Preface

This publication contains a summary in English of Norway's National Budget for 2003, presented to the Storting as Report no. 1 (2002-2003) on 3 October 2002. 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 (chapter 1), structural policy (chapter 2) and the macroeconomic forecasts (chapter 3).

Royal Norwegian Ministry of Finance

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Minister of Finance
October 2002

1 Economic Policy

1.1 Introduction

The Government's *fiscal policy* will adhere to the guidelines for phasing oil revenues into the economy that were agreed upon when the Storting dealt with White Paper No. 29 (2000-2001). The guidelines require central government oil revenue spending to approximately correspond to the expected real return on capital in the Government Petroleum Fund. This entails a gradual increase of oil revenue spending via the fiscal budget, at the same time as the central government will maintain a substantial level of saving in the years ahead to cover future expenditures. This fiscal policy strategy is robust to possible oil price falls and will make for steady and prudent oil revenue spending in the years ahead, thereby avoiding precipitate economic adjustments.

The new guidelines for a gradual and sustainable increase in oil revenue spending constitute a medium-term anchor for fiscal policy. In this situation, *monetary policy* needs to underpin a stable economic development. Hence, the Government gives much emphasis to continuing the monetary policy that was drawn up in White Paper No. 29 (2000-2001) and received broad support in the Storting. The operational target for monetary policy is defined as an annual increase in consumer prices close to 2.5 per cent over time. Monetary policy shall be forward-looking and must pay due attention to the uncertainty in macroeconomic projections and assessment.

Fiscal and monetary policy must interact to a stabilize demand and production. The new policy guidelines imply that in most cases it is monetary policy that should react if the economic situation changes. Nevertheless, circumstances may arise where a more active fiscal policy is called for, either because capacity utilisation is very low or as a result of very high capacity utilisation in the economy.

In the long term, the development of welfare in Norway will be determined by the growth potential in the mainland (non-oil) economy. Oil and gas production will diminish in the decades ahead. Economic policy therefore needs to promote growth and productivity in the mainland economy, both in the public and private sectors. The Government will improve the regulatory framework for businesses, and ensure that the oil revenues are channelled into the economy in such a way as to promote growth. In keeping with this, the petroleum revenues should above all be used to reduce direct and indirect taxes and on other measures that enhance the economy's growth potential. A gradual reduction in the tax level could help to expand the supply of labour and improve utilisation of resources. This will also dampen pressures for adjustments prompted by higher oil revenue spending. Moreover, priority needs to be given to measures to improve infrastructure, enhance the knowledge base and promote technological progress with a view to support the business sector.

Rising prosperity, the ageing of the population and growing international integration tend to increase the pressure on the provision of public services. The *modernisation programme* for the public sector is a response to these challenges. *Employment policy* needs to be geared towards improving search activities in the labour market. A smoothly functioning wage formation system will help to keep unemployment low and labour force participation high. For a period of several years, wage growth has been significantly higher in Norway than among our trading partners. A key aim of the *income policy* is to avoid that an unsustainable trend in Norwegian labour costs seriously impairs the conditions for the exposed sectors of the economy. Responsibility for implementation of the income settlements rests, however, on the negotiating parties.

1.2 Fiscal Policy

1.2.1 Guidelines for Fiscal Policy

According to the guidelines drawn up in White Paper No. 29 (2000-2001), fiscal policy must:

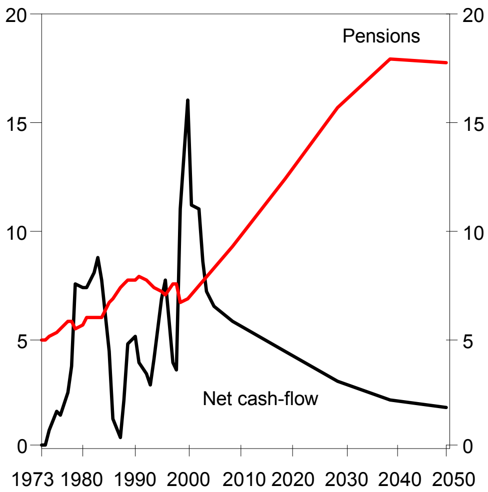
- make for a steady and sustainable increase in the use of petroleum revenues, approximately in line with expected real return on the Petroleum Fund.
- contribute to smoothing fluctuations in the economy to ensure sound capacity utilisation and low unemployment.

The current adoption of the fiscal policy guidelines is based on the following:

- For each fiscal year the structural, non-oil budget deficit should approximately correspond to the expected real return on the Petroleum Fund at the start of the fiscal year. The expected real rate of return is estimated at 4 per cent.
- The point of reference for the spending rule for oil revenues is a normal cyclical situation. In a situation of particularly high capacity utilisation in the economy, fiscal policy restraint should be shown, whereas in a cyclical downturn somewhat higher spending of oil revenues may be needed.
- In the event of extraordinarily large changes in the Petroleum Fund's capital or in factors influencing the structural deficit from one year to the next, any change in oil revenue spending should be smoothed over several years with a basis in the projected return on the Petroleum Fund some years ahead.

Oil and gas are non-renewable resources. Hence the current high receipts from the oil sector are to a large extent rents from the oil and gas resources. In order to benefit from the oil revenues in the long run, the use of these revenues must be separated from the oil revenue payments to the State. The fiscal policy guidelines serve this purpose. The net cash flow from petroleum activities is transferred to the Government Petroleum Fund, while only the real return on the Fund is actually spent. By adopting this strategy, the State will maintain a substantial level of saving in the years ahead. This is necessary in order to meet sizeable future expenditures on pensions, health etc.

Chart 1.1 *Government net cash-flow from petroleum activities and old-age and disability pensions. Per cent of GDP*



Source: Statistics Norway and Ministry of Finance.

Box 1 The structural budget balance

Under the fiscal policy guidelines, the use of petroleum revenues as measured by the structural, non-oil budget deficit equals the expected real return on the Government Petroleum Fund. An important rationale for linking the use of petroleum revenues to the structural, non-oil budget deficit rather than to the actual, non-oil deficit is to avoid a destabilising fiscal policy.

The non-oil budget deficit is affected the cyclical situation, other random factors and accounting changes. For example a cyclical downturn will tend to increase the non-oil budget deficit, while a cyclical upturn will reduce it. As a consequence, linking the non-oil budget deficit to the expected return on the Petroleum Fund would intensify the cyclical fluctuations in the economy. By gearing fiscal policy to a desired trend in the structural budget deficit, this type of detrimental effect is avoided by ensuring that the automatic stabilisers are allowed to work.

To move from the actual, non-oil deficit to the structural, non oil budget balance, corrections are made for the following, cf. table 3.3:

- Budget effects of tax-base divergences from trend levels and cyclical variations in unemployment.
- Transfers from Norges Bank and central government's net interest revenues in excess of trend levels.
- Accounting changes which do not affect the trend in the underlying budget balance.

Table 1.1 The Structural Budget Balance. NOK billion.

	2002	2003
Non-oil fiscal budget surplus	-42.3	-34.8
- Transfers from Norges Bank[1)]	4.4	-4.3
- Net interest payments from Norges Bank and abroad[1)]	-0.7	-1.1
- Extraordinary transfers	-21.8	0.0
- Cyclical corrections	3.4	1.3
= Structural budget balance	-27.6	-30.7
Memo		
In per cent of Trend GDP for Mainland Norway	-2,3	-2,5
Change from previous year in percentage points[2)]	-0.4	-0.1

1) In excess of trend.
2) Negative numbers indicate an expansionary budget.

Source: Statistics Norway and Ministry of Finance.

Given the projected development of the Petroleum Fund, the spending rule implies that oil revenue spending will rise in the next few years. However, as the petroleum reserves are depleted, the growth in the Government Petroleum Fund will come to a halt, and oil revenue spending will level off. At the same time expenditures on pensions, health and care provision will rise substantially over the next few decades. Calculations of the fiscal balance up to 2050 show that some years from now it will be necessary to curb the growth in spending or increase revenues. This will be necessary even if oil revenue spending is kept within the limits imposed by the spending rule. In light of the long-term challenges to fiscal policy, a central policy objective for the Government is to adhere to the guidelines established for spending the oil revenues and for management of the Petroleum Fund. Moreover, a responsible fiscal policy is crucial to stability in the money and foreign exchange markets.

Increased oil revenue spending will over time lead to adjustments and resource transfers from the exposed sector to sheltered industries. Hence, consideration for a balanced development of the economy, in which the exposed sector is maintained to a sufficient degree, also calls for a smooth and gradual introduction of oil revenues in keeping with the fiscal policy guidelines.

