 and 2020, several countries announced that they would revise or enhance their targets. Norway has submitted an enhanced commitment to reduce greenhouse gas emissions by at least 50 percent and up to 55 percent in 2030, compared with the level in 1990. Norway has already concluded an agreement with the EU on cooperation to reduce emissions by 40 percent in 2030, and the Government would also like to meet the enhanced commitment in cooperation with the EU.

Norway has a comprehensive set of policy tools for reducing greenhouse gas emissions. More than 80 percent of emissions are subject to cross-sectoral economic measures such as greenhouse gas taxes and tradable emission allowances. Climate policy has been significantly tightened under this Government. The level of climate taxes has been increased, and the Government has in the Meld St 13 (2020-2021) white paper presented a plan that includes, inter alia, a gradual increase in the CO_2 tax on non-EU ETS emissions to NOK 2,000 at 2020 prices in 2030. Moreover, several exemptions and low rates have been abolished, thus implying that a larger portion of emissions are now facing the same price. This has made climate policy more cost effective. The policy is working. It is estimated in Norway's latest report to the UN that greenhouse gas emissions would, in the absence of the policy measures and initiatives introduced since 1990, have been more than 40 percent higher than their actual level in 2020. In addition, Norway is contributing to significant emission reductions in other countries through for example its International Climate and Forest Initiative and support for renewable energy in developing countries.

About half of Norwegian emissions, primarily from manufacturing industry and petroleum activities, fall within the scope of the EU ETS. The EU ETS caps total emissions from the emissions sources to which it applies. This will over time force major emission reductions at the pan-European level. For EU ETS emissions, it is of no significance to compliance with Norway's climate agreement with the EU whether the emission reductions are actually taking place in businesses located in Norway or in the EU.

Thus far, the largest EU ETS emission reductions have taken place in power generation. Norway does not have emissions from power generation in mainland Norway; see Figure 1.5. Norway has therefore not registered a corresponding reduction in EU ETS emissions. The largest source of EU ETS sector emissions in Norway is petroleum production. These emissions are in addition to the EU ETS also subject to a national CO_2 tax. This means a high total emission price, thereby giving companies strong incentives to reduce their emissions. The industry has itself presented comprehensive plans for electrification of power supply on the Norwegian continental shelf. The authorities have helped facilitate implementation of such plans through support for the Hyvind project. Besides, a steep reduction of about 65 percent in Norway's petroleum production is expected towards 2050.

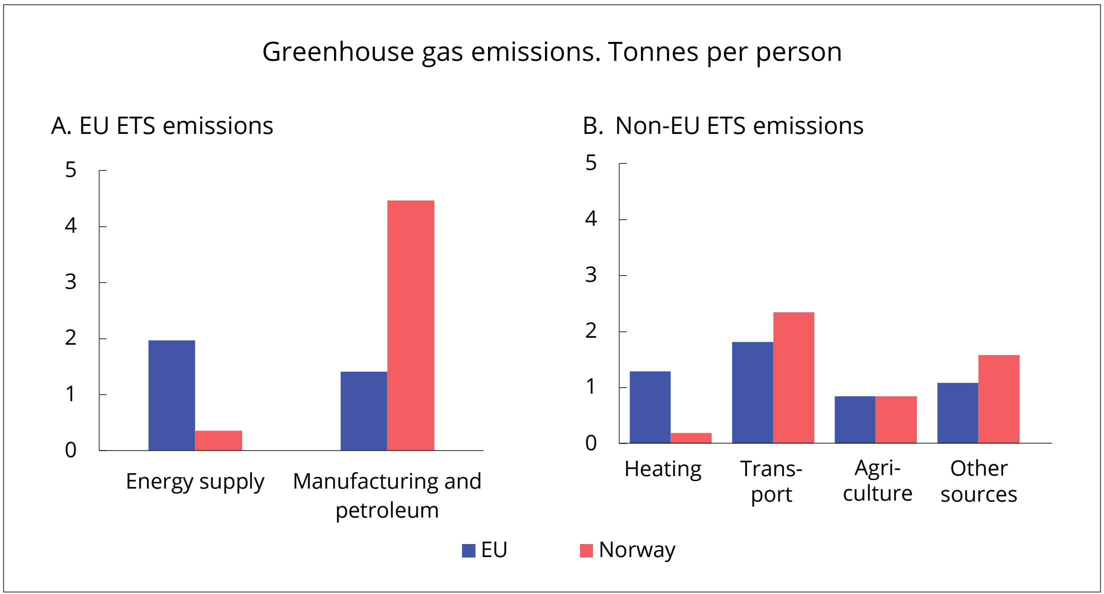

Figure 1.5 Greenhouse gas emissions by sector in 2017. Tonnes per person

Sources: European Environment Agency and the Ministry of Finance.

Through its agreement with the EU, Norway aims to reduce non-EU ETS emissions by 40 percent relative to 2005. Non-EU ETS emissions account for about half of Norwegian emissions and come from, inter alia, transport, agriculture, and waste. Almost 70 percent of these emissions are subject to CO_2 tax. This is a large portion by international standards. Major subsidies have also been introduced to induce transition to zero- and low-emission technologies in the transport sector. The estimated amount of the special tax incentives (the tax expenditures) for electric cars is NOK12.4

billion in 2019, which contributed to more than 40 percent of all new passenger cars that year being electric cars. Norway has relatively fewer readily available opportunities for reducing non-EU ETS emissions than the rest of Europe, and the costs of further emission reductions are high. This has to do, inter alia, with Norway making extensive use of electricity based on hydropower in the heating of buildings, while the EU is heating its buildings with fossil fuels. Norway also has more transport activity than the EU average; see Figure 1.5.

Climate policy has been significantly tightened under this Government. Several tax exemptions and low rates have been abolished, thus implying that a larger portion of emissions are now facing the same price. The number of price brackets on the CO_2 price scale has been reduced. This has made climate policy more cost effective. The level of climate taxes has been increased; see Figure 1.6. As an example, the CO_2 tax on diesel was about NOK 250 per tonne of CO_2 (blue line) in 2013, while it had increased to about NOK 590 per tonne (red line) by 2020.

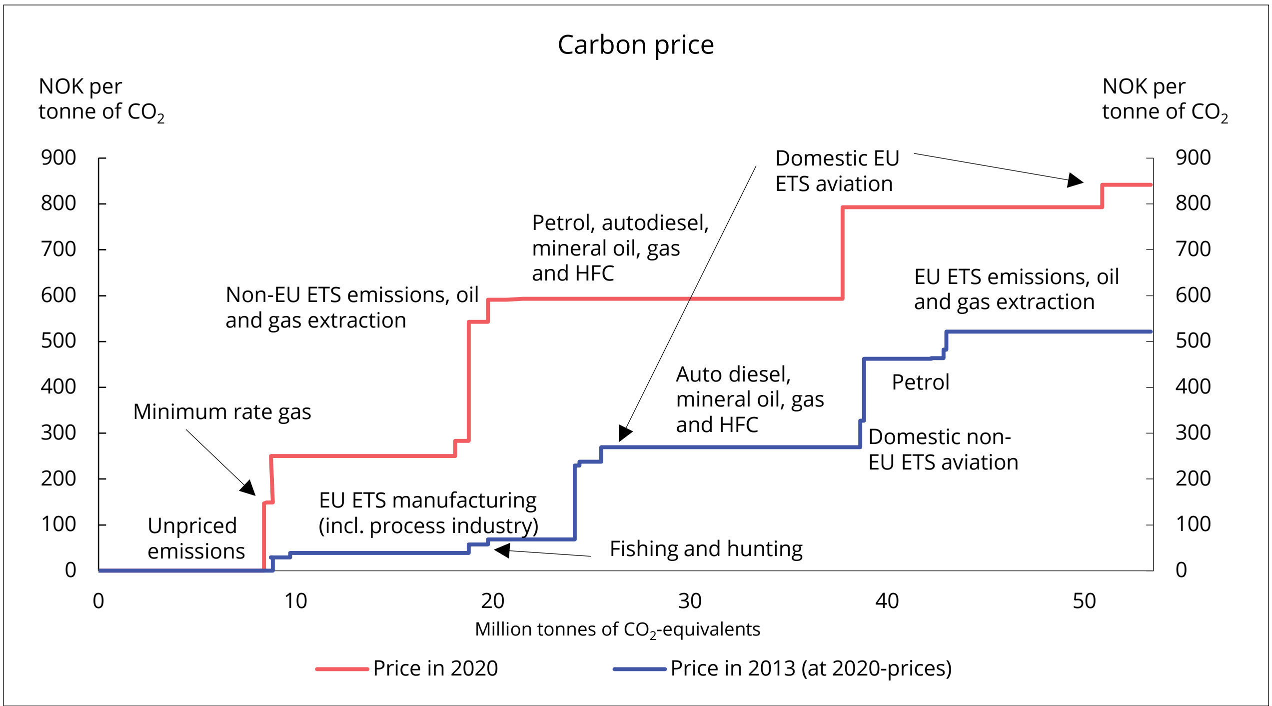

Figure 1.6 Price of emissions in 2013 and 2021 in Norway, at 2020 prices

Sources: Statistics Norway, the Norwegian Environment Agency, and the Ministry of Finance.

The Government presented updated projections of emissions to air in the National Budget for 2021; see Figure 1.7. Projections of emissions are based on assessments of underlying developments in the Norwegian and international economy, including, inter alia, economic, technological and population factors. The projections are, in line with international guidelines, based on a continuation of the current climate policy orientation, both in Norway and internationally.

