

# Executive Summary

## The economy has slowed but inflation persists

The economy has slowed. Inflation remains high but is projected to decline further.

**Growth is projected to slow further before edging up again** (Table 1). Domestic activity will strengthen gradually with disinflation and some monetary easing. Lower financing costs and

housing shortages will spur housing investment. Uncertainty surrounding the projections remains high.

**Table 1. The economy will recover**

<i>(Annual growth, unless specified)</i>	2022	2023	2024	2025
Mainland GDP volume <sup>1</sup>	3.7	0.7	0.8	1.8
GDP volume	3.0	0.5	1.2	2.1
Private consumption	6.2	-0.8	0.7	1.6
Gross fixed capital formation	5.2	0.0	-2.8	5.8
Exports	4.5	1.4	3.4	3.2
Imports	12.5	0.7	1.0	4.4
Unemployment rate (% of labour force)	3.2	3.6	4.0	4.1
Consumer price index	5.8	5.5	3.7	2.8
Current account (% of GDP)	30.3	17.6	14.4	14.8
Budget balance (% of GDP)	25.6	16.3	12.4	12.2

Note: 1. GDP excluding oil and shipping.

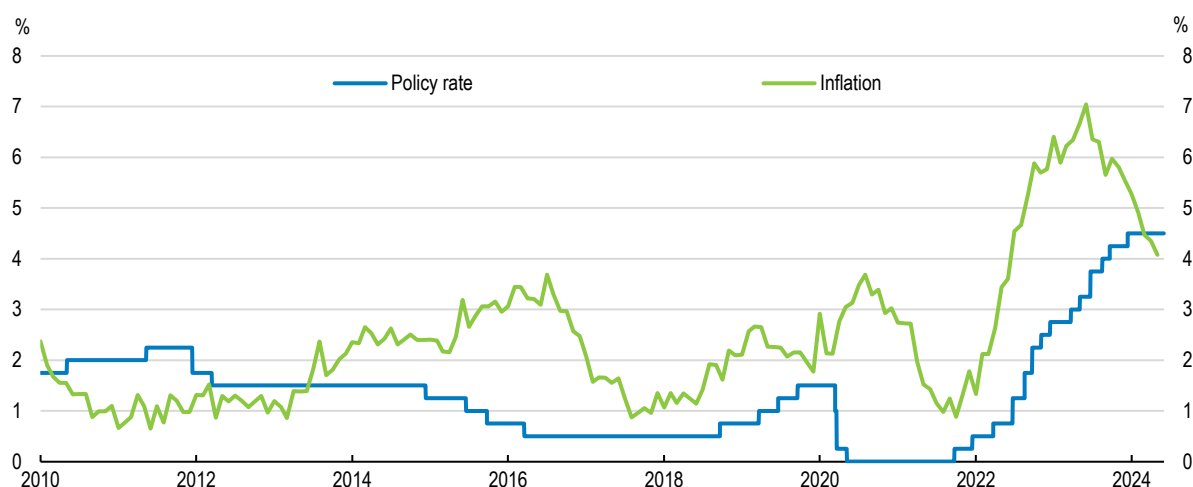
Source: OECD Economic Outlook 115 database (updated).

**Despite some easing, the labour market remains tight.** The unemployment rate remains low at 4.0% in April. Labour force participation has risen again after a decades-long decline. However, labour shortages notably in the technical and health care sectors remain high. The decline in real wages may have come to a halt.

**Inflation is coming down** (Figure 1). It peaked in October 2022 at 7.5%, spreading to domestic goods and services. Second-round effects are increasingly driving inflation. So is exchange rate depreciation, with the krone down by around 8% against the currencies of the main trading partners in 2023. However, inflation is expected to decline following the tightening of monetary policy.

## Figure 1. Inflation is falling

Consumer price inflation and key policy interest rate



Note: Inflation refers to national CPI adjusted for tax changes and excluding energy products (ATE).

Source: Statistics Norway; Norges Bank.

