FINANS- OG TOLLDEPARTEMENTET

Ministry of Finance and Customs

The National Budget 2000

The Norwegian Economy

Table 1 Key projections

	NOK billon 1996-prices	Volume change from previous year, pct.	
	1998	1999	2000
Private consumption	524.2	2.2	2.0
Public consumption	220.4	2.0	1.5
Central Government	87.4	0.8	2.0
Local Government	133.1	2.7	1.2
Gross fixed capital formation	269.0	-9.0	÷11.6
Oil activities	74.6	÷9.6	÷34.1
Shipping	10.9	÷37.2	÷4.0
Mainland Norway	183.5	÷7.0	÷3.0
Of which: Mainland business sector	115.6	÷8.3	÷5.0
Residential construction	29.3	÷5.7	2.5
Public sector	38.6	÷4.1	÷1.5
Central Government	16.5	÷9.7	÷3.7
Local Government	22.1	0.0	0.0
Total domestic demand, excl. stockbuilding	1 013.6	÷0.8	÷1.4
Stockbuilding[1])	28.6	÷0.4	÷0.1
Exports	440.2	2.4	9.1
Of which: Crude oil and natural gas	153.9	4.5	16.9
Traditional goods	174.0	1.5	4.0
Imports	399.9	÷3.0	÷1.1
Of which: Traditional goods	264.3	÷2.4	0.0
Gross Domestic Product	1082.5	0.9	2.9
Of which: Mainland Norway	898.2	0.5	0.7
Memorandum items:			
Gross product manufacturing sector	120.1	÷0.9	÷1.2
Consumer price inflation	..	2.2	2.0
Wage growth	..	4¾	3¼
Employment (persons)	..	0.3	÷0.3
Unemployment rate	..	3.2	3.6
Current account NOK billion	-16.3	32.8	87.4
Per cent of GDP	-1.5	2.8	7.1
Net external assets. NOK billion	95.3	119.1	211.4
Per cent of GDP	8.6	10.2	17.2

[1]) Change in stockbuilding in per cent of GDP in previous year.

Source: Statistics Norway, Norges Bank and Ministry of Finance.

PREFACE

This publication contains a summary in English of Norway's National Budget for 2000, presented to the Storting (Parliament) as Report no. 1 (1999–2000) on 4 October 1999. The National Budget presents the Government's programme for the implementation of economic policy and projections for the Norwegian economy.

The main purpose of this English summary is to give a general picture of the Government's macroeconomic policy (Chapters 1–3), the macroeconomic forecasts (Chapter 7), and a review of some measures aimed at improving the functioning of the economy (Chapters 4–6).

Royal Norwegian Ministry of Finance
Gudmund Restad
Minister of Finance
October 1999

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Chapter 1 Introduction

Economic fundamentals are generally sound in Norway. The employment rate is high and among the highest in the OECD area. The unemployment rate is low relative to the average in Europe. Furthermore, the Norwegian economy is assumed to record a substantial current account surplus both this year and next. Public finances are also fundamentally sound.

The Norwegian economy has expanded sharply since the recovery began in 1993. During this period pressures gradually built up, with a shortage of labour in a number of sectors. This was particularly evident last year when wage growth was about twice the level recorded by Norway's main trading partners. The wage growth from 1998 to 1999 will be lower than last year but higher than in trading partner countries. High wage growth has contributed to a loss of cost competitiveness.

In the summer of 1998, the fall in oil prices, international financial turbulence and imbalances in the Norwegian economy contributed to a sharp depreciation of the krone exchange rate and a doubling of interest rates. In 1999, a tight budget, higher oil prices, a considerable interest rate differential against the euro and moderate wage settlements have contributed to an appreciation of the krone.

After six consecutive years of strong economic growth, the Norwegian economy is set to record a noticeably slower rate of growth in 2000, cf. Chapter 7. In the light of the vigorous growth period the last few years, and the very high level of capacity utilisation in the economy, low growth for a limited period does not represent a dramatic development.

The main challenge to economic policy is to bring price and cost inflation down to the same level as that of Norway's trading partners. This is necessary in order to maintain high employment and low unemployment, as well as to prevent high interest rates in Norway in the years ahead. It is therefore very important that wage growth as early as next year is brought down to the same level as in main trading partner countries, which is estimated at a little more than 3 per cent. Failing this, the prolonged period of expansion in the Norwegian economy may end with a more severe economic downturn and a sharp rise in unemployment. Fiscal policy and co-operation with the social partners have the main responsibility for ensuring balanced economic growth with moderate price and cost inflation, thereby providing scope for a further reduction in Norwegian interest rates.

The Government's economic policy is based on the following key elements:

– *Fiscal policy* has the main responsibility for stabilising growth in the demand for goods and services. The Fiscal Budget must be oriented with a view to preventing strong pressures in the labour market. The budget proposal for 2000 entails a neutral fiscal policy stance. Fiscal policy is discussed further in Chapter 2.
– *Monetary policy* is oriented towards maintaining a stable krone exchange rate against European currencies. So far this year, the krone exchange rate has appreciated, providing a basis for a reduction in Norges Bank's key rates by a total of 2.5 percentage points. The Norwegian money market rate, however, is still about 3¼ percentage points higher than in the euro area. Monetary policy is discussed further in Chapter 3.
– *Co-operation with the social partners* shall contribute to moderate price and cost inflation. Given the current situation in the labour market, *employment policy* must be oriented with a view to ensuring the supply of suitably skilled labour. There is still a shortage of labour in many sectors of the economy, including the health sector. An increase in unemployment in petroleum-related activities as a result of the projected considerable decline in petroleum investment may be alleviated through an active use of labour market measures, intensified placement efforts and training measures. Employment policy and co-operation with the social partners are discussed further in Chapter 4.

- *Structural policy* shall contribute to an optimal management of labour, capital and natural resources. Structural policy is discussed in Chapter 5.

Norway, along with other industrialised countries, will be facing demographic changes that entail a growing proportion of elderly people. Along with higher average pension benefits, this will contribute to an increasing dependency burden for the economically active over the next decades. To address these challenges and maintain a high level of production of government services, it is necessary to set aside a large share of oil revenues and encourage high labour force participation. The trend in recent years towards a lower age for retiring from working life cannot persist. Various issues concerning the funding of the National Insurance Scheme and early retirement schemes are discussed in Chapter 6.

Chapter 2 Fiscal policy

2.1 Main features

In the formulation of fiscal policy, the Government attaches importance to the following factors:

- Fiscal policy has a primary responsibility for stabilising the economy. In a situation when the economy is close to full capacity utilisation and the labour market is tight, public revenues and expenditure must be geared towards preventing excessive total demand for goods and services which could result in an acceleration in price and cost inflation.
- The central government's financial position must be solid in order to secure room for manoeuvre in fiscal policy. The Government Petroleum Fund was established in order to facilitate the accumulation of financial reserves and to function as a buffer against fluctuations in petroleum revenues. Fiscal policy must take into account that petroleum revenues are uncertain.
- Fiscal policy must have a long-term perspective. The Norwegian economy will be facing considerable challenges in the next century as a result of falling petroleum revenues and rising expenditure on pensions and health care services. Part of the savings accumulated through the Government Petroleum Fund shall contribute to covering this expenditure.

The main features of fiscal policy in 2000 are:

- A neutral fiscal policy stance, measured by the change in the non-oil, cyclically adjusted budget surplus net of interest payments.
- An increase in real terms in tax and excise payments of a little more than NOK 1.9 billion from 1999 to 2000, including chan-

Public finances

Chart 1 Non-oil cyclical adjusted surplus net of interest payments. Change from previous year. Per cent of mainland GDP

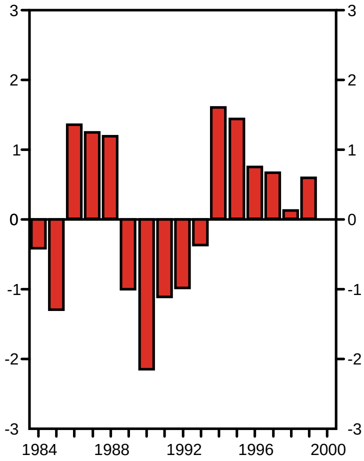


Chart 2 Fiscal Budget's real underlying spending growth and growth in mainland GDP. Percentage change from previous year