Estimates of how the current climate policy orientation in Norway and internationally may affect future emissions are subject to considerable uncertainty. Developments in the sale of electric cars in Norway provide an example of the uncertainty in projecting the implications of existing policy. The value added tax exemption was introduced already in 2001, while exemptions from motor vehicle registration tax and road tolls came much earlier. However, the sale of electric cars did not increase until 2015, when battery technology permitted longer driving distances. Financial measures will provide incentives for research on climate-friendly technologies, but it is not possible to predict when the various technological breakthroughs will occur. The vast majority of the technological developments needed to cut emissions will take place outside the borders of Norway.

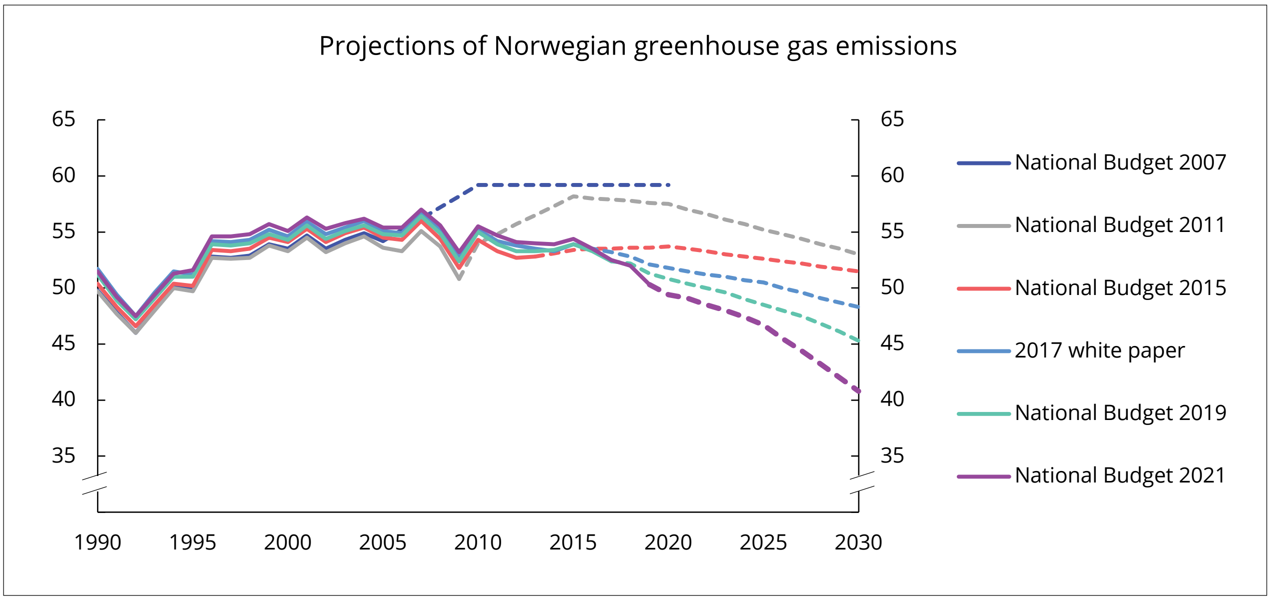

Figure 1.7 Historical emissions[1] and projections of Norwegian greenhouse gas emissions at different times (million tonnes of CO_2 equivalents)

[1] Variations in historical emissions are caused by methodological changes and new emissions knowledge, e.g. new GWP values.

Sources: Statistics Norway and the Ministry of Finance.

The reduction in global *natural diversity* is happening much more rapidly than before. Diversity is currently threatened by, inter alia, deforestation, more intensive agriculture, land degradation, overexploitation of certain resources, spread of invasive species and climate change. About 15 percent of land areas and 7 percent of ocean areas in the world are protected. This is not sufficient to maintain natural diversity. The management of protected areas is also inadequate. A new global framework under the UN Convention on Biological Diversity is to be adopted in the autumn of 2021.

The overall state of Norwegian ecosystems is relatively good. Land intervention and land use changes are nonetheless causing depletion of important ecosystems. The national objectives for natural diversity in Norway are that ecosystems shall be healthy and provide ecosystem services, that no species or habitats shall be made extinct, and that developments for threatened and near-threatened species and habitats shall be improved. A representative selection of Norwegian nature shall be preserved for future generations. To meet these objectives, the Government is in the process of, inter alia, establishing ecosystem management objectives, strengthening water management, preserving moorland, combating species extinction, as well as protecting nature areas.

Air pollution reduces life expectancy and impairs health. Globally, air pollution in cities and urban areas is a serious environmental problem. In Norway, air pollution that is detrimental to health has been reduced in the last decade, but nonetheless remains a challenge in some places. Reduced particle emissions from cars and replacement of old wood-burning stoves have brought improvement. In addition, the amount of long-range air pollution has declined. Measures adopted under the Gothenburg Protocol and earlier international treaties have delivered significant emission reductions in Europe, and thereby also a considerable reduction in the pollution burden in Norway.

Chemical substances, and especially environmental toxins, may have a negative impact on the environment and on human health. Improved waste handling is causing reduced emissions of both environmental toxins and greenhouse gases from waste treatment. 99 percent of hazardous waste in Norway is currently being collected. Moreover, an agreement to reduce food waste has been concluded between the authorities and food chain participants. The agreement seeks to halve food waste by 2030 in line with the Sustainable Development Goals.

Marine plastic pollution and spreading of microplastics are a rapidly growing global environmental problem. The sustainable development goal on marine life calls for marine pollution to be prevented and reduced by 2025. In 2017, the UN Environment Assembly agreed a long-term goal of stopping plastic waste from entering the oceans, based on a proposal from Norway.

The Government will submit a national strategy on a circular economy. The strategy shall serve to protect the environment, reduce greenhouse gas emissions, ensure sustainable production and consumption in line with sustainable development goal 12 and reinforce the competitiveness of Norwegian businesses.

Climate change causes physical changes to the environment, such as for example more flooding, stormwater runoff, landslips, and rockslides. Greenhouse gas emission reduction efforts must be accompanied by *climate risk* detection and reduction. Managing climate change and climate risk is a cross-sectoral undertaking.

The Government is aiming for local government land-use planning to avert loss and damage as the result of, inter alia, flooding and landslips. The natural perils insurance scheme has been amended to provide better protection for persons suffering loss of their main home or holiday home as the result of natural perils. Cost-benefit analysis guidance notes will be reviewed to ensure that climate risk has been adequately considered. Furthermore, the Government is of the view that large Norwegian businesses should report on climate risk, as recommended by the Climate Risk Commission, and has itself taken steps to establish an overview of climate risk in government-held companies. Climate risk is taken into account in the management of the Government Pension Fund Global. The Government will require companies to disclose climate risk in their development plans.

1.7 Diminishing budgetary room for manoeuvre

The savings in the Government Pension Fund Global facilitate, in conjunction with the fiscal rule, long-term management of the petroleum revenues and enable fiscal policy to promote stable and sound economic development. The phase-in of petroleum revenues has given Norway a level of budget growth and a room for fiscal policy manoeuvre in the last two decades thatt few other countries have experienced. This has allowed Norway considerable freedom of action in expanding the scope of public services, implementing new policies and countering economic setbacks.

Net transfers from the Government Pension Fund Global were, in line with the fiscal rule, increased sharply in 2020 to counter the negative impact of the coronavirus pandemic on economic growth and employment. Most of the temporary emergency measures have been extended into 2021 and will over the course of the year be adapted to the infection situation and the infection control measures. In the budget for 2021, net transfers from the Government Pension Fund Global have been reduced towards the level of the long-term yardstick defined by the fiscal rule, and are forecast to be somewhat in excess of three percent of the value of the Fund. Considerable resources are devoted to getting people back to work and making society more inclusive in the 2021 budget as well.

Fiscal budget revenue growth is expected to decline significantly in coming years, while expenditure growth under large statutory benefit schemes will continue to increase.

Public welfare schemes are primarily funded by direct and indirect taxes from the mainland economy. Trend growth in tax revenues has been declining for several years, partly because the tax system has been used to make it more attractive to opt for climate-friendly vehicles. In addition, the decline can be explained by lower labour force and productivity growth having reduced the growth capacity of the Norwegian economy. These trends are expected to continue. Under a continuation of current policy, annual underlying central government tax revenue growth is estimated to decline from NOK 18 billion per year over the period 2011–2019 to NOK 10 billion per year over the period 2023–2030.

It is at the same time likely that the Government Pension Fund Global will be growing much more slowly in the years to come than in the recent past, because the revenue flow to the Fund will be smaller. The Fund will eventually be growing more slowly than the economy of mainland Norway, and the public expenditure funding contribution from the Fund will thereby decline when measured as a proportion of mainland GDP.

Large fluctuations in the value of the Fund have been observed in recent years. Fluctuations must be expected in coming years as well. As a growing portion of the welfare state has been financed by the return on the Fund capital, public finances have become more vulnerable to international financial market volatility, although the fiscal rule stipulates that adjustments may be spread over several years in the event of major changes to the Fund capital.

With increased vulnerability and lower Fund growth, caution needs to be exercised in the further phase-in of Fund revenues. When the Fund stops growing as a proportion of mainland GDP, fiscal rectitude in good times will be necessary to be able to use fiscal policy actively in more challenging times. The economic handling of the pandemic, with comprehensive fiscal policy measures, was made easier because the Government had conducted a responsible economic policy and spent less than the expected Fund returns for a number of years before the crisis. The Government has emphasised that the increased spending during the pandemic shall be temporary and shall be scaled back again as and when the infection control measures can be eased and the economy improves.

Lower petroleum revenues will over time reduce Fund capital growth, thereby narrowing the room for manoeuvre in annual budgets. With a near-neutral fiscal policy, annual net transfers from the Fund may on average increase by NOK 3–6 billion at 2021 prices over the period 2023–2030; see Figure 1.8. In comparison, net transfers from the Fund increased by an average of close to NOK 12 billion per year from the introduction of the fiscal rule in 2001 until and including 2019.