StatLink  <https://stat.link/dioiv15>

## Monetary and macroprudential policies have been tightened

The central bank has kept the policy interest rate unchanged since late 2023. It has moderately tightened macro-prudential rules, notably in the face of housing market risks.

**Interest rates have peaked.** In December 2023, the central bank raised the key policy rate to 4.5%, the 14th and so far last increase since the cycle started in late 2021. The monetary stance is appropriate.

**The financial system looks stable overall.** The banks are liquid and highly profitable, yet their

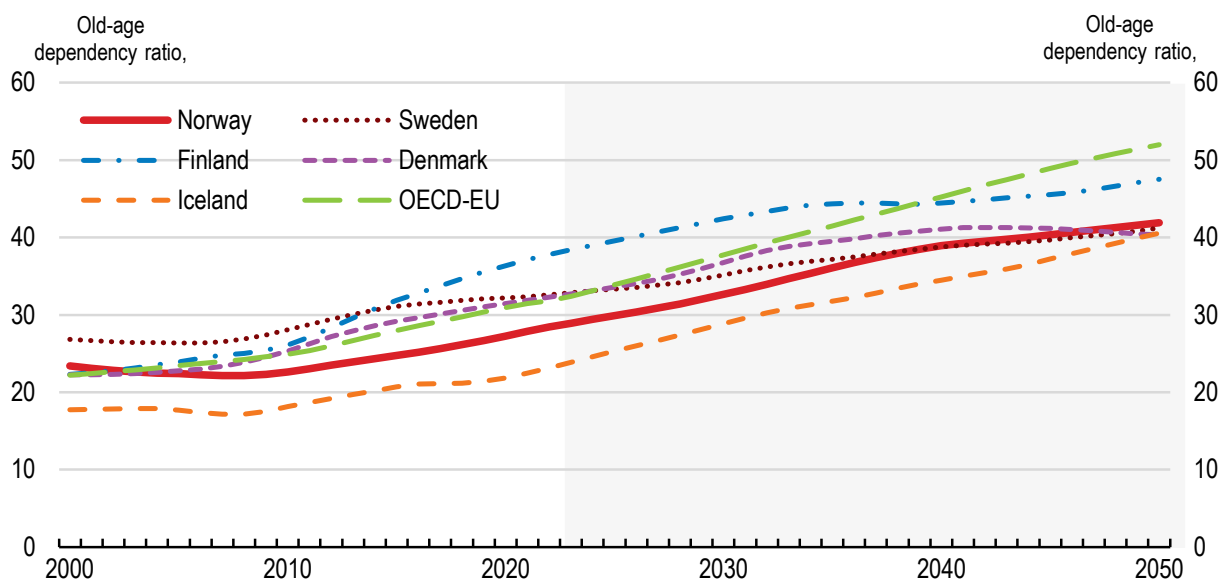
exposure to commercial real estate firms remains a vulnerability with higher interest rates and weakening construction activity. Housing market risks remain elevated as households are the most indebted in the OECD, and debt service costs continue to rise.

## Fiscal policy should be tightened more

Fiscal policy is expansionary, and dwindling oil revenues could pose a risk to long-term sustainability of the public finances.

**The general government non-oil deficit reached around 10% in 2023.** The fiscal rule stipulating that the structural non-oil deficit should over time be in line with 3% of the oil fund's value has been observed. Going forward, fiscal space for new spending initiatives is likely to diminish as petroleum revenues will decline.

**Ageing costs are rising.** Norway's population is getting older and growing more slowly (Figure 2). The government projects ageing costs to rise by around 2.5% of GDP by 2050. The recently adopted measures to encourage later retirement and the increase in the maximum pensionable age in the public sector will reduce fiscal pressure and help increase employment.

**Figure 2. Norway is ageing, though less than other OECD countries**

Note: The old age dependency ratio is the number of individuals aged 65 and more to the population aged between 15 and 64.

Source: United Nations, World Population Prospects 2022.