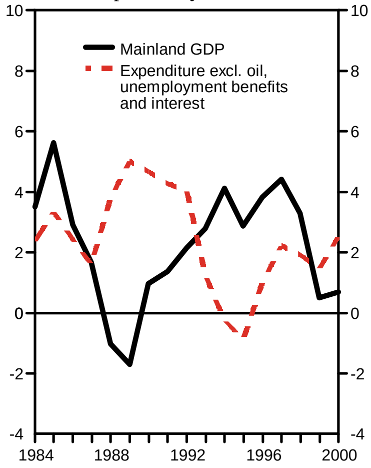


Chart 3 General government net lending. Per cent of GDP

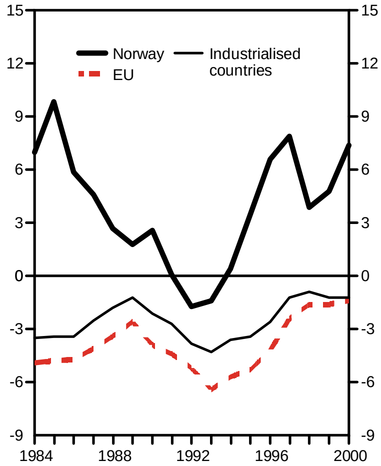
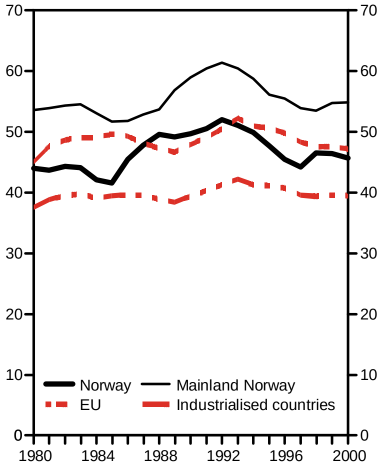


Chart 4 General government expenditure. Per cent of GDP



[1]) Fiscal Budget expenditure adjusted for expenditure on petroleum activities, unemployment benefits and interest.
Source: OECD, Statistics Norway and Ministry of Finance

Table 2 Central and general government net lending. NOK million

	1998	1999	2000
Fiscal Budget surplus	÷395	0	0
+ Surplus in Government Petroleum Fund	34 164	38 492	79 238
+ Surplus in other central government and social security accounts	6 870	3 931	2 676
+ Definitional differences between central government accounts and national accounts[1])	941	3 815	10 425
+ Direct investments in state enterprises	13 086	12 420	2 849
= Consolidated central government net lending	54 666	58 658	95 189
+ Local government surplus	÷4 985	÷3 363	÷3 248
= General government net lending	43 312	55 799	91 361
Per cent of GDP	3.9	4.8	7.4

[1]) Including consolidated and central government accrued, unrecorded taxes.

Source: Statistics Norway and Ministry of Finance.

ges in the child benefit scheme. Accrued taxes and excise duties, including changes in the child benefit scheme, are estimated to rise by a good NOK 2.9 billion.

– A real underlying growth in Fiscal Budget expenditure of 2½ per cent in 2000 measured in relation to the estimates for the 1999 accounts. Measured in relation to the approved budget for 1999, real spending growth is estimated at 3½ per cent. When calculating underlying spending growth, Fiscal Budget expenditure on petroleum activities, interest and unemployment benefits is excluded. In addition, extraordinary expenditure and any special accounting factors are excluded in order to make the figures on expenditure in 1999 and 2000 comparable.
– The non-oil Fiscal Budget deficit is estimated at NOK 13.3 billion in 2000. It is proposed that this deficit be covered through a transfer from the Government Petroleum Fund.
– Based on an assumption of an average oil price of NOK 125 per barrel in 2000, the central government's net cash flow from petroleum activities is estimated at NOK 85.1 billion. The net allocation to the Government Petroleum Fund, after the non-oil deficit has been covered, is estimated at NOK 71.8 billion. In addition, interest and dividends on accumulated capital in the Petroleum Fund are projected at NOK 7.4 billion,

giving a total surplus on the Fiscal Budget and Petroleum Fund of NOK 79.2 billion.
- General government net lending, as defined by the Maastricht-criteria of a deficit of 3 per cent of GDP, is estimated at NOK 91.4 billion, or 7.4 per cent of GDP.

2.2 Implementation of fiscal policy in 1999

The Revised National Budget for 1999 showed a non-oil budget deficit (estimates for the accounts) of NOK 10.9 billion. As a result of the Storting's deliberations on the Revised National Budget, the non-oil deficit increased by NOK 0.4 billion, to NOK 11.3 billion. Since the Storting's deliberations on the Revised National Budget, the following changes have taken place:

- Tax and excise receipts from the mainland economy are now expected to be NOK 0.7 billion lower in 1999 than the estimate in the Revised National Budget.
- Net interest income is expected to be NOK 0.5 billion lower.
- Income from the sale of shares in Den norske Bank of about NOK 3 billion is postponed from 1999 to 2000. This is a pure accounting change that has no impact on activity in 1999 or 2000.
- Estimated expenditure on unemployment benefits is reduced by NOK 0.2 billion as a result of lower-than-expected unemployment.

On the basis of these changes, the non-oil Fiscal Budget deficit is now estimated at NOK 15.4 billion in 1999, representing an overall increase of NOK 4.1 billion in the deficit since the deliberations on the Revised National Budget.

With an oil price of NOK 125 per barrel, the central government's net cash flow is estimated at NOK 47.6 billion in 1999, i.e. an upward revision of about NOK 9.9 billion since the presentation of the Revised National Budget. The allocation to the Government Petroleum Fund, excluding the Fund's interest income and dividends, is estimated at NOK 32.2 billion after the non-oil deficit has been covered. Including interest and dividends of NOK 6.3 billion on accumulated capital in the Petroleum Fund, the total surplus on the Fiscal Budget and Government Petroleum Fund is estimated at NOK 38.5 billion in 1999. The market value of the Petroleum Fund is estimated at about NOK 209 billion at the end of 1999.

2.3 Fiscal Budget for 2000

The proposals in the Fiscal Budget result in a total surplus on the Fiscal Budget and Government Petroleum Fund of NOK 79.2 billion in 2000, which is an increase of about NOK 40.7 billion compared with estimates for the 1999 accounts. The increase in total surplus primarily reflects higher revenues from petroleum activities. The central government's net cash flow from petroleum activities is estimated to rise from NOK 47.6 billion in 1999 to NOK

Table 3 Key figures for the Fiscal Budget (incl. Social Security) and Government Petroleum Fund. NOK billion. Accrued values

		1998	1999	2000
	Total revenues	471.3	493.8	547.5
	Revenues excl. petroleum activities	398.7	417.6	441.9
	Taxes and excises, Mainland Norway	357.4	377.2	392.2
	Other revenues	41.3	40.4	49.7
	Revenues from petroleum activities	72.6	76.1	105.6
	Total expenditure	443.7	461.6	475.7
	Expenditure excl. petroleum activities	416.1	433.0	455.2
	Purchase of goods and services	102.3	101.0	104.2
	Transfers	313.8	332.0	351.0
	Expenditure on petroleum activities	27.6	28.5	20.4
	Surplus before transfer to the Government Petroleum Fund	27.6	32.2	71.8
÷	Revenues from petroleum activities	45.0	47.6	85.1
=	Non-oil budget surplus	÷17.5	÷15.4	÷13.3
+	Transfer from the Government Petroleum Fund	17.1	15.4	13.3
=	Fiscal budget surplus	÷0.4	0.0	0.0
+	Net transfer to the Government Petroleum Fund	28.0	32.2	71.8
+	Dividend and interest on the Government Petroleum Fund	6.2	6.3	7.4
=	Fiscal budget surplus and the Government Petroleum Fund	34.2	38.5	79.2

Source: Ministry of Finance.

85.1 billion in 2000, i.e. an increase of NOK 37.5 billion. A projected reduction in the non-oil budget deficit of NOK 2.1 billion, from NOK 15.4 billion in 1999 to NOK 13.3 billion in 2000, will also contribute to increasing the total surplus for the Fiscal Budget and the Government Petroleum Fund. Interests and dividends in the Petroleum Fund are estimated to rise by NOK 1.1 billion to NOK 7.4 billion in 2000.

The Fiscal Budget entails real underlying spending growth of 2½ per cent compared with estimates for the 1999 accounts. When calculating underlying spending growth, Fiscal Budget expenditure on petroleum activities, interest and unemployment benefits are excluded. In order to make expenditure in 1999 and 2000 comparable, extraordinary expenditure and any special accounting factors are also excluded.

In the budget for 2000, the Government has given priority to the following areas:

- Expenditure on development aid will be increased from 0.88 per cent of GNI in 1999 to 0.89 per cent of GNI next year.
- The reforms in the health and care sector will be followed up through higher appropriations.
- Hospital treatment will be increased through performance-based funding.
- Appropriations for research and education will be increased. Efforts will be focused, among other things, on information and communication technology.
- An independent right to paternity benefits is being proposed. Moreover, the Government is proposing measures that will contribute to the establishment of 6 000 new day-care places in 2000.
- The Government increases its efforts on regional policy, i.a. by promoting knowledge based industries in rural areas.

In order to create scope for increased appropriations for high-priority areas within the framework of a sound fiscal programme, the Government has found it necessary to propose a moderate increase in taxes and excise duties. The tax and excise proposals for 2000 entail an increase in real terms of about NOK 1.9 billion in tax and excise payments from 1999 to 2000, including changes in the child benefit scheme. Accrued taxes and excise duties, including changes in the child benefit scheme, are estimated to increase by a good NOK 2.9 billion. In the tax and excise programme, emphasis is placed on environment and energy, a sound distributional profile and simplifications. The Government has proposed an increase in the excise tax on electricity, to bring about a better balance in the consumption of energy. This must be seen in connection with the Government's overall environmental policy, in which green taxes constitute an important element.