While government revenue growth is expected to decline, expenditure growth under large statutory benefit schemes will increase. The ageing of the population, with a continually growing proportion of retired persons, has brought large increases in expenditure under the national insurance scheme in the last decade, and such increases will continue. The annual increase in expenditure under the national insurance scheme and demographically driven expenditure in health enterprises and the local government sector is expected to be higher towards 2030 than in recent years.

National insurance scheme expenditure is forecast to increase by just over NOK 11 billion per year on average towards 2030, after having increased by just under NOK 9 billion per year in the last decade. The demographically driven local government and health enterprise expenditure has in the last decade increased by just over NOK 4 billion per year. The growth in such expenditure will increase in line with the share of the population above the age of 80 years, and the increase will be close to NOK 5 billion per year in the last few years before 2030. People staying healthy for longer may somewhat reduce the expenditure growth.

Higher growth in statutory expenditure and lower growth in revenue mean less budgetary room for manoeuvre in coming years. The average annual room for manoeuvre is expected to be about NOK 4 billion per year for the next decade, compared to NOK 21 billion per year in the last few years. The annual room for manoeuvre in the next few years corresponds to the amount needed to cover demographically driven local government and health enterprise expenditure. If such expenditure is to be met in its entirety via the fiscal budgets, all of the estimated room for manoeuvre will be absorbed thereby.

New policy expectations are at the same time high. Already adopted or announced plans and ambitions under the Long-Term Defence Plan, the National Transport Plan, etc., may require considerable budget increases in coming years. Such increases must to a larger extent be funded through a reordering of priorities and efficiency improvement measures.

Efficiency improvement measures that have already been introduced and that increase the budgetary for manoeuvre, such as the de-bureaucratisation and efficiency reform (ABE), have not been included in the projections. ABE frees up about NOK 1.8 billion annually for prioritised initiatives under the Government's fiscal budget proposal.

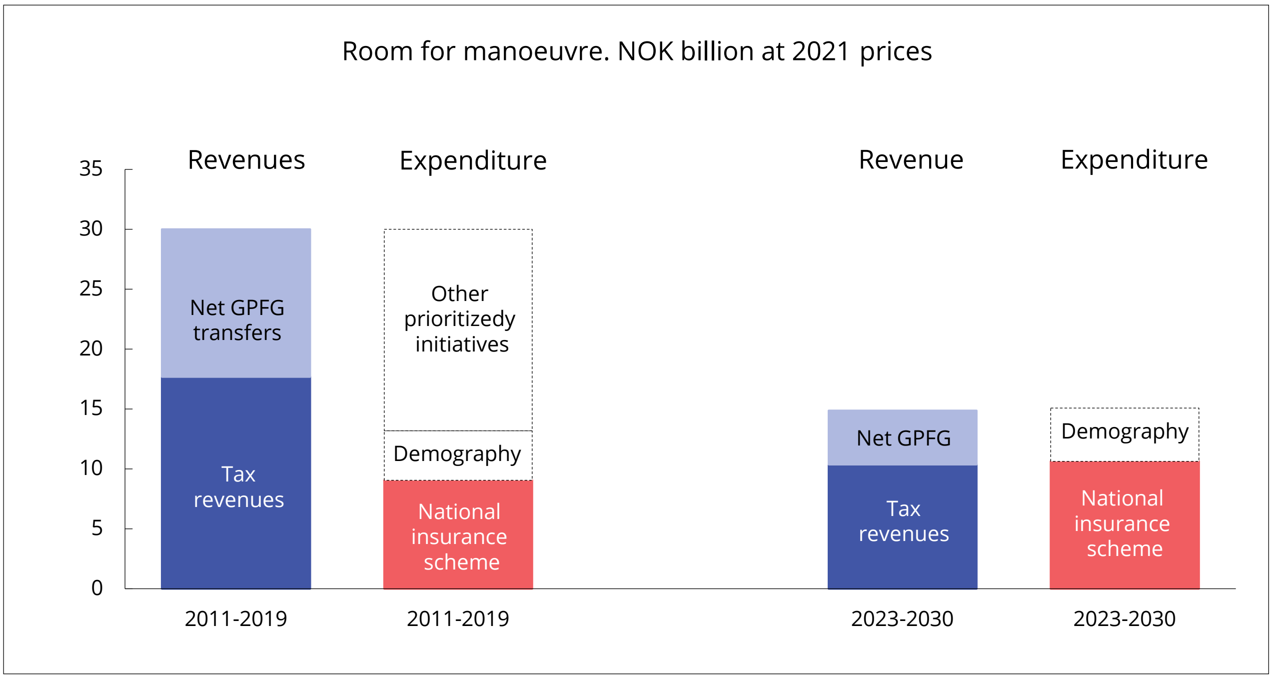

Figure 1.8 Estimated annual growth in structural tax revenues, growth in the spending of petroleum and Fund revenues, the national insurance scheme and demographically driven costs in health enterprises and the local government sector. NOK billion at 2021 prices

Source: Ministry of Finance.

Long-term projections

Looking beyond the next decade, the fiscal challenges will increase. The proportion of the population above the age of 80 years will continue to grow, while Fund revenues will gradually fund a smaller portion of public expenditure. For the oil-adjusted deficit to observe fiscal rule limits, this means that revenues must be increased or that expenditure must be reduced.

The *fiscal gap* indicates what tax level adjustments will be necessary to fund public expenditure for a given net transfer from the Government Pension Fund Global within the limits of the fiscal rule.

The population projections show that future population composition changes will have an impact on public expenditure and tax revenue developments. In Statistics Norway's population projections from June 2020, the population in the main alternative increases from 5.4 million at yearend 2019 to 6.1 million in 2060. The 2060 figure is about 6 percent lower compared to Statistics Norway's 2018-projections, due to lower immigration and lower fertility. Estimated life expectancy at birth has been increased somewhat compared to the previous projection.

The ratio between persons aged 67 years and older and persons aged 20 – 66 years, increases towards 2060, and the increase is more pronounced compared to demographic projections dating from 2016 and 2018.

The ageing of the population implies that public expenditure, in particular expenditure on health care and long-term care, will increase as a share of mainland GDP towards 2060. On the other hand, low birth rates mean that expenditure targeting children and youth is projected to increase more slowly. A growing population also means that the Fund returns need to be shared across more people, thus implying that a larger portion of welfare expenditure will need to be funded on the basis of mainland GDP.

The projections in the baseline scenario indicate a fiscal gap of 5.6 percent of mainland GDP towards 2060; see Figure 1.9. This corresponds to an average annual fiscal gap close to NOK 5 billion. The projection assumes that most measures associated with the pandemic will be phased out during 2021 with net transfers from the Government Pension Fund Global reverting to just under 3 percent by 2022. In the white paper on Long-term Perspectives on the Norwegian Economy 2017, the fiscal gap in the baseline scenario was estimated at 5.3 percent. The increase in the fiscal gap in the present baseline scenario is primarily due to a steeper increase in the proportion of older people relative to the economically active population.

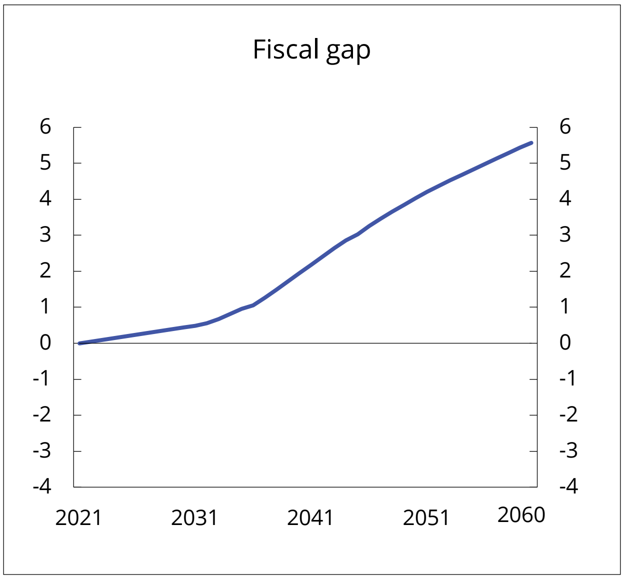

Figure 1.9 Fiscal gap in the baseline scenario. Proportion of mainland Norway GDP. Percent

Source: Ministry of Finance.

In the same way as in the previous white paper on Long-term Perspectives on the Norwegian Economy, the baseline scenario still incorporates a certain increase in standards, both in terms of average resource use per capita and by way of higher growth in intermediate goods and investment than in labour use. The increase in standards in the baseline scenario is nonetheless modest when compared to historical developments.

Secondly, the increase in life expectancy may increase the number of healthy life years. The baseline scenario is based on the assumption that this may reduce the use of long-term care services toward 2060 compared to current levels. In particular, it is assumed that the 7-year increase in life expectancy towards 2060 will mean 3 additional healthy life years, thus implying that the care expenditure on an 80-year old will correspond to the care expenditure on a 77-year old today.

Thirdly, an increase of the number of healthy years implies that older people may continue working for longer. An increased employment rate among older people will serve to reduce the dependency burden as measured by the ratio between the total population and total employment. The baseline scenario assumes that a 7-year increase in life expectancy at birth towards 2060 will extend the economically active period by 2 years. The increased pension accruals resulting from a longer working life compensate for close to two thirds of the effect of the life expectancy adjustment of pension benefits.

The assumptions associated with healthier ageing imply that the fiscal gap in the baseline scenario is reduced, through both increased tax revenues and reduced health and care expenditure.

Effect of alternative assumptions on the fiscal gap

In order to illustrate the significance of assumption choices in the baseline scenario, Figure 1.10 shows how alternative assumptions regarding key variables affect the fiscal gap. The figure also illustrates the significance of alternative assumptions on welfare arrangements (increased service standards and shorter working hours) for the fiscal gap.