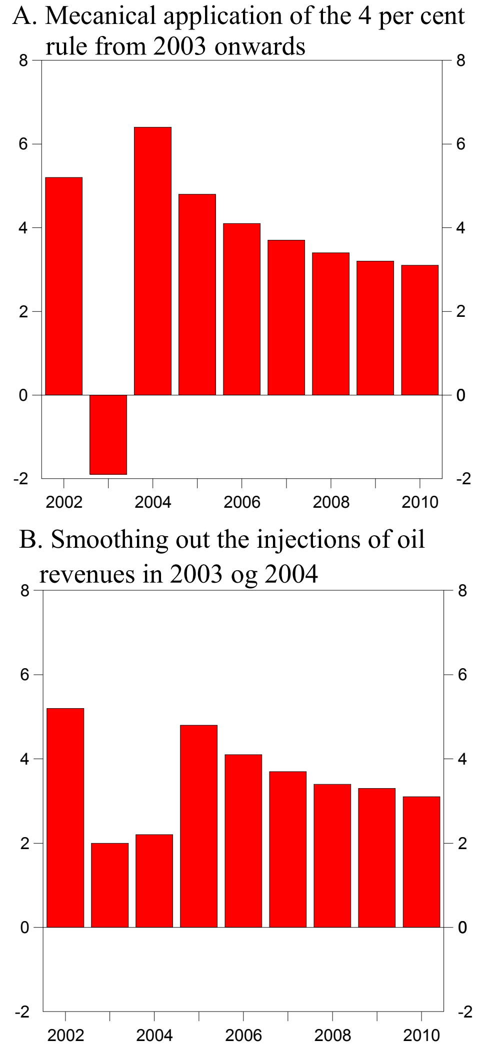
1.2.2 Fiscal Policy in 2003

In the Revised National Budget for 2002 the value of the Petroleum Fund at the end of 2002 was estimated at NOK 776 billion. A very weak equity market and a substantial appreciation of the Norwegian krone implied that the change in the capital of the Petroleum Fund in krone terms in the first seven months of the year was negligible, despite the addition of NOK 93 billion from the Treasury. The Fund's size at year-end is now estimated at about NOK 666 billion, i.e. about NOK 110 billion less than in the Revised National Budget for 2002. The appreciation of the krone explains more than half of this shortfall. However, although the value of the Petroleum Fund in krone terms is reduced when the krone appreciates, the Fund's international purchasing power is not affected. The expected return on the Government Petroleum Fund in 2003, calculated as 4 per cent of the capital in the Fund at the start of the fiscal year, is estimated at about NOK 26.6 billion, just over NOK 4 billion less than previously projected. By way of comparison, the structural deficit in 2002 is now put at NOK

28.7 billion, converted to 2003 prices. As these figures show, a mechanical application of the 4 per cent spending rule would have produced a decline in oil revenue spending from 2002 to 2003 of about NOK 2 billion, following an increase of more than NOK 5 billion in the current year. The expected increase in oil revenue spending in 2004 would have come to just over NOK 6 billion. Thereafter the annual increase in the use of petroleum revenues is projected to gradually decline to a level of about NOK 3 billion towards the end of this decade.

The possibility of wide variations in equity prices, oil prices and exchange rates was one of the reasons why White Paper No. 29 (2000-2001) underscored the necessity of spreading major changes in the phasing-in of petroleum revenues over time, based on the projected size of the real return on the Petroleum Fund some years ahead (cf. above). The aim was to move gradually to a long-term, sustainable level of oil revenue spending. Both short-term and long-term stabilisation needs suggest that a steady increase in oil revenue spending is preferable to a policy in which expansionary impetuses fluctuate widely from year to year. The guideline for fiscal policy accordingly indicates that the unexpectedly weak trend in the Fund's capital in 2002 should not be fully reflected in the fiscal policy programme for 2003, but should instead be smoothed out over time.

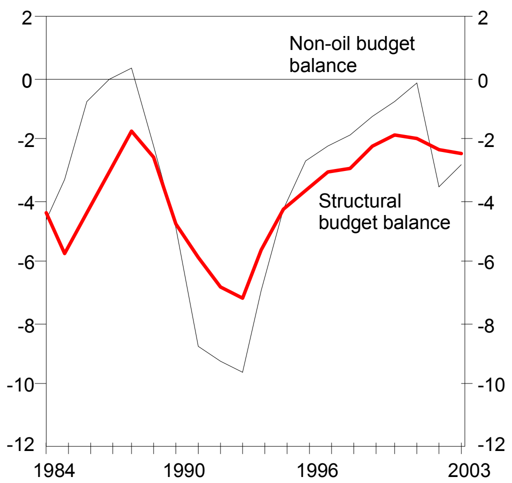
Chart 1.2 *The room for manoeuvre in fiscal policy. NOK billion*



Source: Ministry of Finance.

An overall assessment of the economic situation and of the prospects for the Norwegian economy does not argue against such a smoothing out on stabilisation policy grounds. Mechanically applying a rule to spend 4 per cent of the Petroleum Fund each year, would have produced a tighter budget in 2003, but followed by a correspondingly more expansionary budget in 2004. Since monetary policy is intended to be forward-looking and to aim for an annual rise in consumer prices close to 2½ per cent over time, interest rate setting has to take account of the overall increase in oil revenue spending in the years immediately ahead. Nevertheless, the present high interest rate and the strong krone exchange rate along with the associated impairment of competitiveness underscore the importance of curbing spending growth and of adhering to the Government's objective of a gradual reduction in overall tax level, within the room for manoeuvre provided by a steady phasing in of oil revenues into the economy.

Chart 1.3 *The non-oil budget balance and the structural budget balance. Change from previous year in per cent of trend-GDP for Mainland-Norway*



Source: Statistics Norway and Ministry of Finance.

Against this background, the Government presents a fiscal budget proposal entailing a real increase in oil revenue spending of about NOK 2 billion from 2002 to 2003. This makes room for a similar increase in 2004. The fiscal impulse is clearly lower than in the current year and lower than the projected increase in the use of oil revenues in the years 2005-2010.

The main features of the budget can be summarised as follows:

- A real increase of about NOK 2 billion in the use of petroleum revenues as measured by the structural, non-oil budget deficit. This entails a structural deficit of NOK 30.7 billion in 2003. In terms of trend GDP for Mainland Norway, the structural deficit will rise from just over 2.3 per cent in 2002 to close to 2.5 per cent in 2003, i.e. by a good 0.1 per cent of mainland trend GDP.
- A real, underlying growth of about ½ per cent in fiscal budget expenditure from the 2002 accounts. With the approved budget for 2002 as a point of reference, the real, underlying expenditure growth is about 2 per cent, corresponding to about NOK 10 billion. For 2002 and 2003 combined, real expenditure growth can be estimated at an average of 1½ per cent per year, i.e. somewhat less than the real growth in mainland-GDP.
- A reduction of about NOK 10.6 billion in direct and indirect taxes compared with a prolongation of the rules for 2002. Of this figure, about NOK 10 billion is a consequence of decisions made in the 2002 budget, while about NOK 600 million refers to new tax measures.
- The fiscal budget's non-oil deficit in 2003 is estimated at NOK 34.8 billion. The non-oil deficit is met by a corresponding transfer from the Government Petroleum Fund.
- Assuming an average oil price of NOK 180 per barrel in 2003, the central government's net cash flow from petroleum activities is projected at NOK 172.8 billion.
- Net transfers to the Government Petroleum Fund, excluding transfers to the fiscal budget, are estimated at NOK 138.0 billion. Interest payments and dividends on accumulated capital in the Government Petroleum Fund come in addition. The overall surplus on the fiscal budget and the Government Petroleum Fund in 2003, including interest and dividend revenues accruing to

the Fund, are accordingly estimated at NOK 162.0 billion.

- Overall capital in the Government Petroleum Fund at the end of 2003 is estimated at about NOK 846 billion, compared with NOK 666 billion at the end of 2002.
- General government net lending is estimated at NOK 157 billion in 2003, equivalent to 10 per cent of GDP. Net lending corresponds to the surplus concept used in the Maastricht Criteria for government finances. General government net assets are estimated at about NOK 1195 billion or 76.5 per cent of GDP at the end of 2003.

Table 1.2 Key figures for the Fiscal Budget (incl. Social Security) and the Government Petroleum Fund. NOK Billion.