As a technical assumption, an average oil price of NOK 125 per barrel has been assumed for 2000, which is the same estimate as is now used for 1999. The central government's net cash flow from petroleum activities is estimated at NOK 85.1 billion in 2000, i.e. an increase of NOK 37.5 billion from 1999. The sharp growth is primarily ascribable to higher oil and gas production as well as lower investments. The total surplus on the Fiscal Budget and Government Petroleum Fund in 2000, including the Fund's interest income and dividends, is estimated at NOK 79.2 billion. The total capital in the Petroleum Fund is accordingly expected to rise to just above NOK 294 billion at the end of 2000.

Total general government net lending, or total financial saving in the central and local government sector, is assumed to rise from NOK 55.8 billion in 1999 to NOK 91.4 billion in 2000, equivalent to 7.4 per cent of GDP. The increase primarily reflects higher central government revenues from petroleum activities.

Gross debt, as defined by the Maastricht criteria, is estimated to increase from about NOK 280 billion in 1999 to about NOK 290 billion, corresponding to about 24 per cent of GDP, at the end of 2000. General government gross financial assets, however, are considerably higher than government debt so that net financial assets, including financial assets in the Petroleum Fund and direct investment in state enterprises, are estimated at about NOK 580 billion, or 47 per cent of GDP, at the end of 2000.

Charts 3 and 4 compare some key variables for the general government sector in Norway with equivalent figures on financial saving and expenditure levels in EU countries and the average for industrial countries (in the OECD area).

As a guideline for fiscal policy, real Fiscal Budget spending growth should not exceed mainland GDP growth in periods of strong economic expansion. During the sharp cyclical upturn in the period from 1993 to 1998, growth in Fiscal Budget expenditure was appreciably lower than the growth in mainland GDP, cf. Chart 2. General government expenditure in Norway, measured as a share of GDP, has in recent years been lower than the average for EU countries, but higher than the average for countries in the OECD area. Relatively low spending levels in countries like the US and Japan push down the average for the OECD area in relation to the average for EU countries. When comparing the level of general government expenditure, it must be taken into account that the countries' debt situation can vary considerably. For EU countries as a whole, high general government debt entails that interest expenditure account for a substantial share of general government budgets.

Whereas Norway has generally recorded substantial general government surpluses the last 15 years, the situation in the EU and in the OECD area has been marked by considerable budget deficits. The deficit for EU countries combined, however, was reduced from 6.4 per cent in 1993 to 1.6 per cent in 1998, partly as a result of adaptation to the Maastricht treaty's requirements. The high budget deficits in the EU and for industrial countries as a whole have resulted in a sharp increase in the public sector's net debt, cf. Chart 3. The net debt in EU countries combined is equivalent to about 57 per cent of GDP in 1999. By way of comparison, Norway's general government sector has positive net financial assets of more than 40 per cent of GDP.

2.4 Public finances in the medium term

Fiscal policy must have a long-term perspective. In addition to the calculations presented in Chapter 2.5, special emphasis is placed on monitoring developments the next few years. In connection with the Revised National Budget for 1999, the Government presented budget projections in the period to 2003. The calculations have now been updated based on the Government's Fiscal Budget proposal for 2000. For the years 2001–2003, these projections are of a technical nature and consequently do not reflect political priorities. The projections are based on the following assumptions:

- An oil price of NOK 120 per barrel (2000-prices) for the years 2001–2003.
- An underlying real growth in Fiscal Budget expenditure of 1 per cent per year.
- An unchanged level of direct and indirect taxes in real terms in the period 2001–2003.

Applying these assumptions, the non-oil budget deficit is estimated to increase from NOK 13.3 billion in 2000 to nearly NOK 25 billion in 2003. The increase is partly related to lower transfers from Norges Bank to the Treasury.

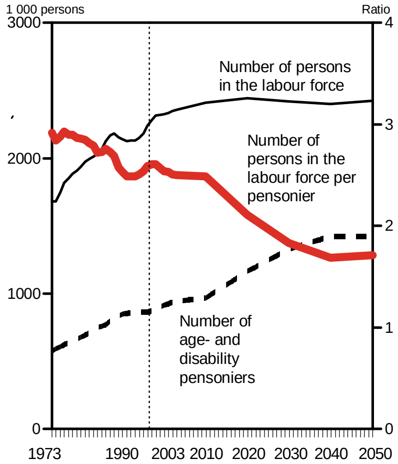
The central government's net cash flow from petroleum activities is estimated to rise from NOK 85.1 billion in 2000 to NOK 111 billion in 2003. The total capital in the Government Petroleum Fund is estimated at NOK 655 billion at the end of 2003.

General government net lending is estimated to increase from NOK 91.4 billion, or 7.4 per cent of GDP in 2000, to a good NOK 111 billion, equivalent to 8.1 per cent of GDP in 2003.

2.5 Long-term fiscal policy challenges

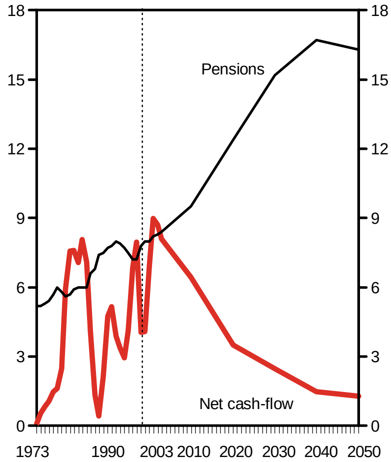
When evaluating the future challenges to fiscal policy, it must be taken into account that public finances in Norway are basically sound compared with most other countries. During the next century, however, the increase in the number of elderly in the population will put pressure on public sector budgets. The number of persons aged 67 and older today corresponds to 27 per cent of the number of persons in the labour force. This proportion is projected to increase to 43 per cent in 2050, reducing the number of economically active persons per pensioner. Central government expenditure on the National Insurance Scheme's old-age and disability pensions is estimated to increase from about 8 per cent of GDP in 2000 to a good 16 per cent of GDP in 2050. At the same

Chart 5 Pensioners and labour force



Source: Statistics Norway and Ministry of Finance

Chart 6 Government net cash-flow from petroleum activities and old age and disability pensions. Per cent of GDP



time, a sharp growth in the number of elderly over the age of 80 will require increased resources for nursing and care services.

A growing use of early retirement schemes may contribute to increasing the dependency burden. The formal pension age in the National Insurance Scheme is 67. The actual average retirement age, however, is considerably lower, and labour force participation among older age groups has fallen substantially the last few decades. Along with an increase in persons on disability pensions, this reflects a greater use of other early retirement schemes.

Substantial petroleum revenues entail that Norway is in a better position than most other countries to address the challenges associated with an ageing population. However, petroleum revenues are expected to fall early in the next century. As a result of higher expenditure on old-age and disability pensions and declining revenues from petroleum activities, fiscal policy will be facing considerable challenges in the long term. In periods of high petroleum revenues it is therefore necessary to set aside considerable capital in order to avoid a severe tightening of general government budgets later on.

The previous Government's Long-Term Programme for 1998–2001 outlined a *baseline scenario* where a sustainable public sector financial position was achieved with the level of taxes and transfers remaining unchanged and with public sector employment growing at a moderate pace. Compared with these estimates, the present value of the central government's net cash flow from petroleum activities has later been revised downwards, and the long-term development path for the Norwegian economy that was outlined in the Long-Term Programme now appears to be even more demanding. Growth in public sector employment cannot be achieved without a reduction in other general government expenditure or increase in revenues. The calculations indicate that, based on assumptions corresponding to those applied in the Long-Term Programme, a permanent improvement in the budget balance in the order of 1½ to 2 per cent of GDP is required in order to achieve the same long term growth in employment in public sector.

Generational accounts have been presented in National Budget documents in recent years. Updated calculations of generational accounts based on the Government's budget proposal now indicate that the budget balance for the general government sector should, on a sustained basis, have been in the order of NOK 5–20 billion (0.4–1.6 per cent of GDP) higher in order to avoid a higher tax burden for future generations.

In calculations of generational accounts, the distribution of total taxes and transfers between different generations is examined, and it is assumed that the net tax burden of subsequent generations should be the same. It is further assumed that this balance shall be achieved through a tightening of general government consumption. Both the calculation of generational accounts and other long term projections underscore that the expected high petroleum revenues the next few years should translate into considerable budget surpluses in order to secure generational balance and a long-term sustainable development path for the Norwegi-

Table 4 Generational Accounting in the EU. 1995

	Increase in all taxes necessary to restore balance[1]		Increase in all taxes necessary to restore balance[1]
Denmark	2.3	Germany	4.7
Finland	8.8	Great Britain	6.0
Sweden	7.6	Ireland	-0.1
Austria	6.5	Italy	4.0
Belgium	0.6	The Netherlands	2.5
France	2.6	Spain	5.1
Average in EU	4.2		
Norway	0.3		

[1]) Per cent of GDP

Source: European Economy, Reports and Studies (1999) and Ministry of Finance

an economy. The uncertainty associated with future petroleum revenues indicates, in isolation, that the budget balance should be strengthened further.