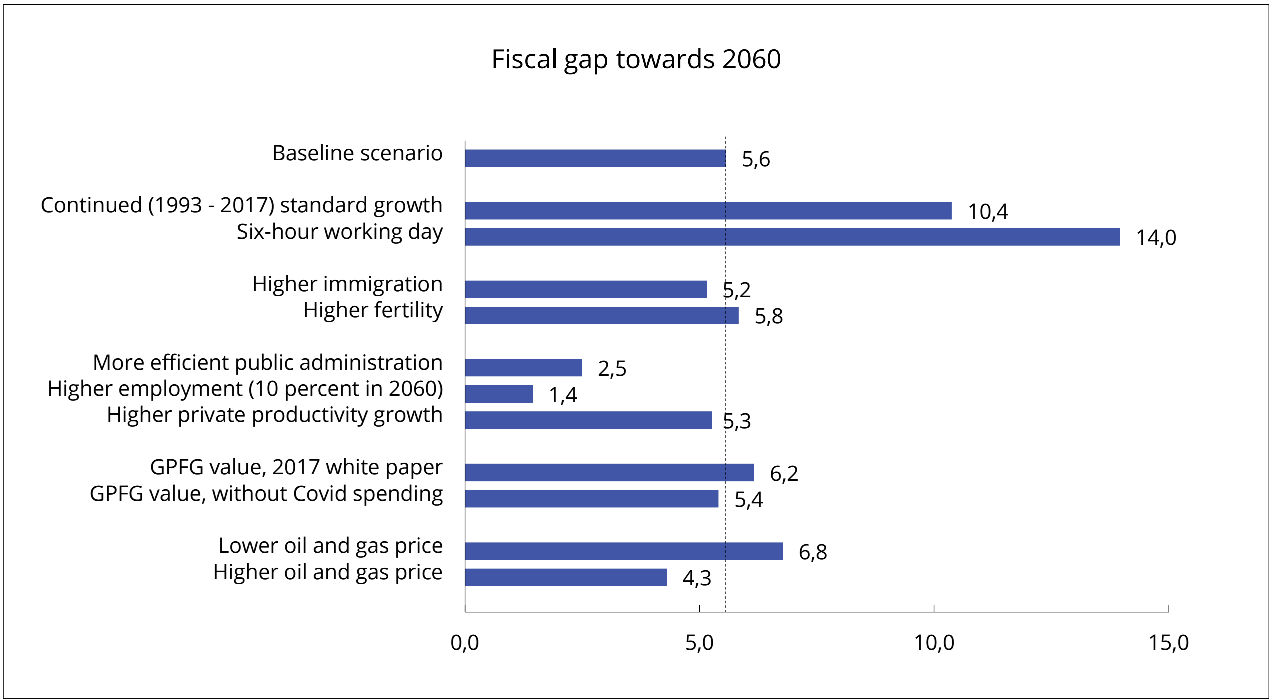

Figure 1.10 Fiscal gap towards 2060. Baseline scenario and alternative scenarios. Proportions of mainland Norway GDP. Percent

Source: Ministry of Finance

The baseline scenario assumes a moderate further growth in the *standard of public service provision.* Towards 2060 projected annual labour input growth in public services per capita is 0.1 percent, which is very modest compared to historical growth, while average annual growth in the standard of civil public service provision measured in terms of labour input per capita was 0.7 percent over the period 1993 – 2017. With standard growth in public service provision more in line with average growth over the 1993 – 2017 period, the fiscal gap will increase significantly, from 5.6 percent in the baseline scenario to 10.4 percent, measured as a proportion of mainland GDP. This corresponds to an annual need for fiscal tightening of just under NOK 9 billion. Measured by the average tax rate on household incomes, this would correspond to an increase from 24.6 percent in 2021 to 38.6 percent in 2060.

Labour market reforms involving *shorter working hours* would sharply increase the fiscal gap. This is illustrated by a scenario in which the gradual introduction of a six-hour working day results in a reduction in average working hours towards 2060 of 15 percent compared to the baseline scenario. It is assumed that the reduction in working hours will be matched by a corresponding reduction in aggregate access to labour, measured in hours. Annual wages are reduced by an amount corresponding to the reduction in working hours. It is assumed that public service production shall be maintained, and that public sector employment will therefore increase, thus reducing private sector employment. The reduction in the tax base will increase the fiscal gap by just over 8 percentage points, to14.0 percent measured as a proportion of mainland GDP. With a 10 percent increase in employment compared to the baseline scenario towards 2060, the fiscal gap over the same period will be reduced by 4.1 percentage points measured as a share of mainland GDP.

Higher immigration serves to improve the age distribution of the population from the perspective of public finances. Below-average labour market affiliation for immigrants from Asia and Afrika reduces the favourable effects on the dependency ratio. Higher immigration also implies that Fund revenues must be distributed across a larger population, thereby covering a smaller proportion of total public expenditure. In aggregate, permanently higher immigration and the accompanying reduction in the demographic dependency burden serve to somewhat reduce the fiscal gap towards 2060 compared to the baseline scenario.

Higher fertility will increase the dependency burden over a prolonged period contributing to increased expenditure on public service provision aimed at children and youth, while over time the tax base for funding public expenditure is strengthened. Towards 2060, the fiscal gap is marginally increased compared to the baseline scenario.

Private sector *productivity growth* is of limited significance for the sustainability of public finances. Major parts of government expenditure, such as public sector wage costs and transfers to households, are linked to general wage and productivity growth in the private sector. Thus, the contribution of productivity growth to tax base growth is to a large extent offset by higher public expenditure growth and a reduction in the relative importance of financing of public expenditures by transfers from the Government Pension Fund.

Public administration productivity growth may enable the public sector to provide better services at a lower cost. An annual reduction in public administration resource use of 0.25 percentage points would reduce the fiscal gap towards 2060 by 3.1 percentage points compared to the baseline scenario.

The base level of the value of the Government Pension Fund Global also has a major impact on the long-term fiscal gap estimates. The value of the Fund by the end of 2021 is forecast to be NOK 1,300 billion higher than was estimated in the white paper on Long-term Perspectives on the Norwegian Economy 2017. Without this increase, the estimate for the fiscal gap towards 2060 would have increased by 0.6 percentage points compared to the baseline scenario.

The fiscal budget weakening in 2020 and 2021 in connection with the coronavirus pandemic serves, when considered in isolation, to reduce the base level of the value of the Government Pension Fund Global by NOK 330 billion. In the absence of this reduction in the value of the Fund, the fiscal gap towards 2060 would have been 0.2 percentage points lower measured as a proportion of mainland GDP.

Alternative scenarios with *high and low oil price* (+/- 20 percent) serve to reduce or increase the fiscal gap by about 1¼ percentage points measured as a proportion of mainland GDP.

1.8 Strategies for sustainable public finances

The future outlook for public finances makes it clear that improved resource use and reordering of priorities within budgets will be needed to continue developing the Norwegian welfare society. The Government's response to the coronavirus crisis points in the same direction as the long-term strategies: We need to produce more and make society more inclusive. The white paper on Long-term Perspectives on the Norwegian Economy 2017 presented two key priorities that were also endorsed by the Storting: It is necessary to get more people into work, as well as to use resources more efficiently. These remain unchanged. Better use of the resources in the economy, and especially labour, will pave the way for both economic growth and more sustainable public finances, thereby enabling the continued coexistence of strong welfare schemes and competitive businesses. It is at the same time necessary to ensure that the increase in prosperity does reach everyone, and that the climate commitments, the Sustainable Development Goals, and other social objectives are met.

Chapter 8 of this white paper discusses the strategies that are the cornerstones of sustainable public finances: Prudent resource use, a growth-promoting tax system and fiscal rectitude. The strategies for prudent resource use are discussed in more depth in the subsequent chapters. These address more effective use of labour by increasing employment and various openings for more efficient public resource use; see Figure 1.11.