	2001	2002[1)]	2003
Total revenues	758.4	709.9	717.6
1 Revenues from petroleum activities	268.9	189.6	188.9
1.1 Taxes and excises	112.1	89.5	106.6
1.2 Other revenues	156.8	100.1	82.3
2 Revenues excl. petroleum activities	489.5	520.3	528.7
2.1 Taxes and excises, Mainland Norway	429.6	467.8	482.1
2.2 Other revenues	60.0	52.5	46.6
Total expenditures	516.8	582.6	579.6
1 Expenditures on petroleum activities	25.7	20.0	16.2
2 Expenditures excl. petroleum activities	491.2	562.6	563.5
Surplus before transfers to the Government Petroleum Fund	241.6	127.3	138.0
- Net cash flow from petroleum activities	243.2	169.6	172.8
= Non-oil budget surplus	-1.6	-42.3	-34.8
+ Transfer from the Government Petroleum Fund	0.4	42.3	34.8
= Fiscal Budget surplus	-1.2	0.0	0.0
+ Net transfer to the Government Petroleum Fund	242.8	127.3	138.0
+ Dividends and interest payments on the Government Petroleum Fund	17.2	22.3	24.0
= Fiscal Budget surplus and the Government Petroleum Fund	258.8	149.6	162.0
Memo:			
Market value of the Government Petroleum Fund at the end of the year	619.3	666.0	846.0
In per cent of GDP	41.0	43.7	54.2

1) Extraordinary repayment of local government debt in connection with the state's acquisition of the specialist health services increases the non-oil budget deficit by NOK 21.6 bn. in 2002.

Source: Ministry of Finance.

Table 1.3 Central and general government net lending. NOK million

	2001	2002	2003
A. Consolidated central government net lending	231 263	178 079	159 830
Fiscal Budget surplus	-1 231	0	0
Surplus in Government Petroleum Fund	260 055	149 582	161 964
Surplus in other central government and social security accounts	4 936	6 978	6 271
Definitional differences between central government accounts and national accounts[1)]	8 266	30 679	-7 337
Direct investments in state enterprises	-40 763	-9 160	-1068
B. Local government surplus	-5 157	10 546	-2 815
C. General government net lending (=A+B)	226 106	188 624	157 016
Per cent of GDP	15.0	12.4	10.1

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

Source: Statistics Norway and Ministry of Finance.

1.2.3 Fiscal Policy in the Medium Term

The guidelines for fiscal policy draw up a path for the budget balance in the years ahead in which the use of oil revenues is equal to the expected return on the Government Petroleum Fund. Calculations of the trend in the structural, non-oil budget balance and of the corresponding development in the capital in the Government Petroleum Fund for the period 2001-2010 are shown in Table 2.3. These calculations are based on two main assumptions:

-Lower oil prices together with declining crude oil production will reduce the state's net cash flow from petroleum activities from an estimated level of NOK 243.2 billion in 2001 to about NOK 119 billion in 2005 and about NOK 105 billion in 2010.

-A gradual increase in the use of petroleum revenues over the Fiscal Budget in line with the expected real return on the Petroleum Fund.

For the coming three years, these assumptions imply an average increase in the petroleum revenue spending of around NOK 3.5 billion per year, measured in 2003 prices. This is approximately on par with the projected average annual increase in the use of petroleum revenues in the following years up to 2010. The table shows that petroleum revenue spending will produce an annual demand stimulus equivalent to about 0.2 per cent of mainland trend GDP for the rest of this decade. In the longer term, the annual increase in the use of petroleum revenues will decrease further as the growth in the Petroleum Fund's capital gradually comes to a halt.

Table 1.4 Medium-term implications of the fiscal rule

	Structural budget deficit in 2003 prices. NOK billion	Structural budget deficit. Per cent of trend-GDP for Mainland Norway	Market value of the Government Petroleum Fund. Per cent of GDP
2001	23.4	1.9	41.0
2002	28.7	2.3	43.7
2003	30.7	2.5	54.2
2004	32.8	2.6	62.8
2005	37.7	2.9	69.2
2006	41.8	3.2	74.4
2007	45.5	3.4	79.7
2008	48.9	3.6	84.8
2009	52.2	3.8	89.4
2010	55.3	3.9	93.2

Source: Ministry of Finance.

1.3 Monetary Policy

A new regulation on monetary policy was established 29 March 2001. The new guidelines stipulate that monetary policy shall be aimed at stability in the internal and external value of the krone, contributing to a stable exchange rate.

In accordance with this, Norges Bank's implementation of monetary policy shall be aimed at maintaining low and stable inflation. The operational target is defined as an annual increase in consumer prices close to 2.5 per cent over time. Monetary policy shall be forward-looking, and direct effects on consumer prices stemming from changes in interest rates, taxes, excise duties and extraordinary, temporary disturbances, shall in general not be taken into consideration. It is expected that consumer price inflation, as a general rule, will be within a 1 percentage point deviation of either side of the target.

The monetary policy guidelines of 29 March 2001 assign to monetary policy a clear-cut role in stabilising economic developments. Low and stable inflation is important in ensuring stable production and employment and will also contribute to exchange rate stability over time.

Norges Bank lowered its key rate on one occasion in 2001, by 0.5 percentage points to 6.5 per cent on 12 December. That reduction was reversed at the executive board meeting on 3 July this year when the key rate was raised by 0.5 percentage points to 7 per cent. At the same time the Bank stated that, given an unchanged interest rate ahead, inflation was more likely to be higher than 2½ per cent than lower on a two-year timescale. Norges Bank largely justified the rate increase with reference to the outcome of this year's wage negotiations, and the bank also expects wage growth to remain high in the years ahead. The Bank left its key rate unchanged at its interest rate meeting on 18 September 2002. However, it revised its assessment of the risk picture ahead stating that, given an unchanged interest rate, inflation was just as likely to be higher than 2½ per cent as lower on a two-year timescale.

The value of the Norwegian krone has risen markedly in the last couple of years. In 2001 the krone's trade-weighted index value rose by 4 per cent, and so far this year by a further 8½ per cent. Last year's appreciation was related to the weakening of the Swedish currency. This year the Norwegian krone has appreciated against most currencies. Against the euro and the

Box 2 Regulation on Monetary Policy

Established by Royal Decree of 29 March 2001 pursuant to Section 2, third paragraph, and Section 4, second paragraph, of the Act of 24 May 1985 no. 28 on Norges Bank and the Monetary System

I

§1.

Monetary policy shall be aimed at stability in the Norwegian krone's national and international value, contributing to stable expectations concerning exchange rate developments. At the same time, monetary policy shall underpin fiscal policy by contributing to stable developments in output and employment.

Norges Bank is responsible for the implementation of monetary policy.

Norges Bank's implementation of monetary policy shall, in accordance with the first paragraph, be oriented towards low and stable inflation. The operational target of monetary policy shall be annual consumer price inflation of approximately 2.5 per cent over time.

In general, the direct effects on consumer prices resulting from changes in interest rates, taxes, excise duties and extraordinary temporary disturbances shall not be taken into account.

§2.

Norges Bank shall regularly publish the assessments that form the basis for the implementation of monetary policy.

§3.

The international value of the Norwegian krone is determined by the exchange rates in the foreign exchange market.

§4.

On behalf of the State, Norges Bank communicates the information concerning the exchange rate system ensuing from its participation in the International Monetary Fund, cf. Section 25, first paragraph, of the Act on Norges Bank and the Monetary System.

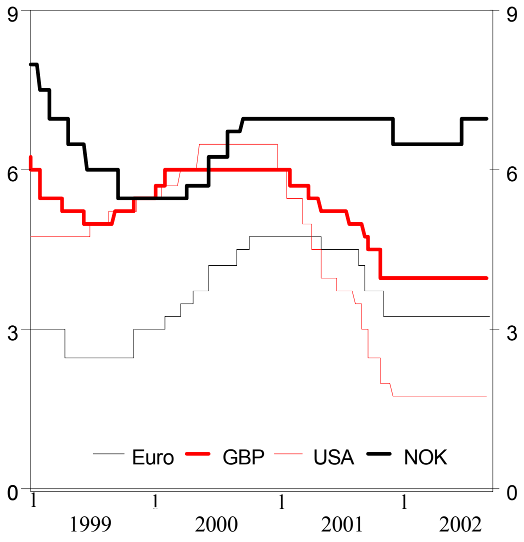
II

This regulation comes into force immediately. Regulation no. 0331 of 6 May 1994 on the exchange rate system for the Norwegian krone is repealed from the same date.

US dollar the krone has strengthened by 7½ per cent and 16 per cent respectively since year-end.

The krone appreciation may reflect the view the Norwegian economy is strong compared with other countries. Capacity utilisation is high, unemployment low and the petroleum revenues give sizeable surpluses in both the balance of payments and the fiscal budget. The petroleum revenues are essentially invested abroad by means of the Petroleum Fund. This is crucial to preventing fluctuations in oil revenues from directly spilling over into the krone exchange rate.

Chart 1.4 *Policy rates. Per cent*



Source: EcoWin.

1.4 The Government Petroleum Fund

The Government Petroleum Fund was established in 1990 when the Storting adopted the Petroleum Fund Act. The Fund's income is defined as the central government's net cash flow from petroleum activities, income from the sale of shares in Statoil and the return on the Fund's investments. The Fund's expenditure includes an annual transfer to the fiscal budget by virtue of a Storting resolution, equivalent to the non-oil fiscal budget deficit.