In recent years it has become increasingly common internationally to present calculations of generational accounts, although international comparisons of generational accounts place considerable demands on uniform procedures and definitions. Generational accounts have been established for 12 of the 15 EU countries during the past year, cf. Table 4. With the exception of Ireland, all countries need to tighten public finances, although this varies substantially across countries. Of the Nordic EU members, Denmark's tightening requirement is less than that of Sweden and Finland, partly because the latter two countries are facing a more pronounced ageing of the population than Denmark. The average tightening requirement for EU countries in the table corresponds to an increase in taxes of about 4.2 per cent of GDP.

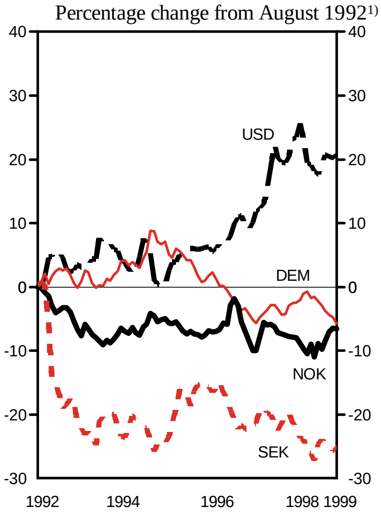
The assumptions concerning growth and interest rates deviate slightly from corresponding assumptions used for Norway. If the Norwegian calculations were based on the same assumptions and base year as those applied to the EU countries in Table 4, the generational accounts for Norway would show a tightening requirement in the order of 0.3 per cent of GDP in 1995.

Chapter 3 Monetary policy

Monetary policy is aimed at maintaining a stable krone exchange rate against European currencies. Given the division of responsibilities between the various economic policy components, fiscal policy has the primary responsibility for ensuring that changes in the total demand for goods and services are compatible with a balanced development of the Norwegian economy. Within the scope for manoeuvre set by a stable exchange rate, Norges Bank can adapt monetary policy instruments to cyclical developments. At the same time, monetary policy contributes to stabilising the Norwegian economy by providing a nominal anchor for income settlements.

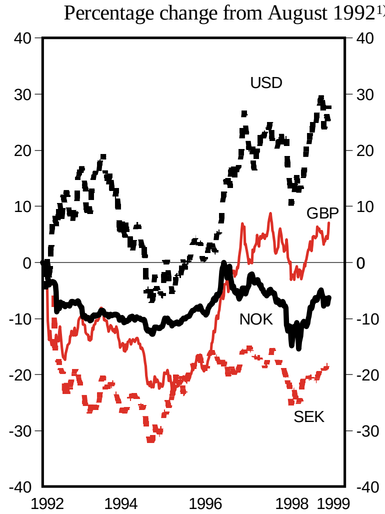
In the event of significant changes in the exchange rate, monetary policy instruments shall be oriented with the view of returning the exchange rate over time to its initial range. At the same time, there are limitations on Norges Bank's use of monetary policy instruments to maintain a stable exchange rate. This is an important difference from the fixed exchange rate regime that was in place until 10 December 1992. In principle, Norges Bank was then under an unlimited obligation to defend the established fluctuation margins for the krone exchange rate. The guideline concerning limited use of monetary policy instruments must be seen in the light of the experience of the fixed exchange rate regimes in Norway and other countries in the early 1990s. Perceptions that the use of monetary policy instruments in the form of interventions and the level of interest rates cannot be sustained, will undermine monetary policy credibility and may trigger speculative capital movements. Norges Bank must therefore continuously evaluate which use of monetary policy instruments that the Bank deems appropriate in the light of conditions in the foreign exchange market and the situation in the Norwegian economy.

Chart 7 Real effective exchage rates.
Percentage change from August 1992[1)]



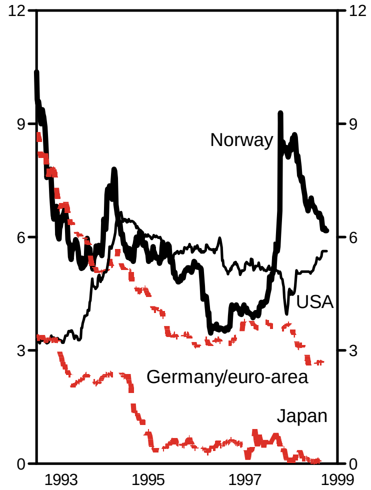
1) Monthly average.

Chart 8 Exchange rates against DEM/euro.
Percentage change from August 1992[1)]



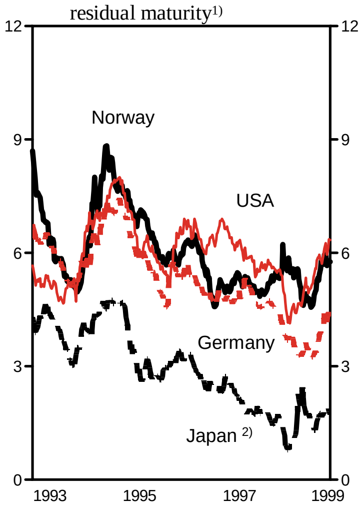
1) Weekly average up till September 17 1999.

Chart 9 3-month Euro-rates[1)]



1) Effective interest rates. Weekly average.
Feb. 1 1993 to Sept. 17 1999.

Chart 10 Government bonds with 5-year residual maturity[1)]



1) Effective interest rates. Weekly average.
Feb. 1 1993 to Sept. 17 1999.
2) 10-years residual maturity.

Source: OECD, Bloomberg and Norges Bank

The experience of both the period before the fixed exchange rate regime was abandoned in 1992 and later implies that there are limitations in the scope for managing the exchange rate in the short term. It is nevertheless important that monetary policy contributes to stable expectations concerning exchange rate movements. Economic policy as a whole must also be compatible with low price and cost inflation. With the objective of a stable exchange rate, fiscal and incomes policy must generally bear the main responsibility for stabilising growth in domestic production and demand.

So far in 1999, Norges Bank has lowered interest rates by a total of 2.5 percentage points, with its key rate standing at 5.5 per cent. At the same time, the krone exchange rate has appreciated, and since mid-August it has generally hovered between NOK 8.15 and NOK 8.35 against the euro. The Norwegian three-month money market rate stood at 6.0 per cent on 23 September, 2 percentage points lower than at the beginning of the year. The interest rate differential against corresponding euro rates was then 3.2 per cent.

Chapter 4 Incomes and employment policy

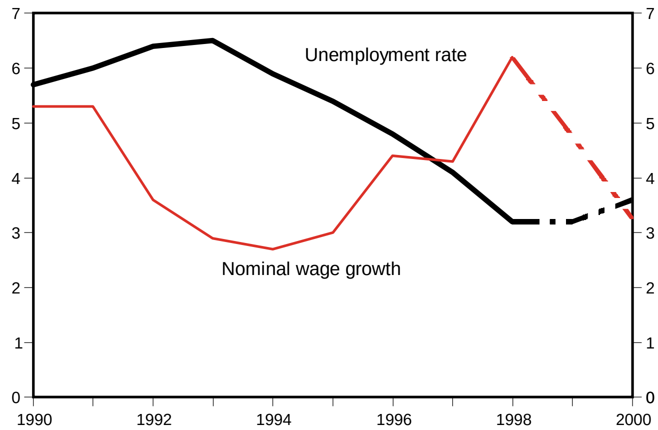
Incomes policy has been a key element of economic policy in the 1990s. As a result of this extensive social dialogue, efforts to combine strong employment growth with moderate price and cost inflation were successful for a long period during the cyclical upturn.

However, due to strong employment growth and a sharp fall in unemployment since 1993, incomes policy is now facing considerable challenges. Growing pressures in the economy, with a shortage of labour in many sectors, gradually resulted in higher wage growth. Last year wage growth in Norway was about twice the rate recorded by our trading partners. Against this background, the Government along with the social partners has taken an initiative to enhance co-operation in the area of incomes policy. As part of this strategy, a committee, with participation from the authorities and the social partners, was appointed to prepare for this year's income settlement (the Arntsen Committee). The committee agreed that wage growth in 1999 should not exceed 4½ per cent, and that as of next year it should be no higher than the level among our trading partners.

The results of this year's wage settlement have to a large extent been in keeping with the recommendations presented by the Arntsen Committee. This provides a sound basis for reducing average annual wage growth in 2000 to the same level as that of our trading partners. However, in the light of the tight labour market, it will be demanding to achieve this slower wage growth, cf. Chart 11.

In order to address the challenges to incomes policy, it is important that *employment policy* contributes to reducing imbalances in the labour market, particularly by alleviating the shortage of labour in some labour market segments. Placement assistance to job seekers and recruitment assistance to employers will be

Chart 11 Wage growth (annual rate) and unemployment rate (LFS)



Source: The Technical Reporting Committee on Income Settlements, Statistics Norway and the Ministry of Finance

used to ensure a good flow of labour from sectors and industries that are being scaled back to activities that are expanding. Active labour market measures are primarily focused on youth and the long-term unemployed.