The Government's strategies for sustainable public finances

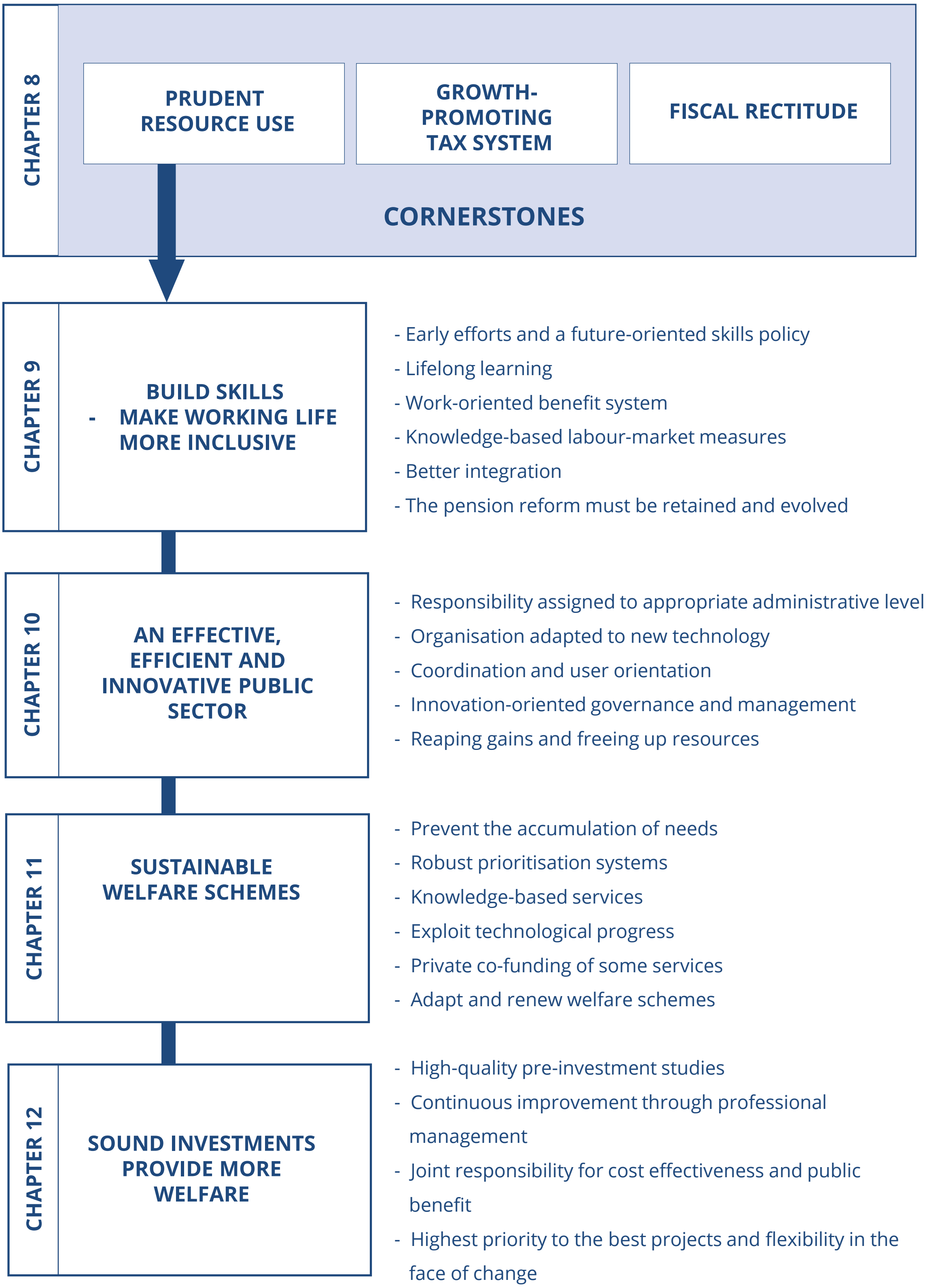

Figure 1.11 The Government's strategies for sustainable public finances

Source: Ministry of Finance.

Policies and reforms that increase the adaptability and sustainability of the economy and the welfare system have been conducted over many years. In the last few years, the Government has implemented transport reforms, local government reform and a de-bureaucratisation and efficiency reform (ABE). The pension reform has continued in the public sector, and a new public sector occupational pension scheme was adopted in the spring of 2019.

When the budgetary room for manoeuvre is reduced, it will increasingly be necessary to cover approved plans, new initiatives and unforeseen expenditure through efficiency improvement and reduction of other expenditure. This may over time also improve the economic growth capacity and result in a more sustainable level of welfare. Public expenditure cannot confiscate an ever-increasing share of the economy.

The large potential that can be released through prudent resource use may be illustrated by different scenarios. Table 1.1 illustrates the significance for public finances if Norway succeeds in making working life more inclusive and using public resources more efficiently. The scenarios are projections of the economy to shed light on the consequences of different events and choices, and are not intended to be forecasts. The states described in the scenarios may be challenging to attain in practice. These will require, inter alia, major changes in the use of policy tools, which it will necessarily take time to prepare and execute.

Increased employment will both increase tax revenues and, in many cases, reduce social security expenditure, and is therefore especially attractive in terms of strengthening welfare and improving budget balance. It is also important for each individual who gets a job. If, for example, enough disability benefit recipients could be brought into the labour force over the next decade to halve the difference between Norwegian and Swedish disability benefit recipient rates, Norway would have 80,000 more people working and NOK 44 billion in increased budgetary room for manoeuvre in ten years. Assuming a phase-in that increases the number of employees steadily year by year, this will increase the budgetary room for manoeuvre by NOK 4.4 billion per year. If the difference in sick leave between Norway and Sweden can be reduced by two thirds, Norway would have about 20,000 more people working and NOK 20 billion in increased room for manoeuvre in ten years. Getting every fourth person who currently works part-time to switch to full-time employment would correspond to an increase in the Norwegian labour force of about 70,000 persons over the coming decade. This would improve the budgetary room for manoeuvre by NOK 30 billion in ten years. Increased employment among immigrants – for example by reducing the gap between the employment rate of the majority population and the employment rate of immigrants from country group 3[4] by one third – would increase the Norwegian labour force by just over 20,000 employees and increase the room for manoeuvre by NOK 10 billion in ten years.

The public sector manages a large portion of the resources in Norwegian society. The ABE reform takes the expected gain from productivity improvements each year out of the budgets of central

[4] Country group 3 is comprised of Africa, Asia, South and Central America, as well as non-EU countries in Eastern Europe.

government entities. This does not mean that the effort to ensure more efficient resource use has been completed. It is necessary to facilitate and systematically pursue actual realisation of productivity gains. The potential for efficiency improvement in other fields also needs to be explored. Weak productivity development over time may indicate an untapped potential for cheaper and more efficient development of public investment projects. Based on the investments made in central government civil buildings, roads (outside the Nye Veier road enterprise) and railways in 2020, a gradual efficiency improvement of 15 percent over a decade would correspond to an annual saving of about NOK 0.5 billion. Realising such efficiency gains will, however, require targeted long-term effort. Calculations also identify a large potential in the local government sector. If municipal administrations impose the same efficiency requirements as apply to central government entities, corresponding to ½ percent of operating expenses, they would within their own budgets be able to free up NOK 1.4 billion per year to be used by them for other purposes and initiatives of their choosing. Efficient use of fiscal budget allocations may deliver important contributions to expansion of the budgetary room for manoeuvre, although the numbers are significantly smaller than for initiatives that increase employment.

Table 1.1 Scenarios with increased employment and improved resource use. Increased budgetary room for manoeuvre in public finances. NOK billion at 2021 prices

Scenarios with increased employment – gradual phase-in over ten years	Full effect[1]
Reduce the number of disability benefit recipients, to halve the difference between Norwegian and Swedish disability benefit recipient rates	44
Reduce sick leave, to get Norwegian sick leave down towards the Swedish level	20
Part-time to full-time; switch every fourth part-time employee to full-time employment	30
Increase employment among immigrants	10
Get more elderly people to continue working	12
Get youth to start working earlier	5
Scenarios with more efficient resource use	
Efficiency gains in the local government sector, ½ percent a year	1.4[2]
More efficient construction of infrastructure and buildings, 15 percent over ten years	0.5
Already introduced	
ABE reform, ½ percent a year for central government entities	1.8[3]

[1] The scenarios for increased employment are calculated on the assumption that these are implemented over the period from 2022 to 2031 and have full effect in 2031. Efficiency gains in the local government sector and the ABE reform will in real terms deliver about the same amount in savings year by year, assuming no real public expenditure growth. This also applies to the scenario of more efficient construction of infrastructure and buildings, but this is calculated on the assumption that the efficiency improvement effect is exhausted in 2031.

[2] The calculation is based on local government revenues in 2021 as estimated in Prop. 1 S (2020-2021).

[3] The number is the ABE reform savings figure stated in Prop. 1 S (2020-2021).

Source: Ministry of Finance.

A growth-promoting tax system and fiscal rectitude are basic prerequisites for maintaining healthy public finances. The main role of the tax system is to fund public services and transfers. Most direct and indirect taxes will, at the same time, affect economic decisions and resource use in society, such as how much people work, invest and save. The tax system should be structured to minimise any unwanted bias in the Norwegian economy. This entails keeping taxation costs down and facilitating efficient use of all resources in society. The key principles have, ever since the tax reform in 1992, been broad tax bases, low rates and equal treatment of different investments, industries, enterprise forms and funding methods. The Government has reduced tax rates on corporate profits, wages, investment and savings.

The tax system needs to be renewed and adapted to changing contexts and new developments. The overall wage and pension tax base is being eroded as the result of population ageing, and the corporate tax base is under pressure internationally. The Government has taken measures to prevent profits shifting, and further measures are required to meet the challenges posed by the digitalised economy. The tax rules must, in conjunction with the benefit and income redistribution system, make it profitable to work.

The best tax bases must be utilised in an effective manner. Value added tax should be a general tax on consumption, with few exceptions, exemptions and reduces rates. The Government will maintain the economic rent tax on petroleum activities and hydropower plants, thereby ensuring that a large portion of the return on exploiting natural resources accrues to society as a whole. Green tax swaps, whereby higher environmental and climate taxes offer scope for reducing taxes on work and production, can deliver large gains. Objectives and commitments with regard to limiting climate change and preventing environmental degradation and health deterioration should be pursued cost effectively and in accordance with the 'polluter pays' principle. Moreover, the Government has presented principles for a car taxation system that is sustainable for both the environment and public finances from 2025.

Norwegian fiscal budgets are characterised by robust public finances and effective control. The fiscal rule enjoys broad political support and limits the annual spending of petroleum and Fund revenues. Norway has a transparent budget system in which integrated assessment of all public expenditure provides the Government and the Storting with ample scope for managing economic developments and allocating resources in accordance with political objectives.

In the years after the financial crisis, many countries experienced challenging budget situations and undesired distributional effects of savings measures. Similar problems will probably be encountered in many countries when the costs of measures in connection with the handling of the pandemic are to be covered. Norway is in the fortunate position of having a buffer of accumulated petroleum revenues, but the value of spending money now needs to be carefully balanced against the value of having the money available for later, and the total extent of petroleum revenue spending needs to be readily comprehensible and prudent.

Responsible fiscal policy needs to be pursued in accordance with the fiscal rule. Fiscal budgets shall provide meaningful insight into the effects of new measures, as well as expected revenue and expenditure developments, to enable decisions to be made on a sound basis. Commitments restricting future budgets shall be limited, to allow sufficient scope for reordering priorities to fund new policies or accommodating unexpected reductions in the budgetary room for manoeuvre. The most important steps towards maintaining and expanding the room for manoeuvre are to get more people into work and to use resources more efficiently.