Norges Bank manages the Government Petroleum Fund in accordance with the guidelines provided by the Ministry of Finance. The capital in the Petroleum Fund is invested in equities and fixed-income instruments abroad. The equity share in the Fund is limited to 30-50 per cent and the Fund may be invested in 28 different countries.

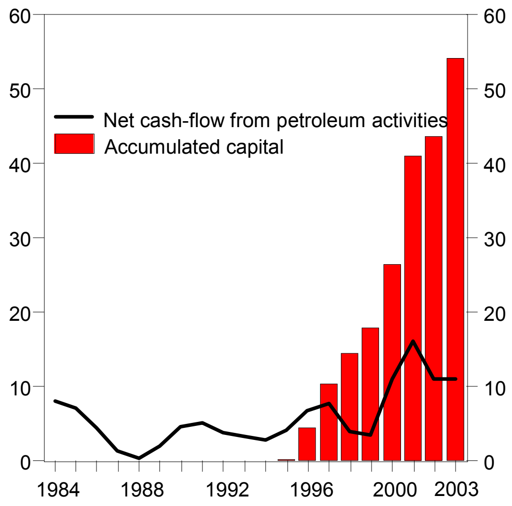
The value of the Government Petroleum Fund came to NOK 605.4 billion at end-June 2002. The Fund is estimated to increase to NOK 666 billion at the end of 2002 and NOK 846 billion at the end of 2003. Since the beginning of 1998, the Petroleum Fund's total cumulative return has been 20.0 per cent.

The Environmental Fund was established on 31 January 2001 with a capital of NOK 1 billion. At the end of January 2002 the capital was increased by another NOK 1 billion. The Fund is invested in companies that are considered to have little negative impact on the environment and in companies that satisfy defined criteria with respect to environmental reporting and certification.

In 2001, the Government established an exclusion mechanism for the Petroleum Fund, whereby the Ministry may exclude companies from the Fund's investment universe if investments in such companies are contrary to Norway's commitments under international law. The framework and procedures for such a mechanism are laid down in the Regulation for the Management of the Petroleum Fund.

The distribution of Petroleum Fund investments across Europe, the Americas and Asia was established in 1998 on the basis of a combination of import weights and global GDP weights. Compared to pure import weights, Europe received a lower weighting, while the Americas and Asia received a higher weighting. The Regulation for the Management of the Petroleum Fund specifies regional weights of 40-60 per cent

Chart 1.5 *Government net cash-flow from petroleum activities and accumulated capital in the Petroleum Fund. Per cent of GDP*



Source: Statistics Norway and Ministry of Finance.

for Europe, 30-50 per cent for the Americas and 10-30 per cent for Asia. The reference portfolio's regional weights were concurrently set at the mid-points in the respective intervals, i.e. at 50 per cent for Europe, 30 per cent for the Americas and 20 per cent for Asia.

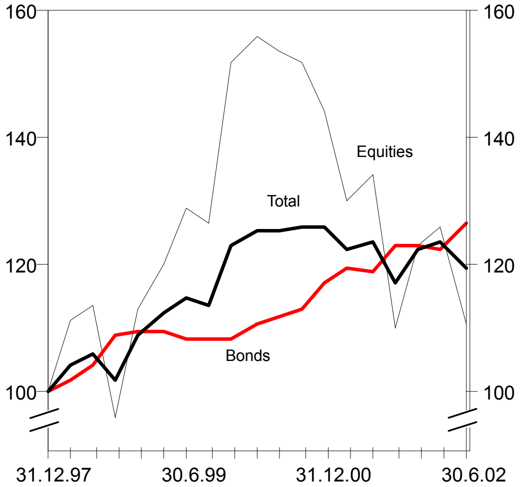
The Ministry of Finance decided in January 2002 to reduce the weighting for Asia in the Fund's reference portfolio for fixed income investments from 20 to 10 per cent, while the weighting for the Americas and Europe was revised up to 35 and 55 per cent respectively. The regulation is now being amended accordingly.

The Ministry of Finance plans to retain a 50 per cent weighting for Europe in the Fund's reference portfolio ahead. The ministry also recommends that fixed regional weights between Asia and the Americas should be dispensed with and that the distribution should be based on the market value weights in these regions as a whole. The Americas will accordingly receive a larger weight and Asia a smaller weight compared with the present regional weights for equities.

The regional distribution will be changed to the following weights in the Regulation for the Management of the Petroleum Fund:

Fixed income		**Equities**	
Europe:	45-65%	Europe:	40-60%
Americas	25-45%	Americas/	
Asia and Oceania	0-20%	Asia and Oceania	40-60%

Chart 1.6 *Accumulated return on the Petroleum Fund. 1 January 1997=100*



Source: Norges Bank.

The Storting adopted the following resolution in June 2002:

> "The Storting requests the Government to appoint a committee to submit recommendations for a set of ethical guidelines for the Petroleum Fund and to introduce a Bill in the spring of 2004. The committee should comprise persons with competence in international law, in addition to knowledge of ethical guidelines and specialist competence in the field of the environment and human rights."

The committee will be appointed by Royal Decree.

The committee should submit, in accordance with the Storting's resolution, recommendations for a set of ethical guidelines for the Petroleum Fund. Issues related to the environment, human rights, employee rights and governance and management of business enterprises are natural issues for assessment in this context. The committee is expected to present its recommendations by 1 June 2003, and the Government intends to submit proposals to the Storting in the Revised National Budget for 2004.

1.5 Tax Policy

A key aspect of the Government's economic policy is to reduce the tax level. The announced goal is to implement tax reductions of a total of NOK 25 billion, in addition to the removal of the investment tax, in the parliamentary period 2002-2005.

The importance of adhering to the Government's aim to reduce tax levels is underscored by the current high interest rates and strong krone exchange rate, which serve to weaken Norwegian firms' competitiveness.

In connection with the budget for 2002, the Government gained the Storting's support for changes which have improved the tax conditions for business activity. Overall tax reliefs adopted in connection with the budget and the Revised National Budget for 2002 totalled about NOK 10.6 billion (accrued) and just over NOK 6.3 billion (cash) in 2002.

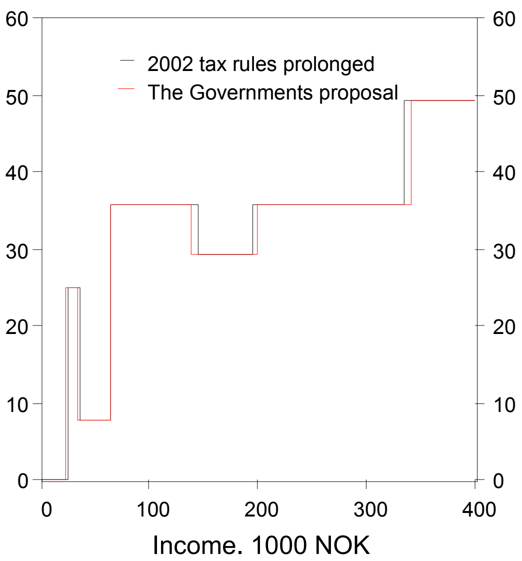
Tax reductions in 2003 will amount to just over NOK 6.4 billion (accrued) and about NOK 10.6 billion (cash) according to the Government's proposal. A substantial portion of the tax reductions is due to a carry-over from tax changes adopted in 2002 but whose full effect will first be felt in 2003. This includes the investment tax, which was removed from 1 October this year and therefore essentially reduces tax revenues in the budget for 2003.

The Government's proposal entails overall tax reductions of about NOK 17 billion (accrued) for 2002 and 2003, including NOK 6 billion from the removal of the investment tax. The Government plans to continue the gradual reduction of the tax level in the budgets for 2004 and 2005, with the emphasis on changes designed to benefit broad groups of taxpayers.

The main elements of the Government's proposal for tax changes for 2003 are:

- An increase in the threshold for the surtax from NOK 320 000 to NOK 340 700.
- An increase in the maximum basic allowance from NOK 43 000 to NOK 45 700.
- Tax exemption for employers' settlement of medical expenses and of medical treatment insurances for employees.
- An increase in the maximum allowance for trade union fees from NOK 900 to NOK 1100.

Chart 1.7 *Marginal Tax rates. Per cent*



Source: Ministry of Finance.

- The introduction of an allowance of up to NOK 6000 for gifts to voluntary organisations.
- A reduction of 5 per cent in assessed tax values for residential and recreational properties.
- An increase from NOK 70 000 to NOK 80 000 in the sea- and fishermen's allowance.
- An increase in the farmers' allowance for both 2002 and 2003.
- An extension of the tax credit arrangement for R&D to include all firms.
- An adjustment of value added tax on alternative medical services, marina mooring places and renewable energy sources in northern Norway.
- The introduction of environmental tax on HFC and PFC greenhouse gases.
- Changes in the tax on final waste disposal in order to better target environmental goals.
- Removal of a number of tariff rates on agricultural goods and follow-up of WTO commitments regarding customs tariff reductions.