Given the current situation in the labour market, employment policy must be oriented towards securing the supply of suitably skilled labour. An increase in unemployment in some geographical areas and industries, for example in the shipbuilding industry and other oil-related activities, can be countered by the demand for many of these workers in other parts of the labour market. An active use of labour market measures and intensified job placement efforts to find new jobs for those seeking employment will also remedy the situation. The labour market authorities will, in close co-operation with manufacturing industry, introduce training measures as part of the necessary adjustments.

The projected annual increase in the labour force over the next decade is limited to 0.4 per cent. In this situation, it is important to maintain high labour force participation and create conditions that allow the labour supply to be used as efficiently as pos-

Disability pensoniers

Chart 12 Number of new disability pensoniers

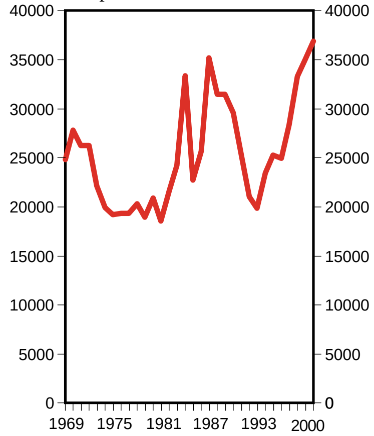
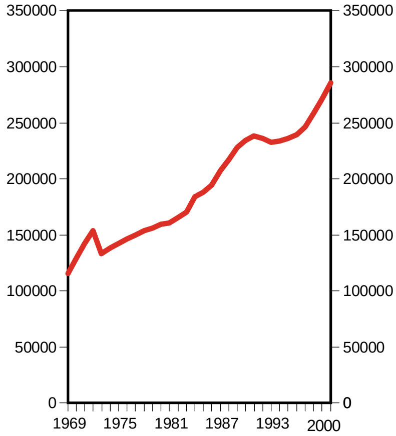


Chart 13 Number of disability pensoniers



Source: National Insurance Administration

sible. In the short term, this is important in order to counter pressures in the labour market and ensure that wage and price inflation is on par with that of Norway's trading partners. In the longer run, it is important to encourage high labour force participation in order to address the problems associated with an ageing population and increase the production potential of the economy.

The demand for labour in the health and social sector will increase considerably in the period ahead, partly as a result of an ageing of the labour force. This may lay claim to a substantial share of the projected increase in the labour force. In this situation the growth in the number of new disability pensioners and those making use of the contractual early retirement, cf. Chart 12 and chart 14, should be curbed and preferably reduced. At the same time, it is important to avoid reforms that contribute to reducing the labour force.

In order to increase the supply of labour, the Government will present a white paper to the Storting this autumn discussing a liberalisation of rules for hiring certain types of foreign labour.

The Government has put forward a proposition to the Storting that the prohibition of private job placement be abolished and that the Employment Act be amended to permit labour contracting. The aim of these measures is to contribute to a more flexible labour market.

Chapter 5 Industrial and Structural Policy

Structural policy shall contribute to achieving an optimal use of national resources. The efficient use of resources is important for maintaining high value added and achieving the growth potential of the economy. This provides the basis for developing the welfare system in Norway. At the same time, the pace and scale of structural policy measures must also be subject to distributional considerations. The effects on the environment and other public goods must also be taken into account when considering structural policy measures.

The authorities intervene in product markets in various ways:

- Effective *business legislation* is necessary to provide a stable framework for economic activity. Furthermore, it is important that laws and regulations are not so extensive and detailed that they impose unnecessarily high costs on enterprises.
- *Support to industries* can be used to promote research and development or other objectives in cases where there are no motives for the company to act fully in the best interest of society. Support to industries can also play an important role in fostering economic activity in the regions. However, it is important that various forms of support be evaluated in relation to the relevant objectives.
- *Competition policy* shall promote the efficient use of resources by fostering effective competition. It is often a demanding task for the competition authorities to determine whether the provisions of the Competition Act should apply in individual cases, for example when considering mergers that have positive effects in the form of cost reductions but negative effects in the form of reduced competition.
- In some cases it may be necessary to introduce separate *regulations* for the market to function effectively. Separate regula-

tions are, for example, necessary in the fisheries sector where various quota systems have been introduced to ensure the effective management of fisheries resources. In other sectors, the authorities play a supervisory role with regard to the conditions for the use of infrastructure used by the entire industry. This is the case, for example, in the telecommunications sector and the electricity industry. Public sector ownership is also considerable in some sectors.

The guidelines for *industrial policy* were presented in Report no. 41 to the Storting (1997–98) «Industrial policy into the 21st century». The objective of industrial policy is to generate higher value added in order to achieve the overriding objectives of welfare and employment.

Ownership and business structures have implications for competition, access to capital and expertise in business and industry. A large share of state ownership in the Norwegian business sector is historically based. Exposure to competition and technological advances has changed the operating conditions for many of the enterprises in which the state has ownership interests. State ownership interests in a number of companies have been reduced or share disposals are under preparation. Some companies have changed their legal form. The Government emphasises that the sale of ownership interests shall contribute to ensuring the continuation of the business, which implies that the new owner must be interested in and have the financial strength to develop the business in Norway.

The estimated *budgetary support to industries* was NOK 18.5 billion in 1998, or 1.7 per cent of GDP. The downward trend in support to industries in the 1990s continued in 1998. Between 1997 and 1998 the support was reduced by about 3.1 per cent. Whereas a small increase in support payments is expected in 1999, a decrease is expected in 2000. The variations in estimated support this year and in 2000 must be seen in connection with the projected changes in support payments to the shipbuilding industry, cf. below.

The calculations show that *agricultural* support accounted for about 67 per cent of total budgetary support to industries in 1998. Most of the support for the agricultural sector is channelled through the agricultural agreement. Like the total support to industries, agricultural support shows a downward trend. The estimates for 1999 indicate a break in this trend, which primarily reflects the agricultural settlement for 1998.

Support payments to the *fisheries sector* are estimated at NOK 273 million in 1998. Transfers through the fisheries agreement make up a large share of the support to the fisheries sector. Transfers channelled through this agreement have been reduced through the 1990s. In order to avoid unnecessary capacity expansion, support to the fishing fleet has in recent years been shifted away from support to new investment in vessels towards support for scrapping.

Support to *manufacturing, mining and private services* amounted to about NOK 4.8 billion in 1998, i.e. a reduction in real terms of 6.1 per cent from 1997. The support payments that target specific sectors have increased in the same period and accounted for about half of total support to the group manufacturing, mining and services in 1998. This is primarily due to the marked increase in payments of contract-related operating support to the shipbuilding industry. Support payments to the shipbuilding industry are expected to increase further, to almost NOK 2 billion in 1999, followed by a sharp decrease in 2000. On 25 March 1999 the Storting decided to increase contract-related operating support to the shipbuilding sector to the maximum allowed rates under the EEA Agreement. Under the existing EEA regulations applying to the shipbuilding industry, all operating support for contracts concluded after 1 January 2001 shall be discontinued.

Competition policy promotes the efficient use of resources by creating conditions for effective competition, among other things through rules and supervision. Competition legislation and the competition authorities' follow-up of this are therefore key elements of structural policy.

Experiences in connection with the Competition Act and the competition rules under the EEA Agreement have shown that there is a need to review Norwegian competition policy and Norwegian competition legislation. So far a proposal to introduce a number of immediate changes has been presented in Proposition no. 97 to the Odelsting (1998–99). Among other things, it is proposed that the Competition Authority be given authorisation to prohibit corporate acquisitions and take temporary measures that are considered necessary pending the Competition Authority's final decision concerning an acquisition. The purpose is to prevent the parties involved in an acquisition from integrating the companies concerned in such a way that it subsequently becomes impossible for the Competition Authority to rule against the acquisition in an effective way.

The proposition also calls for a broad review of competition policy, legislation and the competition authorities» organisation. The effectiveness of enforcement and control of anti-competitive behaviour must also be evaluated. It is necessary to evaluate whether the formulation of the Competition Act's prohibition and intervention rules is appropriate, whether the competition authorities have the necessary instruments of control and action and whether private parties are adequately protected against harmful anti-competitive practices. Furthermore, the applicability of the Competition Act in relation to the competition rules under the EEA Agreement should be evaluated.

Substantial changes have occurred in the *electricity market* in the 1990s. Under the new Energy Act, which was introduced in 1991, the electricity supply sector has changed from a sector that focused on meeting local electricity demand to a market where prices are determined by supply and demand. A market-based Nordic electricity exchange has emerged, and licences have been granted for additional cables for electricity trading with continental Europe.

In the spring of 1999, the Government presented a report to the Storting on energy policy, cf. Report no. 29 to the Storting (1998–99). It is stressed that electricity trading in the Nordic market and in northern Europe will have an increasing impact on developments in the Norwegian energy market. The prerequisite for paving the way for electricity trading is that production and consumption satisfy environmental policy requirements. It is particularly important that energy prices reflect environmental costs as far as possible.