1.9 Build skills - make working life more inclusive

It is important for both individuals and the country to get as many people as possible into work. Although Norway has high employment by international standards, it remains a problem that many people are outside the labour force due to health problems, inadequate skills, or insufficient integration. Moreover, it is important to prevent the unemployment caused by the coronavirus crisis from becoming entrenched at a high level.

High employment and low unemployment are key objectives for the Government's economic policy and of decisive importance for ensuring a sustainable welfare society. Work is a source of income, affiliation and learning for individuals. Increased labour input means higher economic growth and larger tax bases. At the same time, it reduces welfare system expenditure. Labour mobilisation is needed in many fields and from many groups.

Formal qualifications have become increasingly important for gaining access to the labour market. Education and skills are the Government's key responses to employment and inclusion challenges. The Government has during its term in office implemented several reforms to promote learning, from kindergartens and schools to higher education, adult education, and continued education.

A strong skills policy starts with childhood. Security, care and interaction with parents and kindergarten employees are of decisive importance for development and learning in early childhood. In a distributional perspective, early efforts are needed to give everyone as equal and genuine opportunities as possible. It is especially important to reach the children from the least resourceful homes. The Government therefore accords priority to, inter alia, public health centres, parent support and income support for families with young children, as well as early efforts in kindergartens and schools. It is well documented that high-quality pedagogical services before starting school have a positive effect on learning and development further down the line, and that this effect is especially strong in disadvantaged children. The vast majority of children attend kindergarten, but attendance among the children who would benefit the most, including children of parents with limited or no formal education or of immigrant background, still remains too low.

Completing upper secondary education has become more important for permanent labour market participation, and the employment gap between those with upper secondary education and those without has increased. The upper secondary education dropout rate has been reduced, but needs to be lower still, especially for vocational courses. Those who fail to complete are often only a small number of segments away from completion, and there is thus a potential for further reducing the dropout rate.

There also needs to be ample opportunities for topping up skills over the course of one's working life. The Government is pursuing this through the skills reform *Lifelong learning*. The reform shall, inter alia, improve labour force access to flexible continued education services that can be combined with work.

Norway has a high rate of disability benefit recipients and other health-related benefit recipients compared to other countries; see Figure 1.12. This means that many people of working age are outside the labour force. There is, at the same time, nothing to suggest that the state of health of the Norwegian population is inferior to that of populations in other countries. There is also considerable documentation indicating that some of those who receive health-related benefits have a residual fitness for work. There is thus a potential for quite a few people in this group to get into work. Improved facilitation and follow-up, activity requirements and graded benefits may be effective measures. Few of the people who are granted disability benefits subsequently get off the scheme and back into work. Measures that are taken early on in the process are likely to be the most effective, and this means, inter alia, that sick leave needs to be reduced.

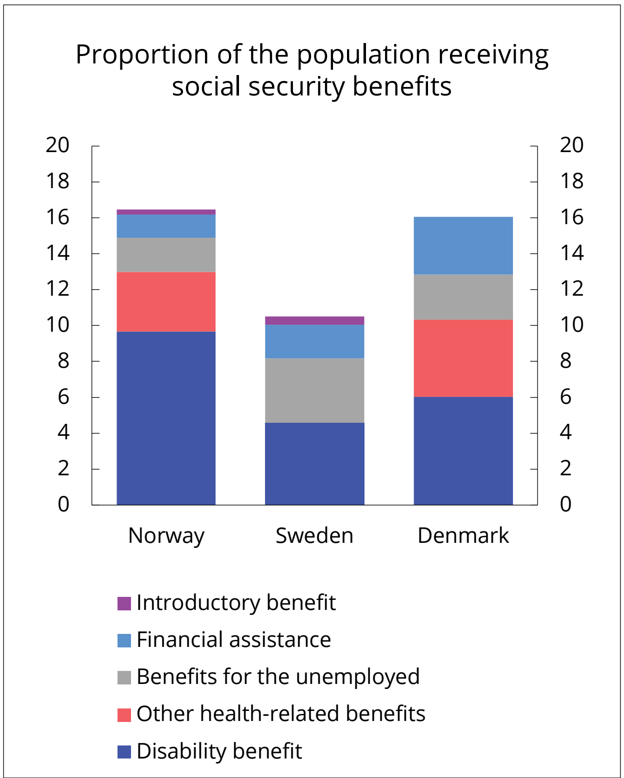

Figure 1.12 Proportion of the population receiving social security benefits. In percent, 20-64 years.[1] 2019

[1] Recipients of sickness benefit and retirement pension are not included. For Norway, «other health-related benefits» include work assessment allowance, while unemployment benefit, transitional benefit and training allowance are included in «benefits for the unemployed».

Sources: Norwegian Labour and Welfare Administration, Statistics Sweden, and Jobindsats.dk.

It is of particular concern that the proportion of youth on health-related benefits has increased significantly in recent years. Mental disorders are an important reason why many people, especially youth, become health-related benefit recipients. For many people with health problems, and especially mental disorders, work can in many instances improve health. Increased cooperation between the Norwegian Labour and Welfare Administration and the health service is therefore important to improve labour force inclusion.

It is important to lower the threshold for hiring individuals with health problems. Measures need to consider, to a greater extent, health, skills, and work-oriented follow-up in conjunction with each other. Active labour market policy can improve the qualifications of individuals or prevent weak groups from dropping out of the labour market. The Government has therefore invited public and private sector bodies to join an inclusion initiative to get more people with disabilities or gaps in their CVs into ordinary jobs. The initiative includes a target of ensuring that individuals with reduced fitness for work or gaps in their CVs account for five percent of all new central government employees.

The integration of immigrants in the labour force is not good enough. More education, additional qualifications and accumulation of skills that are in demand in the Norwegian labour market are prerequisites for successful integration. Increased labour force participation in the short and long run also requires effective language training and work-oriented measures for adult immigrants, as well as early efforts in kindergartens and schools. The Government has presented an integration strategy that includes, inter alia, improved facilitation of formal qualifications, better basic education provisions for youth who have lived in Norway for a short time and enhanced work-oriented measures for stay-at-home women. The Government's follow-up of the strategy includes an integration reform with an emphasis on qualifying recently arrived refugees and immigrants for the Norwegian labour market. A new Integration Act has also been enacted, which entered into effect on 1 January 2021. The new Act imposes clearer requirements on individual refugees and on local government, which is responsible for providing recently arrived refugees with the necessary Norwegian-language training, education or qualifications.

The pension reform has already resulted in more older people continuing to work for longer, and has made important contributions to ensuring the sustainability of welfare schemes. From 2011 until now, the pension reform has had the strongest impact on the private sector. In June 2019, changes were adopted to the public sector occupational pension scheme that will result in the reform also being fully implemented in the public sector. In coming years, it will to a greater extent than before pay to keep working for longer for public sector employees as well. This strengthens the reform.

To ensure a robust and predictable pension system, the key principles underpinning the pension reform must remain unchanged over time. There may nonetheless be a need for evolving the orientation of the pension system in some respects to ensure goal attainment. In June 2020, the Government appointed a commission with broad representation to examine, inter alia, whether the long-term goals for the reform can be met. The commission has been asked to address certain specific issues, including age limits under the pension system and the other income support schemes, as well as retirement pension for disability benefit recipients.

1.10 An efficient, effective, and innovative public sector

Norway has chosen to organise and finance many services on a joint basis for all citizens. When major parts of welfare services are provided by the public sector, the organisation of how these services are provided is of considerable importance, in terms of both economic development and welfare. The public sector employs about one third of the labour force in Norway, and public expenditure represents about 60 percent of mainland GDP; see Figure 1.13. These resources need to be managed well. Innovation and efficient use of resources in the public sector are important for sustainable public finances. Prudent and efficient use of resources is of decisive importance for maintaining high-quality public services and trust in the public sector among citizens.

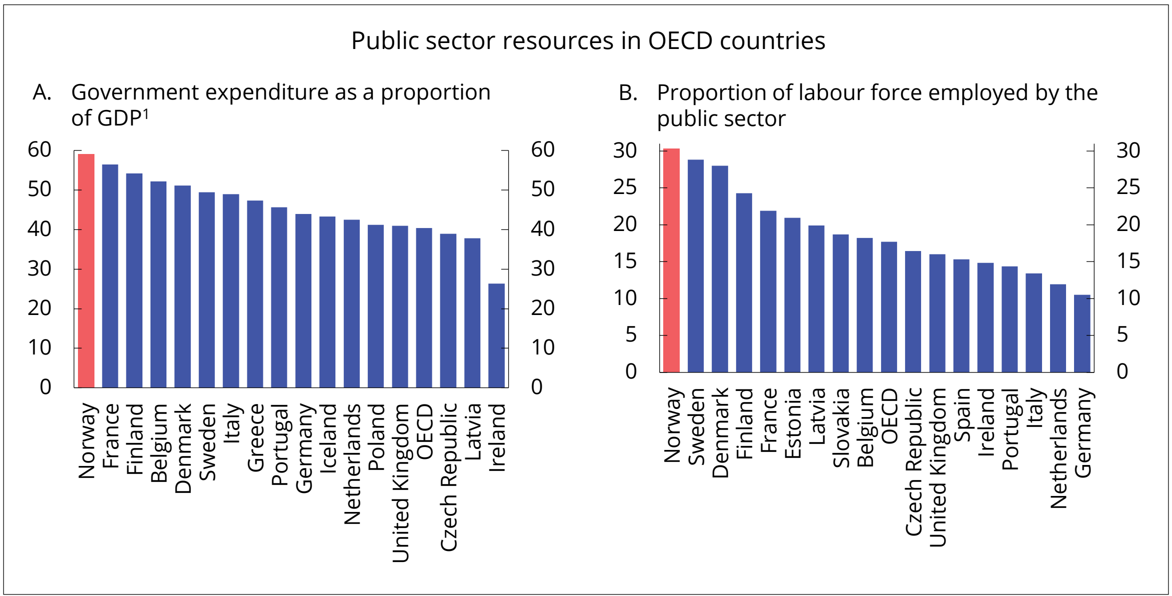

Figure 1.13 Public sector resource use in OECD countries. 2018.

