Economic Survey*

Prospects

2000 was a year of consolidation for the Norwegian economy. Growth in production and employment was very moderate and the economic boom of the last half of the 1990s ended. Cost inflation continued, but at a more moderate pace than in previous years even though unemployment was low and some labour market segments were tight. Despite sharp growth in oil revenues, fiscal policy was neutral while monetary policy shifted to a more contractionary stance. Surpluses in central government accounts and the balance of payments were record high. Excluding the rise in energy prices and the effect of exchange rate movements, price inflation remained moderate, partly because productivity growth in the mainland economy picked up following a sluggish trend in recent years. The picture of the Norwegian economy that emerges at the beginning of 2001 must therefore be said to be unusually favourable. Through our own and, not least, others' help, the Norwegian economy has experienced a soft landing following a relatively turbulent period.

However, the fall in unemployment from 5-6 per cent in the first half of the 1990s to close to 3 per cent the last three years has already given us four years of persistently stronger price and cost inflation than among our trading partners. The objective of today's monetary policy is to bring cost inflation in Norway down to the level in these countries, an objective that is expected to be attained in 2002. However, the effect of persistently higher cost levels on the scale of the internationally exposed sector cannot be expected to be exhausted so swiftly; the loss of market shares is expected to be considerable for some years ahead. In practice, the current orientation of monetary and fiscal policy therefore implies a continued contraction of the internationally exposed sector and thus an increased use of petroleum revenues in the future. The question of increasing the use of petroleum revenues today is therefore actually a debate on whether it is appropriate to plan on further increases in the years ahead.

A number of lessons may be drawn from developments in recent years. First, even a soundly implemented stabilization policy will have a price in the form of varying effects on sectors and groups. Sizeable fluctuations in nominal and real interest rates must necessarily have varying effects, not least across generations. The purpose of the planned supplementary tax on new commercial buildings was that it should result in reduced activity, in this case in the construction industry. This is the way policy instruments must be applied if stabilisation policy is conducted to counter shocks to the economy. However, politicians seem to back down when the use of instruments they have established (monetary policy) or they themselves have used (fiscal policy) actually function as intended. This must either imply an implicit desire to have another instrument – and therefore other groups – bear the brunt, or reduced ambitions for stabilization policy, which in practice may mean that the labour market, i.e. the unemployment queue, will be responsible for demand management.

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Second, many appear to be of the view that in recent years monetary policy has taken over as the main instrument in the conduct of stabilization policy, while fiscal policy in practice has had the aim of having a neutral effect. This description, however, disregards the important point that fiscal policy also has an effect through built-in stabilizers and that these, quantitatively and for long periods, have been more important in stabilizing cyclical fluctuations than explicit fiscal measures. In the formulation of budgetary policy, considerable emphasis should be placed on built-in stabilizers, as they swiftly and without time-consuming new measures make a solid contribution to stabilization policy. It is also important to bear in mind that monetary policy may have clear limitations; for example it may be a temporary phenomenon that a substantial interest rate differential between Norway and our trading does not have a greater impact on the exchange rate.

Third, we have once again registered the importance of being a small and open economy. Norway is very exposed to fluctuations in the international economy, whether this be rapid changes in market growth, commodity prices (such as the price of oil), exchange rates or interest rates. As a result of our petroleum resources, we now have a higher income per capita than most other countries in the world, but these resources have also contributed to making the Norwegian economy more unstable. Institutions and a political culture have been established to address these challenges. However, these can only compensate for our vulnerability, not eliminate the cause itself.

On the other hand, petroleum revenues can be used to increase our scope for manoeuvre. If we can draw any conclusion from three decades of petroleum revenues, it is perhaps that it is economic policy leeway itself that has been important. Our ability to make use of this should the need arise has given us an opportunity to avoid or counter recessions, and thus achieve more favourable economic developments. The actual use of petroleum revenues has naturally also been important, but hardly decisive. One obvious example is how we responded to the fall in oil prices in 1985/1986 compared with how we reacted in 1998/1999. In reality, the adjustments deemed necessary the last time were insignificant compared with what we experienced 15 years ago, even though it must also be taken into account that the challenges were far more modest. However, we cannot exclude the possibility that once again we will find ourselves in a demanding situation, when the very existence of scope for manoeuvre provides us with options and time to reflect.

As we are now approaching the peak for oil production, it is even more important to focus on how we shall develop our economy further when growth cannot be driven by oil. The return on the capital we are today saving in the form of the Petroleum Fund, etc. will still only account for a small share of our total revenue base. A key factor in this connection is that petroleum revenues are no different from other financial resources. Important decisions concerning consumption and investment must be based on an assessment of the social benefits and costs of various measures. Admittedly, the results of this analysis are conditioned on the profile we choose for the use of oil revenues in the economy. The decision to invest in one area or another, however, must be based on our evaluation of what we can derive from this investment and not whether oil revenues can finance this. Oil revenues shall give us increased scope for consumption. They must then not be used as an investment bank with return criteria that deviate from the requirements that are normally established for investment projects. If we manage to increase productivity growth by a few tenths of a percentage point each year, this will over time contribute to increased living standards beyond that which can be provided by drawing on the Petroleum Fund. The present dispute over the right to employ part of the petroleum wealth does not necessarily have this objective.