The opportunity to switch from one supplier to another has steadily improved for end-users. From 1 January 1998, all end-users can switch supplier each week at no charge. The spread in the electricity price charged to households has been substantially reduced in recent years. This indicates that competition in the market is functioning even though the share of subscribers that switch suppliers is relatively small.

The telecommunications sector produces services using one or several networks. Technological advances have resulted in a broad range of new services. At the same time, high fixed costs in the industry have been reduced, providing the basis for introducing market-based competition in the telecommunications sector in a rapidly changing and expanding market. From 1 January 1998, the remaining exclusive rights in the telecommunications sector, which comprised general telecommunications infrastructure and speech telephony in the established transmission line network, were removed.

The Norwegian and Swedish Governments have signed an agreement on the merger of Telenor AS and Telia AB. The agreement stipulates that the merged company shall be partially privatised and listed on the stock exchange no later than in the year 2000.

The merger between Telenor and Telia is subject to a notification requirement under EU Council Regulation 4064/89 on merger control and is now being considered by the EU Commission. The Commission consults national competition authorities in such cases, which also have the opportunity to submit comments to the Commission. The Commission has the right to approve the merger with or without conditions and to prohibit it.

The Competition Authority has evaluated the effects of the merger on competition. It is the Authority's view that the merger will increase an already substantial restriction of competition in the Norwegian telecommunications market. In the view of the Competition Authority, the adverse impact on competition of any merger may, however, be countered if Telia's activities in the telecommunications market in Norway are sold to one or several operators that act independently of the merged parties.

On 15 June the Commission decided to carry out a more in-depth analysis of the merger between Telenor and Telia, bringing the process into phase two. The Commission's final decision is expected in October.

Over the last five years, the *civil aviation market* has changed from being a heavily regulated market to a competitive market, albeit with fairly dominant operators. This trend has occurred in pace with the gradual removal of flight service limitations for scheduled flights. SAS and Braathens continue to dominate the domestic market.

The opening of Oslo Lufthavn Gardermoen, the new international airport, has increased capacity primarily in the domestic market. In the autumn of 1998 the company Color Air was established with flight services between Oslo-Gardermoen and Ålesund, Trondheim, and Bergen, in addition to Oslo-London. Stronger competition may have contributed to reducing profits in airline companies.

A number of international alliances between airline companies have been established in recent years. The EU Commission has examined some of the agreements between European and US airline companies in relation to competition rules. All airlines that offer scheduled services in the EEA have group derogation from the EEA Agreement's competition rules. In 1999, this was extended to 30 June 2001. The group derogation may therefore, in isolation, contribute to weakening competition also for domestic flights.

Airline companies' bonus systems and business customer agreements influence the entry conditions in domestic markets. Combined with a high concentration, this means that competition must still be characterised as limited. However, the competition authorities are still of the view that the opening of the new international airport has increased flight services that have to some extent intensified competition.

Chapter 6 Pensions

In 1998, two official reports dealing with pension policy issues were submitted, NOU 1998:10 «Funding the National Insurance Scheme» and NOU 1998:19 «Flexible retirement». The background for the two reports is the demographic changes, with an increasing share of elderly in the population combined with higher average pension benefits. This will cause an increasing dependency burden over the next decades. This problem is enhanced by the growing tendency of early retirement. The total disbursement by the National Insurance Scheme on old age and disability pensions is estimated to increase from 8 per cent of GDP in 1995 to 15 per cent of GDP in 2030. At the same time, public finances will be strained by a gradual decline in petroleum revenues. In order to address these challenges and to maintain a high level of public services, a large share of current petroleum revenues must be set aside.

The Government will continue to work on these important pension policy issues during the period prior to the Long-Term Programme 2002–2005, which will be presented early in 2001. The Government has already followed up certain proposals in NOU 1998:19 regarding more short-term measures. In the National Budget 2000 additional measures are discussed, aimed at stimulating higher labour force participation among older workers.

Funding the National Insurance Scheme?

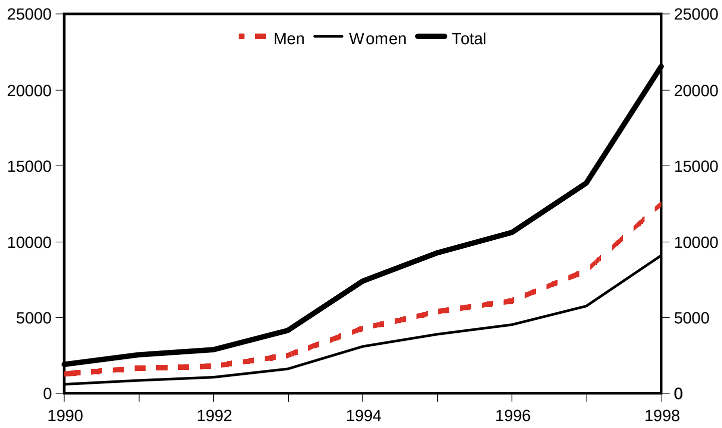
The Moland Committee was established by the Parliament to evaluate different funding strategies. It's report, NOU 1998:10, was presented in July 1998. The present policy entails that pensions are financed on a pay-as-you-go basis, while government financial savings are accumulated in a general purpose state fund, the State Petroleum Fund. The funding mechanism of the State Petroleum Fund reflects public savings. The Moland committee explored the creation of a public pension fund. The committee also explored funding through private pension funds, either benefits or defined contributions.

The main contents from NOU 1998:10, and the viewpoints of the consultative bodies are presented in the National Budget. It is the Government's view that funding parts of the National Insurance Scheme will not in itself solve the long-term challenges to public finances. The Government will, however, continue to work on these important pension policy issues during the period prior to the next Long-Term Programme. An assessment in the Long-Term Programme will take place within a comprehensive long-term economic framework, in which public supply of health and care services and educational services will be taken into account. The Government will, however, stress that the Government Petroleum Fund is an appropriate instrument for public financial savings and that the accumulation of reserves in the Fund reflects real public savings. A public pension fund may cause further commitments for fiscal policy in the years ahead.

Early retirement

The main challenge with an increasing dependency burden in Norway today is caused by the increased use of early retirement schemes in the past years, especially through the national Insurance disability pension scheme and the contractual early retirement scheme. Chart 14 shows the number of persons under the contractual early retirement scheme in the 1990s. Labour force participation rates among older age groups have fallen substantially over the last few decades. The labour force participation rate for the age group 64–66 declined from about 50 per cent in 1980 to just above 30 per cent in 1998. In the Government's view, the trend towards increasing early retirement cannot persist. The work following NOU 1998:10 and NOU 1998:19 is therefore focused at measures aimed at reducing the extent of early retirement.

Chart 14 Number of persons under the contractual early retirement scheme in the 1990s



Source: National Insurance Administration

At the same time, individual needs have to be taken into consideration. Some older workers are tired after a long career and may feel the need to retire before the age of 67. It is the Government's view that the pension schemes should be developed in order to provide for increased flexibility.

Following up the proposals in NOU 1998:19, the Government has proposed new rules for partial pensions under the contractual early retirement scheme. The Government has also proposed that persons receiving an early retirement pension no longer shall be permitted to earn increased pensions from private occupational pension schemes.

The Government is of the view that there are reasons to follow up the proposal from NOU 1998:19 to discontinue the arrangement involving the crediting of pension points in the National Insurance Scheme for pensioners under the contractual early retirement scheme from 2007.

Moreover, the Government will consider to follow up the proposal from NOU 1998:19 that until 2007 new early retirement pensioners are demanded to have at least two thirds pension in order to benefit from the tax exemption rule for pensioners. The same applies to the Committee's proposal that all new early retirement pensioners from 2007 no longer should be taxed according to the tax exemption rule, and that this should be applied to all age groups.

Pensioners under the contractual early retirement scheme receive a special supplement in addition to the ordinary pension, which is tax exempted for some groups. The Government considers a statutory amendment to make the special supplement to the early retirement pension taxable for all groups. The Government does not want to follow up the Committee's proposal to increase social security contributions on pensions from contractual early retirement pension schemes.

Businesses that want to reduce or reorganise the workforce can offer an early retirement pension from the employer to those willing to terminate their employment. The Government is of the view that a statutory amendment would be appropriate so that the contractual early retirement pensions is reduced by the same amount as the early retirement pension from the employer, as is the case today for disability pensions and unemployment benefits.

Under both public service and private occupational pension schemes certain occupational groups are subject to special age limits, entailing the retirement of a number of persons with a full pension before the general pensionable age of 67. In the public sector, about a third of the employees are subjected to these special age limits, whereas in the private sector the share is considerably lower. In addition, in the public sector, a special rule gives the employee the option to retire three years before the age limit if the sum of the age of the employee and the period of work amounts to 85 years or more.

In the NOU 1998:19 it is pointed out that several of the special age limits were set during a period when physical and mental job requirements were different from today and suggests that a special committee should be appointed to reassess the special age limits in both private and public sector. The Committee also proposed the 85-year-rule to be discontinued. The Government will continue to work on the proposals submitted by the Early Retirement Committee in NOU 1998:19 on these issues.