Sources: OECD Government at a Glance 2019 and the National Budget for 2020.
[1] Norway: Mainland GDP

The Norwegian population has a high level of trust in the country's public sector. Digitalisation has made great strides, both in the public sector and in Norwegian society in general. This has provided Norway with a public sector that performs many duties efficiently. It is nonetheless notable that key drivers such as population change, slowing growth in government revenue and new technological opportunities change the conditions that determine how the public sector could and should perform its tasks.

It is a trend in all the Nordic countries that population growth is primarily taking place in cities and urban areas. Depopulation of rural areas has been observed for a long time. In addition, birth rates in small municipalities are lower than before. The smallest municipalities will therefore have the largest number of retired persons and persons who need nursing care per person of working age. Government services are largely decentralised in Norway. Care of the elderly is a local government responsibility, and the smallest municipalities, in particular, will be faced with a steep increase in needs in this area. There are already major differences between municipalities in size, skills and how well they discharge their responsibilities, and there is a risk that such differences will increase. The Government has through the local government reform made efforts to better prepare local government for meeting the needs of the future. Merging of municipalities needs to continue and is encouraged through positive incentives and tools that promote local processes.

Technological developments enable responsibilities to be discharged in new ways, both when it comes to care of the elderly and in the public administration. While technology in the past predominantly has been driving productivity developments in the production of goods, an increased potential for raising productivity is now opening up in service production as well. Digitalisation, artificial intelligence and robotisation can pave the way for faster productivity development in the public sector in coming years than has been observed thus far. This can provide improved services for the population, free up labour for other services, and give rise to considerable economies of scale. There is also much to suggest that the pandemic has accelerated the development of digital public services.

The way in which responsibilities are discharged needs to reflect social developments and the expectations of the population and businesses for a future-oriented and user-oriented public administration. There is an expectation that public services will be digitalised and simple to use. Digital solutions have reduced the need for attending appointments, and reduced personnel needs in various parts of the public administration. This development will continue. There is, at the same time, every reason to expect higher demand of labour in the health and care sector. It will be necessary to change the way in which the public sector operates and provides services, while at the same time ensuring that skilled government jobs continue to be located in different parts of the country.

New technological solutions will often require large investments. The costs of such investments can only be justified if one succeeds in reaping equivalent gains. It will require a high degree of coordination across sectors and geographical divides to exploit new benefits of economies of scale. A willingness to think in new ways about the organisation of work processes and entities, and to free up labour for other duties wherever possible, will be needed. Unfortunately, it has frequently been the case that public digitalisation projects neither deliver the expected benefits, nor give rise to savings.

Appropriate organisation of the public administration is of decisive importance for efficient use of resources. Organisation of central government entities on the basis of functions or responsibilities will enable specialisations spread around the country to be co-located. Appropriate financial division of responsibilities between different administrative levels and general budget allocations for local government are also key principles for promoting efficient use of resources.

All managers of public sector entities have a responsibility for promoting innovation and prudent resource use. Annual reallocation of productivity gains through the de-bureaucratisation and efficiency reform (ABE) establishes a predictable expectation that public sector managers will engage in a long-term effort to free up resources that can be reallocated for the top-priority initiatives. Public sector entities are not subject to the competition of a market or the innovation and efficiency pressures experienced by private businesses. The ABE process provides a similar long-term incentive for innovation, while at the same time ensuring that gains from central government productivity growth are allocated through the political processes of prioritising.

1.11 Sustainable welfare schemes

Norway has strong and comprehensive welfare schemes that are predominantly funded via government budgets. A financial safety net catering for sickness, unemployment and old age in the form of the national insurance scheme, along with universal publicly-funded health and care services, provides security and independence for the entire Norwegian population. Universal welfare schemes that offer benefits for all have made it possible to combine family life and careers and have served to improve gender equality. A robust welfare system thereby contributes to the realisation of several key Sustainable Development Goals.

The welfare schemes facilitate good health irrespective of individual income and provide a strong basis for handling both economic and health crises. A number of the welfare schemes have been temporarily expanded during the coronavirus pandemic, in terms of both compensation level and scope.

The welfare schemes are of importance to the sustainability of public finances, both because they affect work incentives and because they account for such a large portion of total expenditure. More than 55 percent of all public expenditure at the central and local government level takes the form of welfare scheme expenditure. The sustainability of the welfare state is challenged by potential increases in the proportion of the population that is not working.

It is good news for both individuals and for society that people live longer lives. Pension, health and care expenditure will nonetheless increase steeply with an ageing population, and funding of the welfare state will demand more of those who are of working age. While people above the age of 80 years currently comprise just under 4½ percent of the population, that share is expected to increase to almost 12 percent in 2060 under the main alternative in the population projections; see Figure 1.14. Age developments will require a significant increase in resources allocated to health and care services in the years to come.

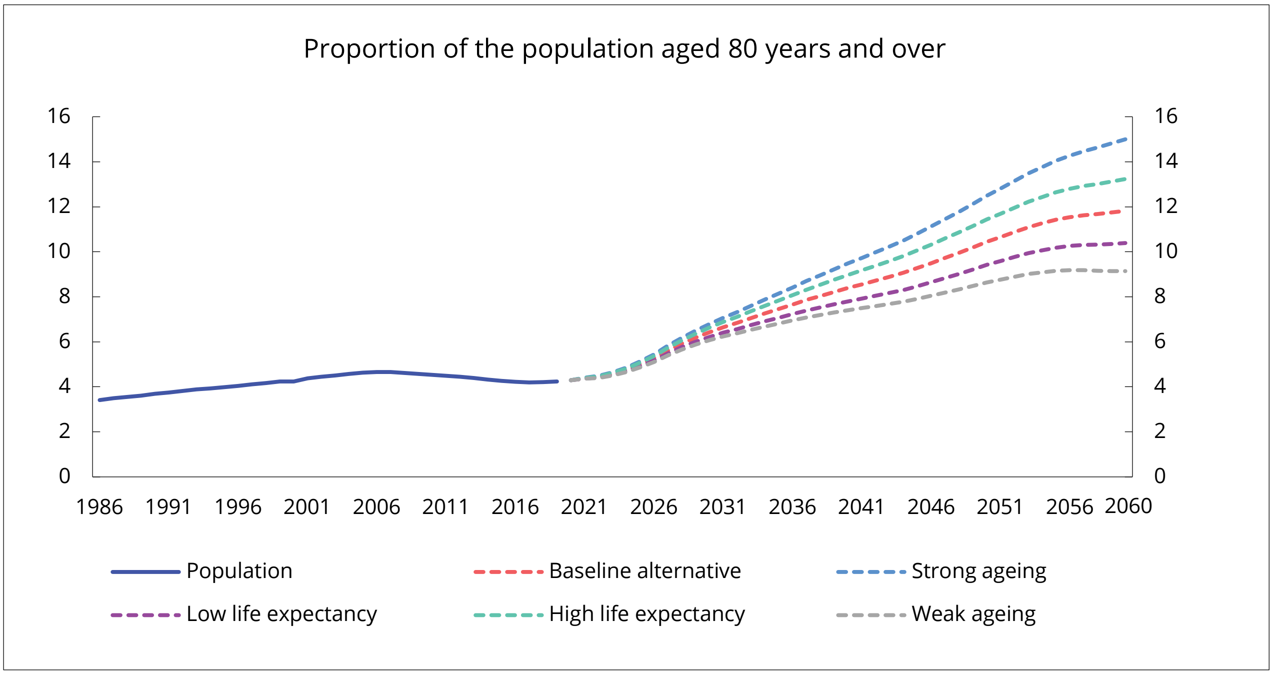

Figure 1.14 Proportion of the population aged 80 years and over. Percent

Source: Statistics Norway.

Improved sustainability cannot be attained through one single measure. Efforts are required in multiple fields. Welfare schemes have to be adapted to the needs these are expected to meet, and the services on offer need to be produced efficiently.

The coronavirus pandemic has been a reminder of how important it is to plan for major crises and to have emergency preparedness in place for when key social institutions and people's health are under threat. It will not, however, be feasible to safeguard against all risks. There will always be a trade-off against alternative uses of resources. It is important in this context to acknowledge that the next severe crisis will in all likelihood be different from the present one. This suggests that planning for the future must be based on strong and flexible emergency preparedness that can be swiftly adapted to new threats.

There are challenges associated with the services provided at present as well, which are likely to be exacerbated by the anticipated developments. Coordination between the specialist health service and the municipal health and care service is important for people with chronic diseases. There will in an ageing population be more people living with such diseases. It is a challenge to ensure equal quality in the services provided to every person and in all parts of the country. There has in numerous parts of the health service been uncovered variations in the services provided that cannot be explained by structural factors, the morbidity of the population, patient preferences or other variables. Variation in the services provided may be a symptom that the effects of various public policy measures are often not sufficiently well known, or that treatments with little effect are being used. This illustrates that there is a potential for improved use of resources.

Efficient use of resources can be achieved through in-depth knowledge of how measures work, systematic comparisons of services provided and effective exploitation of technological progress. It will, moreover, be increasingly important to make conscious choices about the scope of the welfare services. When resources are scarce, prioritisation becomes a necessity. Well-founded prioritisation criteria can serve to capture important considerations and confer predictability and legitimacy on the choices made. Important progress is being made in this regard in the health sector.

Some public welfare schemes have existed for a long time and are influenced by social conditions and challenges that applied when these schemes were established, and that are not necessarily equally relevant at present. Prudent use of resources requires continuous adaptation of regulations and schemes.