The Government has appointed a committee to consider changes in income and wealth tax and goals and principles for the tax system. At least one of the alternatives in the committee's recommendation must be revenue-neutral and one must contain an overall tax reduction of NOK 8-10 billion. The Government has also appointed a committee to report on solutions that ensure that the value-added-tax rules have a more neutral effect on local government purchases versus own production. The committees have been asked to deliver their reports in the course of 2002.

2 Structural Policy

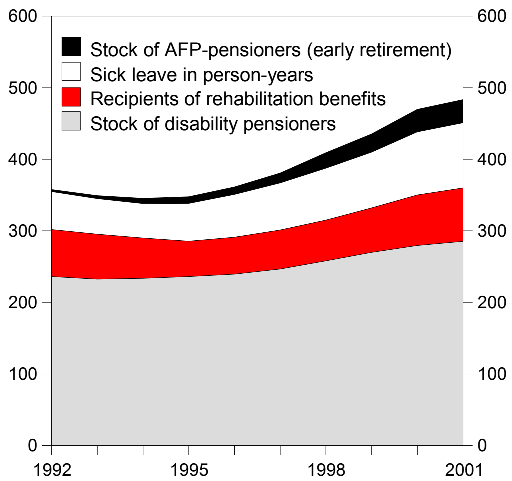
2.1 Labour Market Issues

Despite high labour force participation rates, the supply of labour has become a key constraint on growth, as evidenced by an extended period of low unemployment and real wage increases in excess of productivity growth. Consequently, a key priority for the Government is to prevent further reductions in participation rates related to early retirement and disability pension schemes as well to increases in sick leave. At least half a million people, equivalent to one sixth of the population of working age, are currently on various transfer schemes, cf. chart 2.1.

The Government proposes a number of measures designed to increase the supply of labour:

- A reform of the disability pension scheme was proposed by the Government in June 2002. A key element of this reform is the introduction of a temporary disability benefit. The benefit will be granted for a period of one to four years and can be extended thereafter whereas permanent disability pension will only be granted to individuals evaluated as having no potential work capacity. In order to stimulate participation in rehabilitation programmes, the temporary disability pension will be 10 per cent lower than the support received while participating in such programmes.
- A tripartite agreement was concluded in October 2001 among the social partners and the previous government aiming at reducing sick leave, increasing employment among disabled persons, and raising the effective retirement age. The measures include voluntary company-level agreements between the employers and the National Insurance Authority. The Government will follow developments closely, in particular with regard to sick leave. A tightening of the sick leave benefit scheme will need to be considered if the rising trend in sick leave persists.
- As of 2002, the Immigration Act has been liberalised to attract highly skilled jobseekers from outside the EEA. The Government is considering ways to further

Chart 2.1 *Persons of working age on transfer schemes*



Source: The National Insurance Authority, Statistics Norway and Ministry of Finance.

liberalise the Immigration Act with respect to unskilled labour from outside the EEA.

- In June 2002, the Government proposed replacing the current cap on overtime per week and per four consecutive weeks by a less restrictive cap of 48 hours per week as an average over a period of four months.

Labour market policy will be geared to ensuring a quick return to employment for the unemployed and in such a way that it meets changing labour market conditions. Accordingly, in the fiscal budget for 2003, the Government proposes to reform the unemployment benefit scheme with a view to enhance the incentives for recipients to seek employment. As part of the reform, the maximum period for which an unemployed person can receive unemployment benefit is reduced from three to two years. Furthermore, the period in which the employer is liable to pay unemployment benefit for a temporarily laid-off worker is increased from three to 20 days. This is to ensure that temporary lay-offs are confined to situations where changes in output are the result of genuinely unexpected factors.

2.2 Product Market Issues

Measures to improve the functioning of the economy are designed to promote an efficient use of resources, and thereby strengthen the growth potential of the economy.

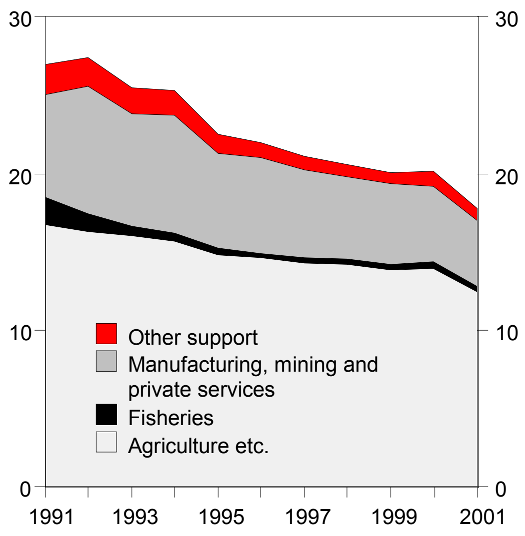
At the turn of the year 2001/2002 the Government initiated a *review of the general body of policy instruments* applied at businesses and industries. Greater emphasis will be given to general framework conditions whereas the direct policy instruments will be concentrated on areas where government measures can promote well-functioning markets.

Overall budgetary support to industries is estimated at NOK 17.8 billion in 2001, a reduction of 11.7 per cent from the 2000 level measured in constant prices. Schemes primarily *targeted at specific industries* constitute about 80 per cent of total budgetary support to industries, while general schemes make up a mere 20 per cent.

The *agricultural sector* received about 70 per cent of overall budgetary support in 2001. Over the past ten years the real value of budgetary support to this sector has been reduced by 25 per cent.

Budgetary support to *manufacturing, mining and private services* amounted to about NOK 4.2 billion in 2001, which is a reduction in real terms of 13.5 per cent from 2000. Support to the shipbuilding industry, which in recent years has constituted about 30 per cent of budgetary support to manufacturing and the services sector, was halved in 2001. This is due to reduced disbursements of contract subsidies to shipyards. As a result of the EEA regulations applying to the shipbuilding industry, all support for contracts was discontinued with effect from 1 January 2001.

***Chart 2.2** Budgetary support to industries. Tax concessions excluded. NOK billion. 2001 prices*



Source: Ministry of Finance.

Support payments to the *fisheries sector* are estimated at NOK 376 million in 2001. Support to this sector fell sharply in the years 1991 - 1994 as a result of reduced transfers via the fisheries agreement. Transfers via this agreement came to NOK 113.5 million in 2001.

The Storting has adopted a tax credit for firms' *research and development expenditures*, to apply with effect from 1 January 2002, which will replace the previous FUNN R&D grant system. Central government financing of R&D, including the tax credit scheme, is estimated to increase to NOK 12.2 billion in 2002. The tax credit scheme is extended to include all firms in the 2003 budget.

In 1995, the OECD launched a broad-based programme of regulatory reform – the OECD Regulatory Reform Programme. As part of this programme the OECD is currently conducting a review of regulatory reform in Norway. The Government's programme for modernisation, efficiency and simplification in the public sector largely mirrors regulatory reform programmes to be found in many other countries.

As a result of the EEA Agreement, two sets of *competition rules* have existed since 1994: the national Competition Act and the competition rules under the EEA Agreement. Both sets of rules are designed to ensure that commercial undertakings do not restrict or distort competition. The Norwegian authorities have appointed a preparatory committee to review Norwegian competition legislation and to table proposals for new rules by November 2002. In its initial report the committee proposed giving the Norwegian authorities responsibility for fully enforcing Article 53 of the EEA Agreement prohibiting anti-competitive practices and Article 54 prohibiting abuse of a dominant market position. Moreover, the committee recommends that a new Norwegian competition act should be drawn up on the basis of the model set out in the EEA Agreement's competition rules.

Public sector ownership in the Norwegian business sector is somewhat higher than in most other OECD countries. A large portion of government ownership is related to the depletion of natural resources, network industries with natural monopolies or regional policy considerations. In recent years, a number of companies have been converted to public limited companies, partially privatised, listed on the stock exchange and, in some cases, fully privatised. In White Paper No. 22 (2001-2002), "Reduced and Improved State Ownership", the Government drew attention to the benefits of reducing the State's ownership interests in a number of companies. Following the partial privatisation of Statoil and Telenor, the proportion of companies that are partially owned by the government is now much higher than the proportion of wholly-owned state companies. In accordance with the Storting's resolution on White Paper No. 22 (2001-2002), a preparatory committee will be appointed to address issues and give recommendations on improving the organisation and management of State ownership.