Chapter 7 Economic developments and prospects

Developments in 1999 and the prospects ahead point to a considerably slower growth rate in the *Norwegian mainland economy* in 1999 and 2000 than in the period 1993–1998. However, the situation varies in different sectors of the mainland economy. On the one hand, the production outlook in manufacturing appears to be weak, partly reflecting the projected contraction in petroleum investment this year and next. On the other hand, the growth outlook remains favourable for some private service sectors and other industries that primarily supply goods and services to the domestic market.

After six years of continuous robust growth, a cyclical peak was passed towards the end of 1998. In the period between 1993 and 1998, mainland GDP expanded by an average of 3.6 per cent annually. This is about one percentage point higher than average growth the last 25 years. The number of persons employed rose by a good 11 per cent from 1993 to 1998. Unemployment was reduced by almost half in the same period, falling to 3.2 per cent in 1998. The cyclical upturn was reasonably balanced for a long time, but pressures gradually emerged. Capacity utilisation was high in 1998 in all parts of the mainland economy. Pressures in the economy were most clearly evident in wage growth last year, which was about twice the level recorded by Norway's trading partners.

Developments through the end of 1998 and into 1999 indicate that pressures in the mainland economy have subsided. In particular, activity in some manufacturing sectors of the economy has levelled off as a result of lower demand for goods and services supplied to the petroleum sector. In other parts of the economy

Main indicators for the Norwegian economy

Chart 15 GDP. Volume indices. 1980=100

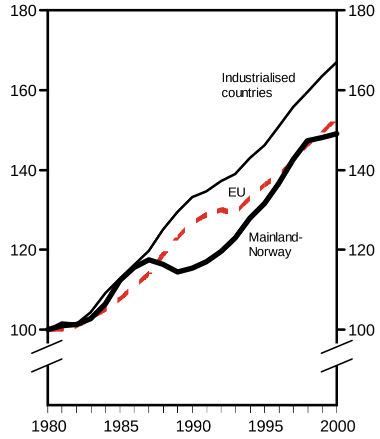


Chart 16 Unemployment rate

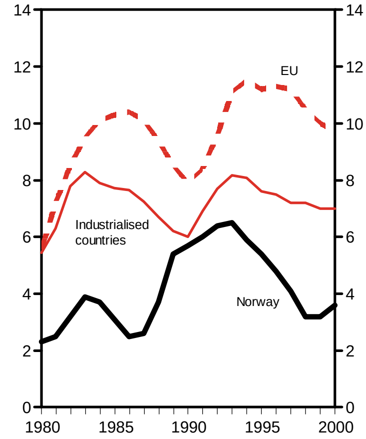


Chart 17 Consumer prices. Percentage change from same month the previous year

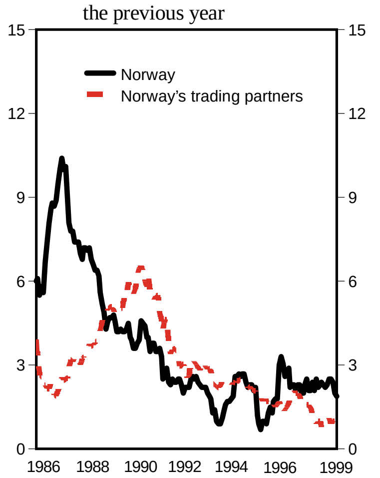
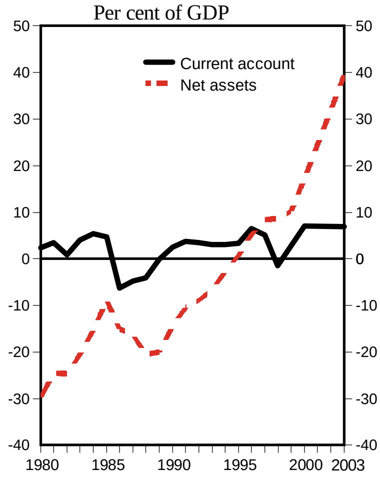


Chart 18 Current account of the balance of payment and net foreign assets. Per cent of GDP



Source: OECD, Statistics Norway and Ministry of Finance the situation continues to be characterised by high capacity utilisation and a shortage of labour. In the first half of 1999, mainland GDP was ½ per cent above the level in the first half of 1998.

Traditional merchandise exports have remained broadly unchanged since the fourth quarter of 1998, after expanding by an average of 3.4 per cent from 1997 to 1998. The substantially slower growth in exports may partly be seen in connection with lower growth among Norway's main trading partners. The prospect of higher growth internationally, however, may point to a pick-up in traditional merchandise exports through 1999 and next year.

Growth in private consumption has slowed the past year. Just as the increase in interest rates last autumn probably contributed to curbing consumption growth in 1998, the reduction in interest rates so far this year has stimulated the consumption of consumer durables. Expectations of further reductions in interest rates, a continued strong rise in prices for existing dwellings and growing optimism in the household sector point to continued growth in private consumption.

The slowdown in demand growth so far this year is reflected in a considerable decline in imports, particularly capital goods and intermediate goods. In the first half of 1999, the volume of traditional merchandise imports was 2 per cent lower than in the same period one year earlier.

Projections for 1999 and 2000

- *Private consumption* is projected to rise by 2¼ per cent from 1998 to 1999. Growth in household real disposable income is expected to slow from 4½ per cent in 1998 to about 2½ per cent in 1999. A projected decline in wage growth, combined with a fall in employment, is expected to contribute to a further deceleration in income growth next year. In the light of households' solid financial position, it is assumed that the decline in income growth will to some extent be countered by lower saving. Private consumption is projected to expand by 2 per cent next year.
- *Housing starts* were low throughout most of 1998. The sharp

rise in house prices and growth in new orders and order backlogs may imply that housing starts will pick up through 1999. Housing investment is projected to fall by 5¾ per cent in 1999 and increase by 2½ per cent in 2000.

- Following an average annual growth in volume of 13 per cent over the last five years, *mainland business investment* is estimated to decline by 8¼ per cent from 1998 to 1999. The latest investment intentions survey indicates that manufacturing investment may drop by more than 20 per cent. The completion of some major projects, such as the main airport at Gardermoen and the National Hospital, will also contribute to a contraction in investment. The need for capacity expansion has been reduced as a result of generally weaker growth in the economy. At the same time, corporate profitability was reduced through 1998. Higher commodity prices, falling interest rates and slower wage growth, however, imply that that this trend can swiftly be reversed. On the basis of the latest investment intentions survey for manufacturing, it is assumed that the fall in manufacturing investment will moderate as early as next year. All in all, mainland business fixed investment is projected to contract by 5 per cent from 1999 to 2000.
- The sharp rise in *petroleum investment* has been an important factor behind the growth in activity in the mainland economy the last few years. From the record-high level recorded last year, however, this investment is expected to fall by about 9½ per cent this year and by as much as 34 per cent in 2000. The decline in petroleum investment is expected to make a substantial negative contribution to mainland growth. As a result of the high level of investment in 1998, projects had to be postponed due to a lack of capacity in supplier industries. In the calculations, it is assumed that adjustments in supplier industries will partly offset the effects of a reduction in petroleum investment on the level of domestic activity.
- *Public consumption and investment* are projected to show a moderate increase of 1 per cent this year, after expanding by 3.6 per cent in 1998. The weaker growth primarily reflects lower investment. Public sector demand is estimated to increa-

se by a good 1 per cent from 1999 to 2000. The estimates must be seen in connection with the budget proposal, which is discussed further in Chapter 2.

- *Traditional merchandise exports* have increased at a very slow pace so far this year. The international outlook is now more positive than just a few months ago, a factor that points to higher export growth. All in all, traditional merchandise exports are estimated to increase by 1½ per cent in 1999 and by 4 per cent next year.
- The projections are based on technical assumptions concerning developments in the *krone exchange rate and interest rates.* Since the beginning of the year, the Norwegian krone exchange rate has strengthened against the euro from NOK 8.90 to 8.19 on 22 September. A substantial interest rate differential against the euro, the increase in oil prices, a weak euro against the US dollar and noticeably lower rise in costs have contributed to a stronger krone exchange rate. As a technical assumption, the krone exchange rate is assumed to remain stable in the period ahead. It is assumed that Norwegian interest rates will approach the European level in the course of 2000.

All in all, *mainland GDP* is projected to increase by ½ per cent from 1998 to 1999. As in 1999, it is assumed that private consumption will provide the strongest impetus to growth next year, while investment, particularly in the petroleum sector, is expected to generate substantial negative growth impulses. Higher growth in traditional merchandise exports is expected to boost growth in activity next year. Total GDP is estimated to increase by about 1 per cent in 1999 and by close to 3 per cent in 2000.