Private co-funding may in some instances serve to identify the appropriate priorities. This applies if, for example, the user may unconsciously choose the most expensive of several equally good solutions.

It will be best for both individuals and society if the need for public health services and benefits is prevented. A society that is structured to support the opportunities of individuals for making healthy choices and assuming more responsibility for their own health will lay the best foundations for a healthy population, a productive labour force and reduced health-related benefit expenditure. Public health policy is important, and cooperation with non-governmental organisations, employee and employer confederations, as well as businesses, is one of the keys to success.

The care and assistance need of the elderly can be reduced through adapted housing facilities. Increased prosperity of the population and technological innovations may make the elderly better equipped to modify their homes to prepare for a situation of impaired health. Welfare technology solutions can improve the ability of individuals to look after themselves in their own home and serve to ensure quality of life and dignity for users. Welfare technology can also in some cases serve as an attractive alternative to ordinary service provision.

1.12 Sound investments deliver more welfare

The level of public investment is high in Norway compared to most other countries. Investments account for ten percent of total public expenditure; see Figure 1.15 A. In the last decade, transport infrastructure investments have been accorded special priority. The level has been more than doubled as a share of GDP, after a period of reduction in the preceding decade; see Figure 1.15 B. The Government has given priority to using higher petroleum revenue spending on knowledge and infrastructure investments, as well as growth-promoting tax reductions. This has been in conformity with the priorities that were highlighted upon the adoption of the fiscal rule.

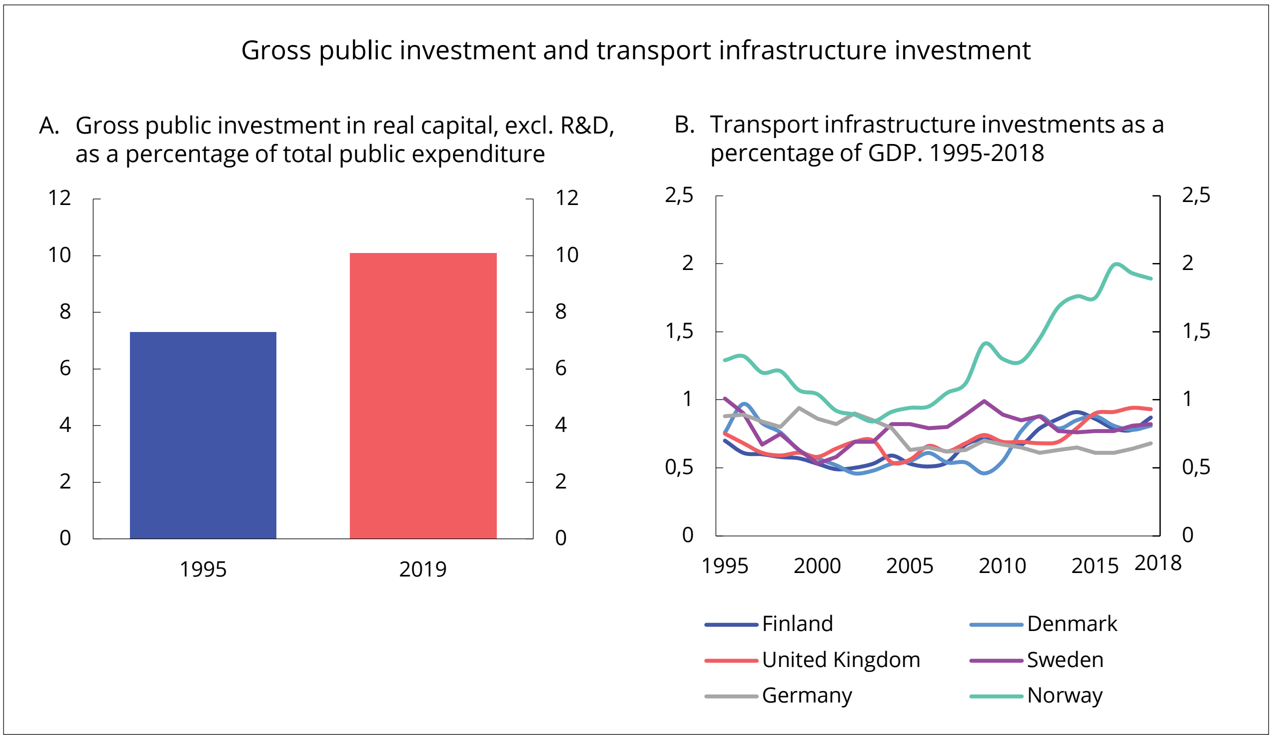

Figure 1.15 Public investment

Sources: OECD and Statistics Norway.

Economically profitable investment can enhance the growth capacity of the economy, and the public sector has an important role in facilitating welfare and growth. An investment is economically profitable if the overall benefits to society exceed the costs. The assessment must pay heed to both business needs and the impact on the population and on the environment. Public and private investments need to contribute to meeting the Sustainable Development Goals and to furthering the transition to a low-emissions society. The benefits from a public investment depend on its purpose. For educational institutions, this may be improved research and education conditions, for ICT projects it may be a reduction in the time spent on regulatory compliance and for transport projects it may be travel-time savings, improved road safety and reduced pollution. Typical costs include investment and operating expenditure, as well as any negative effects on the natural environment or other factors.

It is of decisive importance to choose the right investments and ensure efficient implementation. Investments whose costs are disproportionate to their benefits to the population may absorb large sums that should have been spent on other priorities. When numerous large projects are under implementation at the same time, professional management, leadership, and control are needed to keep costs in check.

Investments have a long lifespan, and decision makers need to take future needs and opportunities into account. It is important to monitor key developments in technology, economic conditions, climate change and climate commitments, as well as demography and population patterns.

Crises and unexpected events may have long-term effects that influence what investments society needs. It is too early to know what long-term changes the coronavirus pandemic will cause and how the pandemic will affect public investment needs. However, the handling of the coronavirus pandemic has illustrated the potential for expanded use of digital meeting places and flexible use of transport infrastructure and office buildings. An increased focus on infection control has, on the other hand, presented the transport system with new challenges. The coronavirus pandemic has significantly accelerated experimentation, innovation and learning in these regards within a short space of time.

Transport sector planning stands out as especially challenging. New climate commitments and the scope for automated, connected vehicles may within a few decades completely change how transport is structured, in addition to which digital interaction may change what type of infrastructure is needed. Investments currently being planned against this backdrop are nonetheless supposed to deliver benefits for up to 75 years. New technology may provide more environmentally-friendly solutions, improved mobility and lower costs in the transport sector. Improved mobility may at the same time increase transport demand. These developments are also changing what policy tools are best suited for solving the challenges facing society. For instance, an increasing share of zero-emission vehicles on the roads reduces the climate advantage of railway investments.

The largest potential for improvements in public investment projects is probably to be found in the phase before projects are presented to the Storting for a final implementation decision. Numerous extensive and costly changes are made to projects in the planning phase. It has over many years been observed that project costs have increased by more than 40 percent from the Government has chosen a conceptual solution until planning has been completed. If project costs increase without a commensurate increase in benefits, projects become less economically profitable. Cost increases in the planning phase may imply that political decisions early on in the planning process were made on the basis of incorrect assumptions.

The Government has taken steps to ensure that low costs and high benefits take centre stage throughout the planning phase and the implementation phase of new projects. There are four components to the Government's strategy for better investments.

Firstly, high-quality official studies are needed. Studies need to identify alternative ways of solving specific challenges facing society and provide knowledge on the benefits and costs to society. Clear requirements to official studies and to quality assurance shall deliver a sound basis for decision making, thereby enabling the best projects to be identified and selected.

Secondly, economic profitability of the projects must be emphasised throughout the entire planning process. Existing knowledge on what drives investment project cost increases, and the challenges faced in deriving the maximum benefit from public projects, shows that *the way* investments are planned and decided is important for the outcome. By planning for economic profitability through all phases of public project development, key priorities for society can be attended to in a more efficient and effective manner. Entities with investment responsibility shall be managed with a view to maximising benefits at the minimum cost, and such entities shall have incentives to plan for cost-effective solutions. The Government has taken a number of steps to achieve this. The Government is preparing the next National Transport Plan for the period 2022 – 2033 in a different way than before. The Ministry of Transport has for example asked central government transport entities to examine all resource use with a view to reducing costs and increasing benefits from resource use in the sector. «Design to cost» is a tool used to provide the right incentives to systematically pursue project optimalisation in both the planning phase and the implementation phase. A new model has been introduced for the planning of central government civil buildings to provide a more thoroughly prepared basis for decision after concept choice and closer follow-up throughout the subsequent planning process. The establishment of the road enterprise Nye Veier AS is another example of new ways of organising government functions that take onboard this knowledge.

Thirdly, all public sector entities with an influence on public investment share a joint responsibility for cost-effective solutions. The needs and requirements of technical and local authorities shall be attended to in a cost-effective manner. In instances where the benefits of a given change accrue to a specific group or region, without any financial or other type of obligation on those receiving such benefits, there will be a risk of costly changes. It may also be challenging for entities with a clearly defined sectoral mandate to pay heed to the effects of their investment decisions on other aspects of society. When different considerations are to be balanced against each other, cost effectiveness must be emphasised in making the overall assessment. This will improve the operating framework for private businesses and contribute to sustainable public finances.

Fourthly, the best projects shall be accorded the highest priority. Long-term planning shall be combined with the flexibility to reorder priorities in response to changes in projects and in society, and there shall be scope for adapting overall activity to the budgetary room for manoeuvre. The coronavirus pandemic has provided a clear demonstration that society may experience large and sudden changes. This illustrates the value of investment plans being flexible and updated to reflect changes in society. Investments will improve and offer better value for money when long-term planning of public investment is organised to take changes in projects and other circumstances into account, and when resource use is prioritised on the basis of what delivers the most benefits to society relative to costs.