Extensive changes have taken place in the *electricity market*. The electricity supply sector has changed from a sector focusing on meeting local/regional demand for electricity to a market where prices are determined by supply and demand. In recent years there has been a tendency towards increased cooperation and mergers between energy companies as well as acquisitions of distribution companies and customer portfolios. Licensing rules for the hydro power sector, important elements of which are the State's pre-emption right and reversion of expired concessions to the State, affect power company sales and corporate structure in Norway. The EFTA Surveillance Authority (ESA) has asserted to the Norwegian authorities that conditions governing time-limited licences and reversion that differ according to the owner in question are in conflict with the EEA Agreement's provisions on free right of establishment and free movement of capital. In parallel with the ESA issue, the Ministry of Petroleum and Energy has considered whether equal treatment can improve competitive conditions in the electricity market. It turns out that the present licensing rules are far from optimal in the electricity market established by the Energy Act of 1990, since the system negatively affects both competition and efficiency in the electricity sector. Therefore, the Government is assessing the possibilities for, and consequences of, harmonising the licensing conditions applied to the State and private parties by maintaining reversion, but in an owner-neutral form.

Liberalisation of the *Norwegian telecommunications sector* has largely adhered to the schedule for deregulation laid down in the EEA Agreement. With effect from 1 January 1998, the remaining exclusive rights pertaining to general telecommunications infrastructure and speech telephony in the established transmission line network were removed. However, Telenor maintains a strong market position in most market segments. The White Paper No. 32 (2001-2002), "The Situation in the Norwegian Mobile Market", pointed to the apparently unsatisfactory competitive situation in the Norwegian mobile market, and examined policy instruments to strengthen competition. In December 2001, four nationwide licences were awarded for the establishment and operation of third-generation mobile communications systems (UMTS) in Norway. Following the bankruptcy of one of the licensees, the Government recommends reallocating the available licence by auction. The Government also advocates enabling telecommunications operators with a UMTS licence to collaborate on the development and operation of infrastructure for third-generation mobile telephony. The Ministry of Transport and Communications aims to introduce in the winter of 2003 a Bill on electronic communications to replace the existing Telecommunications Act. The Bill is in line with the EU's new body of rules in this sphere, and is expected to come into force in July 2003, at the same time as equivalent legislation takes effect elsewhere in Europe.

In recent years, the Norwegian *civil aviation market* has shifted from a market based on exclusive right to a regulated competitive market, but with a single dominant operator. On 23 October 2001 the Norwegian Competition Authority (NCA) approved SAS's acquisition of the other main operator of air services in Norway, Braathens. The SAS Group (SAS, Widerøe and Braathens) acquired a virtual monopoly in the Norwegian domestic market with a market share of 98 per cent. Norwegian Air Shuttle AS (NAS), a privately owned company, started servicing the major domestic routes in the autumn of 2002. The authorities have taken a number of steps to improve conditions for start-ups and competition in the domestic market. The air passenger duty was removed with effect from 1 April 2002. The NCA barred the SAS Group from offering its passengers bonus programmes on domestic flights with effect from 1 August 2002. The State has established new agreements with NAS to buy domestic air travel for civil servants with effect from 1 September 2002.

Norway is about to open the *railway network* to competition. Parts of the network will be opened to competition from 2004 onwards when selected sections will be put out to tender. In Norway, cross-border railway lines and most railway lines of importance have been opened to international goods traffic via voluntary European cooperation. With effect from 1 July 2002, NSB BA (Norwegian State Railways) was converted to a wholly state-owned limited company, NSB AS.

In June 2002, the EU adopted an amending Directive to the Postal Services Directive with regard to a further gradual and controlled opening to competition of the *postal services market* in Europe. The amending Directive is likely to be incorporated in the EEA Agreement and will in that case have to be implemented in Norwegian law. Posten Norge BA (Norway Post) was converted to a wholly-owned limited company, Posten Norge AS, with effect from 1 July 2002.

The Norwegian *pharmaceuticals* market is extensively regulated. A new Pharmacy Act came into force on 1 March 2001. The new Act opens the way for free establishment of pharmacies and removes the need for pharmacy owners to hold pharmacy qualifications. It also opens the way for generic replacement. However, brand-name manufacturers still appear to dominate the market, and at higher prices than the generic manufacturers. This indicates that there is a potential for increased generic replacement and lower prices. The Ministry of Health is to table a Proposition on the establishment of an index-price-based refund system for a selection of pharmaceuticals facing generic competition which, if passed, could take effect on 1 March 2003.

A special feature of the *fisheries industry* is the extensive regulations relating to business activities. There is currently surplus fishing capacity in relation to the available resource base in most areas. Regulations are needed in order to maintain sustainable stocks and ensure profitability in the industry. The formulation of some regulations, however, may cause value added in the fisheries to be lower than might otherwise have been the case. Establishment, ownership and production (catch quotas in the fisheries, feed quotas in fish-farming) are regulated in the fishery and aquaculture industries. Unit quota schemes have been introduced in order to adapt the ocean fishing fleet to the resource base. Such schemes enable fishing quotas for several vessels to be assembled on a single vessel for a limited period, provided other vessels are taken out of the fisheries. The Ministry of Fisheries has now circulated for comment a proposal for quota schemes for the coastal fishing fleet. The Government has also recommended the establishment of a structural fund in order to adjust the capacity of the fishing fleet. The fund is designed to ensure a stable supply of funds for condemnation purposes, thereby laying a basis for the requisite structural adjustment to include the coastal fishing fleet. Moreover, the legislation governing both fisheries and aquaculture is undergoing modernisation.

2.3 Public Sector Reform

The key policy instruments of the *Government's programme for modernising* the public sector are decentralisation and delegation within the central government, and decentralisation of tasks to the municipalities. The Government's main task consists in designing framework conditions that stimulate reform efforts at the local level. Modernisation is currently focusing on putting in place framework conditions which create incentives for increased user-orientation and for improved cost efficiency.

The public sector service providers in Norway are funded for the most part on a block grant basis. The Government is considering the introduction of *funding systems* in which the funds to a greater extent follow the user. This is with a view to widening consumer choice and establishing a level playing field in new areas. In order to contain the overall level of public expenditure, sound cost control needs to be given high priority when assessing various modes of funding.

Regardless of funding system, excess demand will exist in a number of areas unless demand is regulated via user payment. While user payment is relatively high within technical services, public transport, nursing homes and day care centres, user charges are generally low or non-existing in public health and education, including higher education.

High priority is given to scrutiny and strengthening of *regulatory agencies* in the reform effort and the Government intends to present a White Paper on regulatory agencies during the current year.

The principles underlying the disposition and treatment of the *fiscal budget* set important parameters for reform efforts at the local level. A committee is due to present, by 1 December 2002, recommendations on what changes should be made in the central government's budget and accounting principles. The committee is also considering the merits of multi-year budgeting in order to take better account of the characteristics of investment, adjustment and development projects that span several years.

The Government will this year publish a White Paper on merging the social welfare, labour market and social security agencies into a single body in order to improve the *co-ordination of public services.*

The Government is committed to a block grant system as the central source of *financing of local government.* Block funding with no earmarking enables municipal authorities to assign their own priorities as regards resource use. Furthermore, it gives the central authorities a good basis for cost control and macroeconomic management. Through adjustments in the framework conditions, the central government will facilitate cost-efficient funding of service provision at the municipal level.

Many municipalities are too small or sparsely populated for efficient markets to be established for municipal services or for economies of scale to be exploited. *Inter-municipal collaboration and municipal mergers* may in some cases make for more effective and efficient operations. The Government has proposed improved incentives for municipal mergers.

In conjunction with this year's wage settlement, steps were taken towards a more flexible *wage formation* both at central and local government levels. The Government will also work for more flexible rules for appointments and working time, and has already presented a proposal entailing a relaxation of the rules on overtime worked to the Storting, cf. above.

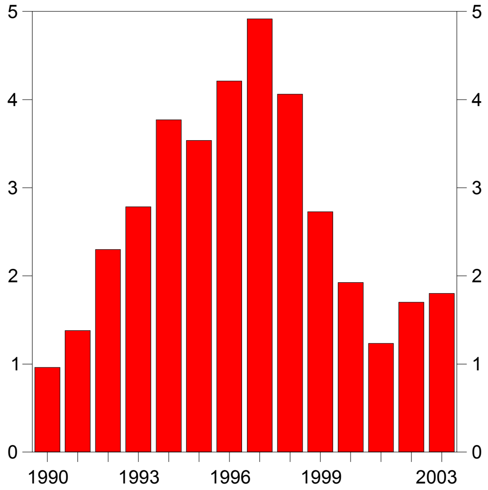
The Government gives particular priority to *public sector reforms* in the following areas:

- A committee will assess the content, quality and organisation of *primary schools.* Laws and rules will be simplified and the funding system will be evaluated. The Government also intends to make it easier to set up independent (private) schools in Norway.
- Reforms of *higher education* include a new degree structure, a results-based funding system, and new acts on state universities and colleges. A new financial support scheme will be introduced for higher education in the autumn of 2002 in which grants will partially depend on completion of the course in question.
- The *hospital reform* concentrates sectoral responsibility, funding responsibility and ownership in State hands.
- In the period 2002-2005 the *Norwegian Armed Forces* will establish a new forces structure that will substantially improve operational ability within a tighter funding provision.
- The *police reform* entails a significant reduction in the number of police districts with a view to achieving better

service provision for the public and greater cost-effectiveness.