StatLink  <https://stat.link/2pa59z>

**Norway's tax burden tops the OECD average despite high oil revenues.** Tax reforms since 2022 have made the tax system more equitable but

increased overall tax pressure. The marginal tax rate on savings and investments is high, with the risk of burdening small and family businesses.

### Public spending efficiency should be increased

**Government spending is rising fast and very high in international comparison.** It has risen more than mainland GDP and tax revenues. Budgets are established for a single year only, making longer-term planning difficult. Norway could benefit from applying a medium-term expenditure framework, introducing a spending rule, and establishing a full-fledged fiscal council.

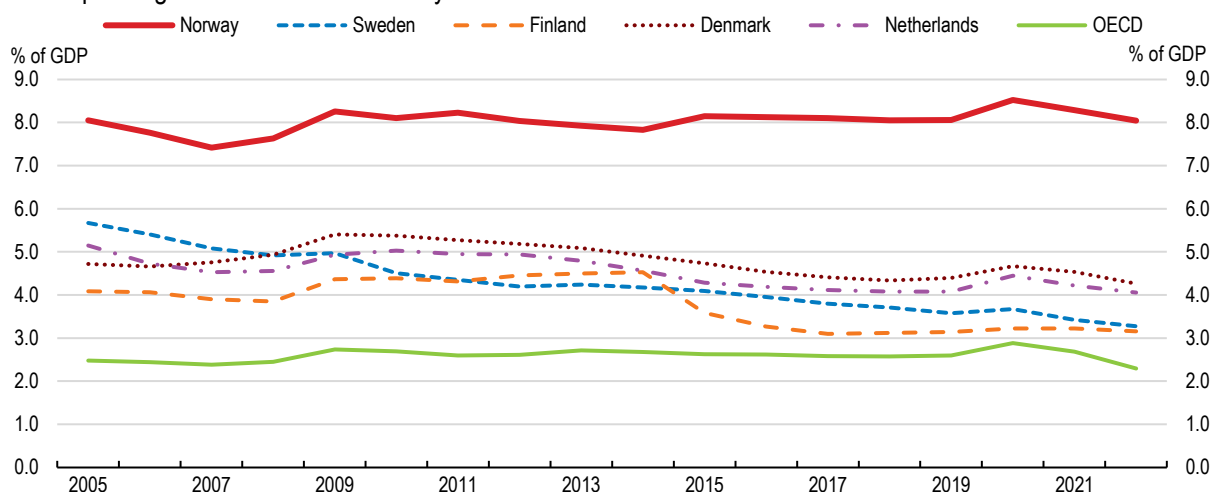
**Regional policy should become more cost-conscious.** The government aims at maintaining a decentralised settlement pattern. Municipal mergers should be restarted to reap scale economies, at least for small municipalities. Obstacles to municipal co-operation should be removed and better incentives to do so should be provided.

**Sickness and disability benefit reform has had limited traction so far.** Spending on these schemes is still four times the OECD average (Figure 3) and they are a major channel for exit from the labour force. As medical assessment for the disability scheme is often carried out by the claimant's own general practitioner, admission rates are very high. The very generous sick leave compensation could be reduced.

**Infrastructure investment is very high.** It includes however projects with low benefit-cost ratios, which could be remedied by imposing a minimum benefit-cost ratio. More ex-post evaluations of investment projects should be undertaken.

### Figure 3. Public spending on disability and sickness far exceeds the OECD average

Public spending on sickness and disability benefits



Note: Mainland GDP for Norway. The OECD aggregate represents the simple average of its members for which data are available.

Source: OECD, National Accounts database.