Employment growth now appears to have stalled following substantial growth in the period from 1993 to 1998. Growth through 1998 nevertheless entails that the number employed will still be considerably higher than one year ago. Whereas employment in business services and in the health and social sector has continued to increase, manufacturing employment has declined. Employment in the construction industry appears to have shown little change in recent months following pronounced growth the last few years. The Labour Market Administration's Business survey from May 1999 shows that there are still recruitment problems in the health and social sector, construction industry and some manufacturing sectors. The slowdown in growth in the mainland economy from 1998 to 1999, points to a moderate employment growth in the period ahead. After increasing by as much as 50 000 in 1998, employment is expected to rise by 7000 this year. Employment is projected to fall by 7000 next year.

The labour force expanded substantially in the period from 1993 to 1998, primarily as a result of higher participation rates, which last year reached the highest level ever recorded. In the first half of 1999, however, the overall labour force participation rate fell slightly compared with the same period last year. This may indicate that labour force reserves are now being exhausted. In addition to an increase in recruitment of foreign labour, increased immigration from abroad may have helped to cover labour requirements the last few years. In recent years, foreign labour has been particularly concentrated in the construction industry and some service sectors.

The decline in *unemployment* over the past six years now appears to have come to a halt, and so far this year unemployment has remained lower than assumed earlier. In the last three-month period to July, unemployment, measured by the labour force survey (LFS), came to a seasonally adjusted 2.9 per cent. As a result of noticeably slower employment growth, unemployment may edge up through the second half of this year. On an annual basis, however, average LFS unemployment is expected to be approximately the same as in 1998, i.e. 3.2 per cent. Unemployment is projected to increase to 3.6 per cent next year.

The rise in *consumer prices* has been moderate in recent months. The year-on-year rise in August of 1.9 per cent was the lowest recorded since December 1996. Consumer prices are now estimated to increase by 2.2 per cent from 1998 to 1999. Several factors imply that consumer price inflation will be moderate in the period ahead. The rise in import prices is expected to remain subdued next year, and lower wage growth points to a moderate un-

Table 5 Current account of the balance of payments. NOK billions

	1994	1995	1996	1997	1998	1999[1]	2000[1]
Exports	333.2	353.4	414.5	448.6	414.1	448.4	499.8
Goods	246.6	267.2	321.7	343.7	306.1	338.0	379.7
Of which:							
Crude oil and natural gas	106.4	156.7	156.7	163.7	118.3	150.9	181.6
Traditional goods	128.5	143.4	155.8	169.2	176.8	176.9	187.6
Services	87.6	86.2	92.8	105.0	108.0	110.4	120.1
Imports	279.2	297.7	327.1	371.5	411.6	397.4	395.5
Goods	197.7	216.9	242.2	266.4	296.0	280.5	276.5
Of which:							
Ships	8.0	6.3	6.3	14.0	13.3	9.1	9.1
Traditional goods	184.3	202.9	223.2	238.9	265.2	255.6	255.6
Services	81.5	80.8	84.8	105.1	115.6	116.9	118.9
Export surplus	54.0	55.8	87.4	77.1	2.5	50.9	104.3
Net interest and transfers from abroad	-27.6	-24.9	-21.4	-21.0	-18.7	-18.1	-16.9
Current account surplus	26.4	30.9	66.0	56.1	-16.3	32.8	87.4
Memorandum items							
Current account surplus, per cent of GDP	3.0	3.3	6.5	5.2	-1.5	2.8	7.1

[1]) Estimates.

Source: Statistics Norway and Ministry of Finance.

derlying rise in prices ahead. However, the excise programme in the Fiscal Budget for 2000 will, in isolation, push up the rise in prices by about a quarter percentage point next year. All in all, consumer prices are projected to rise by 2 per cent from 1999 to 2000.

As a result of strong pressures in the economy, *wage growth* in 1998 was as high as 6.2 per cent, cf. Chapter 4. Average wage growth is now estimated at about 4¾ per cent from 1998 to 1999, slowing to 3¼ per cent in 2000.

The *oil price* has risen sharply the last six months, partly because OPEC countries have largely observed the agreed production limits. On September 23 the oil price was about NOK 190 per barrel. An average oil price of NOK 125 per barrel is assumed in both 1999 and 2000.

Table 6 Key figures for the petroleum sector

	1998	1999[1])	2000[1])	2003[1])	Oil price sensitivity 2000
Assumptions					
Crude oil price, NOK per barrel	96	125	125	125	10
Production, mill. $Sm^3o.e$	223	232	271	275	
– Crude oil (incl. NGL)	179	184	213	210	
– Natural gas	44	49	57	65	
NOK billion					
Export value[2])	123.2	156.5	188.8	193.8	13.7
Accrued taxes and royalties[3])	18.5	25.5	43.9	46.5	6.3
Paid taxes and royalties[3])	27.6	20.1	35.1	47.3	3.2
Net cash flow[4])	45.0	47.6	85.1	110.9	9.5
NOK billion, 1996 prices					
Gross fixed capital formation in petroleum activities	74.6	67.4	44.4	53.2	
Direct import to petroleum activities	26.9	23.6	15.2	17.4	
Demand impetus on mainland economy	47.7	43.8	29.2	35.8	

[1]) Estimates.
[2]) Crude oil, natural gas and pipeline transport.
[3]) Sum of taxes, royalties, area fees and CO_2 excise tax.
[4]) Sum of paid taxes and royalties incl. CO_2 excise tax, dividends from Statoil and net cash flow from State Direct Financial Interest in petroleum activity.

Source: Statistics Norway, Ministry of Petroleum and Energy and Ministry of Finance

After showing a deficit in 1998 for the first time since 1989, the *current account* of the balance of payments is projected to show a surplus of close to NOK 32 billion this year. The current account surplus is estimated at NOK 88 billion next year. On an annual basis, net financial assets are estimated to increase by nearly NOK 24 billion from 1998 to 1999. Net financial assets are projected to amount to about 40 per cent of GDP at the end of 2003.

Risks to the forecast

The Norwegian economy is vulnerable to changes in the international economy, particularly in the oil price which is of considerable importance to government finances and the current account. However, there now appears to be less risk of a dramatic recession in the world economy and unstable financial markets as was the case in the summer and autumn of 1998. The uncertainty associated with economic developments the next few years is instead particularly related to the amplitude of the cyclical turnaround in domestic demand.

- Higher *wage growth* in the years ahead compared with the level assumed in this report, would erode the basis for growth in internationally exposed activities. As a result of low pay increases in the spring wage settlement, wage growth in 1999 will be lower than last year. The estimates are based on the assumption that wage growth in 1999 will be reduced to a level on a par with wage growth among Norway's trading partners, a little more than 3 per cent, as early as next year. However, continued strong pressures in the Norwegian labour market entail a risk that wage growth will not be reduced sufficiently in the years ahead.
- A *reduction in household saving* compared with the fairly high level in recent years will contribute to less balanced developments in sheltered and exposed sectors. A lower rate of growth in household income compared with earlier years points to a reduction in household saving the next few years. On other hand, demographic factors will, in isolation, contribute to a continued build-up of wealth in the period to 2010.
- Historically, changes in the cyclical situation can have a considerable impact on *business fixed investment.* Such effects can contribute to amplifying the reduction in the mainland growth rate the next few years. In the projections, it is assumed that the reduction in the mainland growth rate in the period to 2003 will to some extent be amplified by a reduction in the gross investment rate in mainland enterprises.
- *The decline in petroleum investment* entails a sharp fall in demand impulses for the mainland economy in 2000 and 2001. The uncertainty associated with changes in petroleum investment is considerable and investment plans may be adjusted substantially over time. For example, the sharp rise in oil prices so far this year may prompt some companies to move ahead some investment projects, thereby contributing to a somewhat steadier trend towards a lower level of investment activity in 2003.

Table 7 Key projections for 2000. Percentage change in volume from previous year

	Date of publishing	Private Consumption	Gross fixed capital formation Mainland Norway	GDP Mainland Norway	Consumer price inflation	Wage growth[2]	Employment	Unemployment[1]
Den norske Bank	Aug	2.4	÷0.1	0.8	1.7	3.5	0.1	3.6
Den norske Bankforening	Sep	2.4	1.7	1.6	2.0	..	..	3.4
Handelsbanken	Jul	0.9	÷4.8	÷0.1	2.3	4.0	..	4.5
Kreditkassen	Sep	2.5	÷1.7	1.0	2.1	3.7	..	3.6
Norges Bank	Sep	2	÷4½	¼	2	3¾	÷¾	3¾
OECD	May	1.8	..	0.5	2.3	..	÷0.1	4.0
Statistics Norway	Sep	2.4	÷1.5	1.0	2.0	3.5	0.2	3.5
Average		2.0	1.7	0.8	2.0	3.8	÷0.1	3.8
National Budget 2000	Oct	2.0	÷3.0	0.7	2.0	3¼	÷0.3	3.6

[1]) Per cent of the labour force.
[2]) Hourly wage growth.

Source: As indicated in the table.

In the Ministry of Finance's view, the projections in this report represent a reasonable balance between conditions that influence developments in the Norwegian economy. The Ministry of Finance's projections for the Norwegian economy are compared with estimates from other institutions in Table 7.