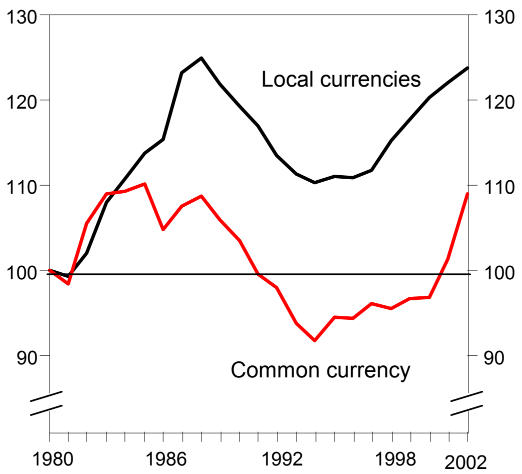
- The *courts reform* will reduce the number of court districts and courts of first instance.
- The *Public Roads Administration's* production operation is to be converted into a public corporation, and all Public Roads Administration contracts will be opened to competition.

***Chart 3.1** GDP for Mainland-Norway. Percentage change from the previous year*



Source: Statistics Norway and Ministry of Finance.

***Chart 3.2** Relative wage costs in manufacturing. Indicies 1980=100.*



Source: The Technical Reporting Committee for the Income Settlements and Ministry of Finance.

3 Economic Prospects

After strong expansion for much of the 1990s, the Norwegian economy has shown relatively moderate growth in the past couple of years. Preliminary national accounts figures suggest relatively weak growth in the mainland economy in the first half of the current year as well. However, a continued rise in household demand and higher oil investment are expected to push up growth somewhat ahead. The unemployment rate has risen slightly over the past year, especially in a number of private service industries. However, other parts of the labour market remains tight, contributing to the sizeable wage increases agreed upon in this year's wage round. Several years of high wage growth and a marked appreciation of the krone have impaired earnings in the exposed industries.

The growth prospects internationally have deteriorated somewhat in recent months. In the US, recent figures suggest that the upturn is weaker than previously anticipated. Moreover, declining confidence in accounting routines in major US corporations has kindled renewed disquiet in financial and foreign exchange markets. In Europe too, there are signs that growth is long in coming. Economic developments in Japan, however, have proved better than expected, thanks to higher growth in exports. All in all, international growth prospects appear to have weakened somewhat in recent months.

The *Norwegian economy* is affected by weaker international growth prospects, partly through lower export demand, falling share prices and increased uncertainty about the future. Moreover, the appreciation of the Norwegian currency has contributed to weak traditional merchandise exports in the first half-year, and a reduction in manufacturing output in the exposed sector. The number of bankruptcies rose substantially in the first half-year, particularly in ICT industries. The rise in house prices appears to be levelling off, and household consumption proved weak in the second quarter. However, buoyant income growth indicates that household consumption will pick up ahead. At the same time, oil investments look likely to exceed previous estimates, both this year and next. This has contributed to a pick up in overall manufacturing production in recent months, despite the decline in export-oriented industries. In addition, Statistics Norway's investment survey suggests substantial growth in investments in manufacturing and electricity supply this year. All in all, Mainland Norway GDP is projected to expand by 1.7 per cent this year and 1.8 per cent next year.

Norges Bank raised its key rate by 0.5 percentage points to 7 per cent in July this year, having lowered it by the same margin in December last year. Three-month money market rates have picked up somewhat so far this year to 7.0 per cent, while short rates in

Box 3 Strong productivity growth in the Norwegian economy in the 1990s

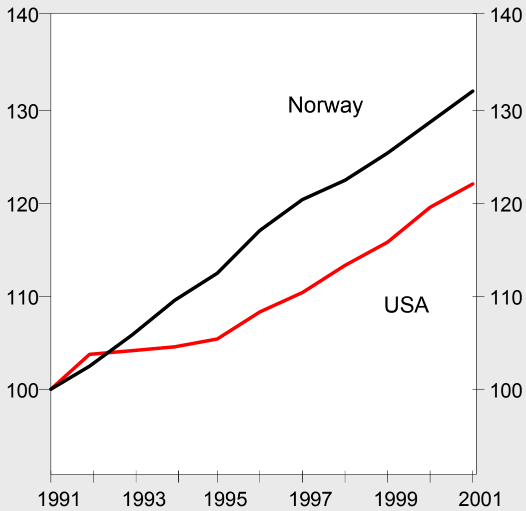
According to new national accounts figures, *Mainland-Norway's GDP* rose by an average of 3.3 per cent annually in the 1990s, which is 0.4 percentage points higher than previously estimated. The main factor explaining the stronger rise in GDP is stronger growth in service trades.

The trend in employment in terms of man-hours worked is little changed by the revision. Hence growth in labour productivity is increased substantially. For private business activity in Mainland-Norway apart from housing services, primary industries and electricity production, productivity growth is revised upwards by an average of 0.7 percentage points annually, to 2.9 per cent for the period 1991-2001.

The upward revision of the Norwegian national accounts figures, and a substantial downward adjustment of the US figures, mean that productivity growth in the Norwegian economy in the 1990s is now seen to be far stronger than in the US.

The upward revision of productivity growth in the 1990s suggests that the growth potential in the Norwegian economy is higher than previously assumed. On the other hand, the main contributors to higher overall productivity growth were strong productivity growth in retail trade and financial services. These sectors have been through a far-reaching evolution in technological and market terms, and it is not certain that this trend will continue in the years to come or spread to other areas.

***Chart 3.3** Labour productivity[1)]. Index 1991=100*



1) Figures for Norway refer to private mainland sectors apart from housing, primary industries and electricity production, while the figures for the USA refer to the non-farm business sector.

Source: Statistics Norway and the Bureau of Labour Statistics.

international markets have marginally declined, resulting in a wider interest rate differential. The yield on Norwegian 10-year government bonds is at about the same level as at year-end.

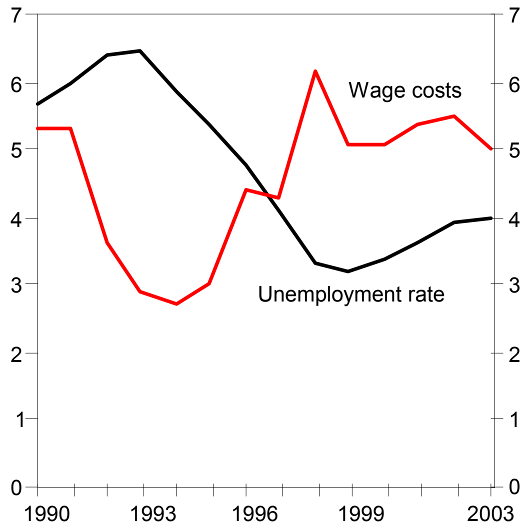
The value of the Norwegian krone has risen substantially in the past two years. In terms of the trade-weighted index, the krone appreciated by 4 per cent in 2001 and by a further 8.6 per cent up to mid-September this year. The krone is now at its strongest since the mid-1980s.

Although the *labour market* has weakened somewhat in the past year, labour remains in short supply in several sectors, including the construction industry and the health care sector. In some service industries, above all the ICT sector, unemployment has risen. Employment rates have been fairly stable so far this year according to figures from Statistics Norway's labour force survey (LFS). Between the second quarter of last year and the same quarter this year employment rose by 0.3 per cent, according to preliminary national accounts figures. Employment growth remains buoyant in health and social services, while in transport and hotels and restaurants the number of employed persons has edged down in the past year. Overall employment is now projected to rise by 0.5 per cent this year and 0.4 per cent next year. As a result of increased sickness leave, a rising proportion of part-time employment and two additional vacation days this year, total hours worked are estimated to fall by ¾ per cent from 2001 to 2002.

Registered unemployment has increased somewhat in the past year, also when corrected for the reorganisation of the unemployment statistics, while the supply of vacancies advertised in the media has declined markedly. The increase in registered unemployment is most pronounced in service industries located in central areas of south-east Norway, while recently there has also been signs of a more general rise in unemployment. According to the LFS, *unemployment* has remained at 3¾ per cent over the past three quarters. Compared with the second quarter of last year, unemployment has risen by 0.4 percentage points. Unemployment is projected to increase to 4 per cent next year.