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### Fostering strong and relevant skills to raise productivity and employment

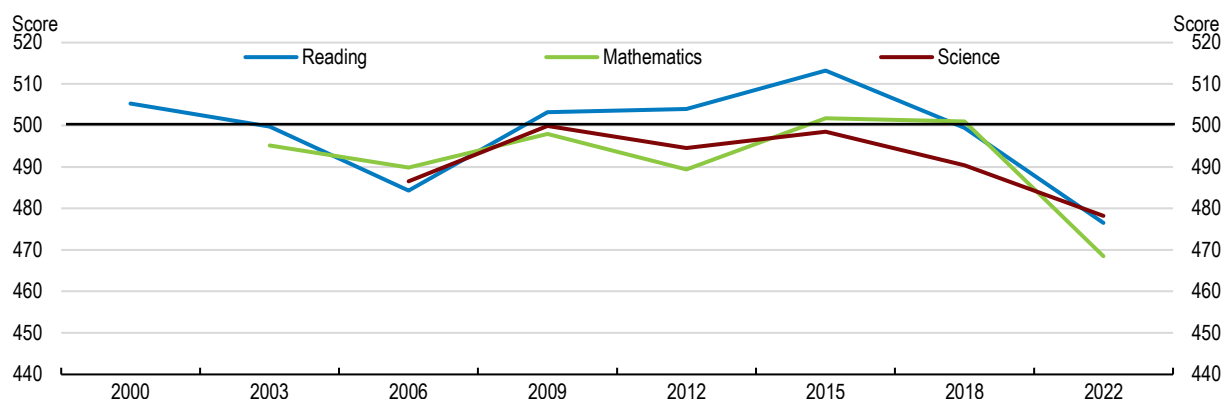
Labour productivity growth, at 0.5%, remains below the OECD average, although Norway is still one of the most productive countries. Stronger and more relevant skills could reinvigorate productivity growth.

**Shortages of skilled labour have become more acute**, notably in the technical and health sectors. Occupations that require vocational or higher education are among the most difficult to fill. A forthcoming reform of upper-secondary education aims at tightening the links between education institutions and the labour market.

**The quality of fundamental skills is declining to a worrying extent.** While Norway scored above

the OECD average between the 2009 and 2018 PISA waves, it is now below (Figure 4). Girls fare better than boys, and this difference is larger than on average in the OECD. Differences across schools are negligible, while within-school differences are large. The role of socio-economic background for success is low. To contain cost, the stringent pupil-teacher ratio could be lifted and co-operation among municipalities strengthened.

### Figure 4. PISA results have declined



Source: OECD, PISA 2022 results.

StatLink  <https://stat.link/o13my8>

**Vocational education and training (VET) should be strengthened.** While Norway has a well-established work-based VET track, apprenticeships start late in a student's career. Drop-out rates remain high. Norway's VET system lacks a comprehensive tertiary level and offers limited progression opportunities.

**Labour market relevance of tertiary education could be improved.** Despite reforms over the past few years, there is a dearth of qualified labour especially in the technical and health sectors, and women's participation in STEM areas is low. Collaboration between universities and the business sector is weak, and corporate funding of tertiary education almost non-existent.

## Power supply should be increased

Electricity demand is projected to exceed planned supply by 2030. The rising imbalance between generation in the North and consumption in the South leads to large price differences.

**New investment could help lift the supply of power.** New green industries and rising power exports require the expansion of generation and transmission capacity. Yet land-use conflicts are often an obstacle to more hydro and wind generation. A recent reform strengthened municipal veto rights and the local share in tax revenues from generation.

**Cross-border transmission capacity should be strengthened.** Integration of national power grids can help improve security and stability of electricity provision in Norway and neighbouring countries. Grid extension across borders should be facilitated, notably in the North Sea, and a fully integrated wholesale electricity market created.

## Decarbonising the economy

Norway has committed to reduce carbon emissions by at least 55% from 1990 levels through climate cooperation with the European Union. It should do so in a sustainable and cost-efficient manner.

**Norway's per capita carbon emissions are declining.** Industry accounts for the highest relative share of emissions, while emissions from energy generation and the rapidly electrifying car fleet are below the OECD average. Agricultural methane and nitrous oxide emissions exceed the OECD average, and they remain untaxed.