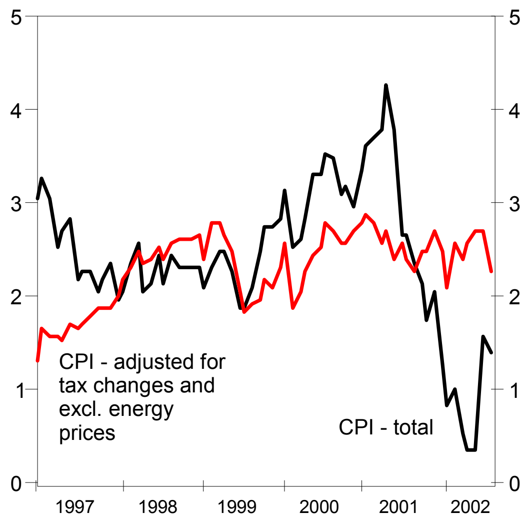
Annual wage growth from 2001 to 2002 is now estimated at 5½ per cent. For employees in the hospital and municipal sectors, wages are likely to increase by about 6 per cent this year. In manufacturing and other enterprises facing foreign competition, wage growth is set to be somewhat lower due to the marked impairment of cost competitiveness. Wage costs for workers in Norwegian manufacturing were about 22 per cent above that of our trading partners last year. In view of this year's wage settlement and the appreciation of the Norwegian currency, the differential is likely to widen further this year. An annual wage growth of 5 per cent is projected in 2003.

Chart 3.4 *Wage costs and unemployment. Percentage change from previous year*



Source: Statistics Norway and Ministry of Finance.

Chart 3.5 *Consumer prices. Percentage change from previous year*



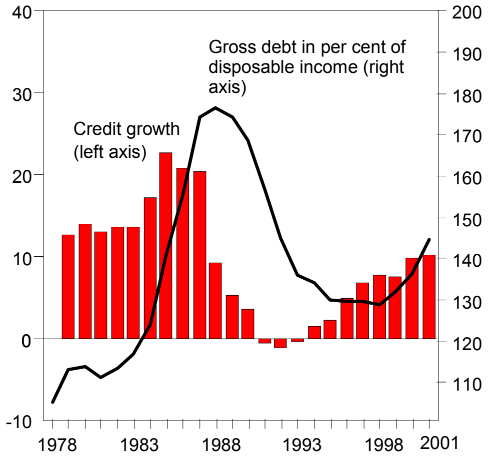
Source: Statistics Norway and Ministry of Finance.

Year-on-year growth in *consumer prices* measured 1.4 per cent in August this year. In the past year a sharp increase in housing rents has been a main contributor to higher price growth, while price developments of energy commodities and imported consumer goods have worked in the opposite direction. The marked appreciation of the krone over the past couple of years is expected to contribute to low growth in prices of imported goods ahead. On the other hand, the rapid rise in wages may fuel growth in prices of domestically manufactured goods and services. All in all, consumer prices are expected to rise by 1¼ per cent this year and 2¼ per cent next year. Adjusted for tax changes, and excluding energy prices, consumer price inflation is projected at 2½ per cent this year and 2¼ per cent next year.

Table 3.1 summarises the macroeconomic projections for 2002 and 2003. The figures are based on the following assessments:

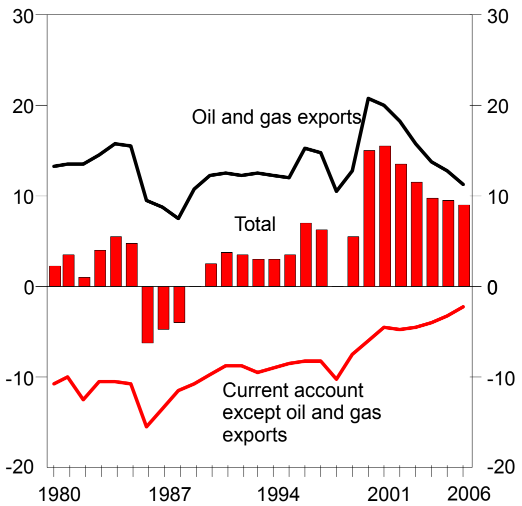
- As a technical assumption, the krone's trade-weighted index value in the forecasting period is assumed to equal the average rate for the last six months. In addition, short interest rates are assumed to shadow the implied forward rates. The projections are also based on the fiscal policy programme set out in the National Budget.
- *Mainland business investment* is estimated to fall by 3¾ per cent this year and 1 per cent next year. Investment in transport and other private services is the main factor pushing down investment this year, while manufacturing investment pulls in the opposite direction. This year's growth in manufacturing investment is related to major investment projects in the metals industry.
- *Petroleum investment* is projected to expand by just under 5 per cent this year and by 12 per cent next year, before falling markedly again thereafter. The growth in oil investment this year and next points to higher activity in manufacturing segments that supply the petroleum industry.
- The appreciation of the krone and increased international uncertainty have weakened the outlook for export-oriented industries. Compared with the Revised National Budget, projections for *traditional merchandise exports* are revised downwards both this year and next, to 1½ and 2¾ per cent respectively. The projection for 2003 should be viewed in conjunction with the higher exports resulting from higher production capacity.
- *Household demand* has risen moderately in the first half of the current year, and the growth in house prices has levelled off. Credit growth has, however, remained high, and gross debt as a share of disposable income has increased, although the level is clearly lower than in the end of the 1980s, cf. chart 3.6. In addition, the households' overall financial assets is still at a

Chart 3.6 *Household indebtedness and credit growth. Per cent*



Source: Norges Bank.

Chart 3.7 *Current account of the balance of payment. Per cent of GDP*



Source: Statistics Norway and Ministry of Finance.

high level, and with prospects for continued high wage growth, low unemployment and high house prices the household sector's financial standing still seems relatively robust. The sizeable nominal income growth following this year's wage negotiations and the low consumer price growth is likely to lead to a strong growth in real disposable income for the household sector. On this background, consumption growth is expected to pick up markedly in the second half of this year. All in all, private consumption is estimated to rise by 3 per cent this year and 3½ per cent in 2003. This implies that the saving rate will rise appreciably this year and remain more or less at the same level in 2003.

- The *oil price* has averaged NOK 197 per barrel so far this year, compared with NOK 220 per barrel for last year as a whole. An average oil price of NOK 200 per barrel is now projected for 2002, falling to NOK 180 in 2003.

- Overall petroleum production on the Norwegian continental shelf is expected to rise by 5½ per cent from 2001 to 2002, and to remain more or less unchanged in 2003. This, together with the other assumptions, entails a surplus on the current account of the balance of payments of NOK 206 billion in 2002 and NOK 179 billion in 2003, or 13½ and 11½ per cent of GDP respectively.

Uncertainty about the further development of the international economy has increased in recent months. Lower international growth, and/or turbulent international financial markets, may result in lower growth impulses in the Norwegian economy. With a sustained strong krone exchange rate, there is a risk that activity levels and investment in industries facing foreign competition will be weaker than anticipated. On the other hand, the petroleum activity and associated revenues entail that the Norwegian economy is to some extent shielded from slower international growth, at least as long as oil prices hold up well.

The further trend in the exchange rate, and the effect of the krone's appreciation since last summer on domestic prices, represent a substantial factor of uncertainty for price projections. For the time being, the buoyant krone has made only a small contribution to lower inflation. This is probably because each stage in the distribution chain essentially allows changes in the exchange rate to be reflected in operating margins in the short term. However, over time competition in commodity markets must be expected to normalise margins. This could suggest that the impact on consumer prices of the appreciation of the krone since the summer of 2000 will gradually increase if the exchange rate remains approximately at the current level.

Table 3.1 Main figures for the Norwegian economy. Percentage change from the previous year

	NOK billion	Volume change from previous year, pct.	
	2001	2002	2003
Private consumption	651.5	3.1	3.5
Public consumption	306.1	1.7	0.5
Gross fixed capital formation	280.0	-0.2	3.2
Oil activities	56.2	5.1	12.2
Shipping	12.5	-6.2	19.1
Mainland business sector	115.5	-3.8	-1.0
Residential construction	55.7	-1.5	2.2
Public sector	40.1	6.0	0.3
Total domestic demand, incl. stockbuilding	1253.9	2.0	2.7
Exports	698.9	1.3	0.8
Of which: Traditional goods	215.9	1.5	2.7
Imports	441.9	0.9	2.9
Of which: Traditional goods	287.0	2.1	3.2
Gross Domestic Product	1510.9	2.0	1.9
Of which: Mainland Norway	1152.0	1.7	1.8
Memorandum items:			
Gross product manufacturing sector	131.4	-0.1	-0.2
Consumer price inflation	..	1.2	2¼
Wage growth	..	5½	5
Employment (persons)	..	0.5	0.4
Unemployment rate, level	..	3.9	4
Current account surplus, NOK billion.	233.4	206.2	178.9
Per cent of GDP	15.4	13.6	11.5
Net external assets, NOK billion.	587.8	689.1	885.5
Per cent of GDP	38.9	45.4	56.7

Source: Statistics Norway and Ministry of Finance.