**Climate policies need to be strengthened further.** Cutting emissions in Norway is expensive, notably in industry. Crediting emission cuts abroad against domestic emission targets, as allowed by the Paris agreements, could help reduce the cost of climate action. The government also started to invest in adaptation, for instance better flood control.

## Main findings and key recommendations

Main findings	Key recommendations
<b>Monetary, financial, and fiscal policies</b>	
Inflation remains high and is expected to decline only gradually, amidst continuing high uncertainty.	Maintain a sufficiently restrictive monetary policy stance to bring inflation down to around 2% over the medium term.
The fiscal stance is expansionary.	Reduce fiscal stimulus to support monetary policy, mainly by reining in spending.
Housing markets have cooled, but house prices remain high. Housing affordability is low. Tax treatment of owner-occupied housing is one of the most favourable in the OECD.	Remove obstacles to expand housing supply notably in urban areas, by allowing for denser city space and greenfield development close to public transport hubs.
Notwithstanding recent cuts, income taxation continues to discourage work. Marginal tax rates can be high due to wealth taxation.	Further reduce income taxation, notably for low-income earners. Increase allowances in wealth taxation and/or reduce rates while taxing all assets at market prices.
<b>Policies to improve productivity and employment</b>	
There is a dearth of qualified labour especially in the technical and health sectors. The low share of students in tertiary vocational education and training (VET) and high dropout rates constrain VET's potential to meet labour market demands.	Strengthen the tertiary level in VET, by extending the current short cycle and/or by opening university colleges to upper-secondary VET graduates.
<b>Decarbonising the economy</b>	
Carbon emissions are declining but remain only just below the OECD average. The cost of reducing carbon in Norway is very high.	Carry out careful cost-benefit analysis for carbon-reducing policies and prioritize policies with a lower reduction cost per tonne of carbon. Gradually broaden and increase carbon taxation and consider taxing methane and nitrous oxide. Credit emission reductions achieved through international low-carbon emission programmes against national targets, at least partly
Demand for electricity is growing, while supply and transmission capacity are lagging. Electricity price differences across regions have widened, pointing at a lack of transmission capacity between the north and south of Norway.	Simplify and shorten the licensing and permit process for power generation and transmission.
<b>Raising the effectiveness of public spending</b>	
Expenditure rules help contain spending. Norway is among the few countries that have not implemented any such rule.	Implement an expenditure rule that aims at containing spending as a share of GDP.
A medium-term fiscal framework is lacking.	Introduce a medium-term fiscal framework.
Municipal mergers have been stopped. Cooperation among municipalities is still limited in some core sectors.	Enlarge the operational scale of small municipalities, through mergers or co-operation.
Despite considerable efforts, fragmentation of health care between municipal health centres and hospitals persists.	Pursue efforts to improve the coordination of care between municipal health centres and hospitals.
The share of poorly performing students has risen.	Sharpen the targeting of the grant system. Reduce the teacher shortage and continue to raise the quality of teaching.
Spending on education is very high in international comparison.	Lift the stringent pupil-teacher ratio and strengthen co-operation among municipalities.
Often infrastructure projects with a low benefit-cost ratio are selected.	The benefit-cost ratio should be given more importance in the selection of infrastructure projects.
Sick leave compensation is very generous. Employers pay little in terms of sick leave compensation.	Expand employer payments for long-term sickness leave and consider reducing the sick leave compensation rate towards the level of the other Nordic countries.
Chances of returning to work decline steeply the longer individuals remain on sick leave.	Strengthen early intervention, especially for young people, so that they do not end up in the disability scheme.
Medical assessment for the admission to the disability benefit scheme is still often carried out by the claimant's own general practitioner.	Add an independent medical assessment, for instance, by a doctor appointed by social security.
Exposure of agricultural producers to market signals is weak and output-related measures are prominent.	Move away from the most economically distorting and environmentally damaging forms of agricultural support, and consider reducing overall support.



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