EUROPEAN PARLIAMENT

DELEGATION FOR RELATIONS WITH SWITZERLAND, ICELAND, AND NORWAY AND TO THE EEA JOINT PARLIAMENTARY COMMITTEE

BACKGROUND NOTE

ON

THE POLITICAL AND ECONOMIC SITUATION OF NORWAY

AND ITS

RELATIONS WITH THE EU

11.05.05/LE

POLITICS

General information

Executive branch

Head of state: Norway is a constitutional monarchy. **King Harald V** has been the country's head of state since 1991, when he succeeded to the throne. The heir apparent is Crown Prince Haakon Magnus, son of the monarch.

Head of government: Prime **Minister Kjell Magne Bondevik** (Christian Democratic Party) was appointed prime minister by the King following the September 2001 elections. The monarch usually appoints the leader of the majority party or majority coalition as Prime Minister, with the approval of the Storting.

Legislative branch

The **Storting**, the unicameral parliament of Norway, is composed of 165 members, elected by proportional representation for four-year terms. Candidates are elected from party lists. The current Storting was elected in September 2001, while the next elections are scheduled for 12 September 2005.

At each election, the Storting divides itself into a lower (*Odelsting*) and upper (*Lagting*) house, the latter composed of one-quarter of the Storting's membership. Bills are submitted by the Government to the Odelsting first, having been considered by a Standing Committee, and subject to hearings. They are then sent to the Lagting for review or revision. If the Odelsting approves the Lagting amendments, the bill is signed into law by the King. If it does not, the bill returns to the Lagting. If still no agreement is reached, the Odelsting submits the bill to a plenary session of the Storting, where a two-thirds majority is needed for its approval.

Political outlook

Norway's political scene is currently dominated by the approaching general election, scheduled for September 12th 2005, and the party's preparation for the election campaign. The Economist Intelligence Unit expects that a coalition of centre-left parties will win the election and replace the ruling centre-right minority coalition consisting of the Conservative Party, the Christian Democrat Party (KrF) and the small Liberal Party, but the outcome is by no means clear-cut yet.

The current parliamentary session "the last before the election" has mainly been taken up with debate on reform of the pensions system, and in May the government's revised budget for 2005, the last one before the poll, will be put before parliament. At the end of 2004 the centre-right government made a deal with the Progress Party (FrP) over the 2005 budget, which included more spending on police, children and healthcare, and a rise in the tax threshold for low incomes. The budget also included an easing of the tax burden on higher marginal-rate payers and a cut in capital gains tax. This seemed to highlight the developing left-right divide in Norwegian politics, as the budget deal was opposed by the Labour Party, the Socialist Left Party (SV) and the Centre Party.

Mr Stoltenberg, leader of the Labour Party, has been trying to consolidate the ranks of the left and piece together a Labour-Socialist Left-Centre Party coalition that could challenge the current government.
On the other hand, the Christian Democrats have lost some of their electoral support since entering the current coalition, as they are seen to have made too many concessions to the Conservatives and the Progress Party. Unconstrained by governmental responsibilities, Carl I Hagen of the Progress Party has been calling for populist measures that have boosted his party's electoral success in the 2003 local elections. The Progress Party has made substantial inroads into the conservative electoral base since 2001, taking votes away from both the Christian Democrats and the Conservatives.

Carl I Hagen has announced that he will stand down after the next election, and his deputy, Siv Jensen, is widely tipped to take over.

The Economist Intelligence Unit forecast that a coalition of Labour and the SV, and possibly also the Centre Party would be in a position to form a government after the election.

International relations

Norway's foreign policy might be expected to be dominated by its membership of NATO and the European Economic Area (EEA), which links it closely to the EU. The possibility of joining the EU will most probably be continued to be debated at regular intervals during the forecast period.

ECONOMICS

Overview

Norway has an open, service-based economy that relies for a large part of its GDP on trade in commodities. With a nominal GDP of 202 billion euro in 2002, Norway ranked 12th out of 19 west European economies. However, in terms of GDP per head (44,562 euro), Norway was the second wealthiest country in Europe after Luxembourg in 2002.

The country is richly endowed with natural resources—such as petroleum, hydropower, fish, forests, and minerals—and is highly dependent on its oil exports and, therefore, international oil prices. Norway's mountains and high rainfall allow her to generate almost all her electricity by hydropower. However, dry periods resulting in water shortage and higher electricity prices have triggered a domestic political debate on energy supply, whether or not the use of natural gas from the Norwegian Continental Shelf should be promoted. Very high environmental standards are enforced.
Norway is the world's third-largest exporter of crude oil, behind Saudi Arabia and Russia, with the sector contributing 19.2% to economic output in 2002 and nearly 24% of total budget revenue. Norway is also the world's third-largest exporter of pipeline gas. The country has recoverable oil resources for another 50 years and gas resources for another 100 years.

Economic policy outlook

Trends

The government's 2005 budget introduced cuts in the top marginal tax bracket for personal incomes, from 64.7% to 61.5%, in two steps. Local governments will receive additional funding for childcare, the integration of immigrants and improved psychiatric care, as well as for some job-creation schemes. The government is discussing reform of the pensions system. The proposal is to go before parliament in late May, but it is unclear what shape it will take. Proposals to increase labour-market flexibility are also under discussion, but Labour has vowed to reverse most of these measures, such as greater use of temporary workers, if it wins the September election. Monetary policy is expansionary, with interest rates at their lowest levels for 50 years.

Fiscal policy

Preliminary data indicate that the surplus on the general government budget widened in 2004 thanks to higher tax receipts from the oil sector thanks to higher-than-forecast oil prices, despite strong growth in government consumption. The 2005 budget raises the non-oil deficit to Nkr74.3bn (US$11.3bn, or roughly 4.9% of mainland GDP) through a combination of cuts in income tax and other tax adjustments, and increased spending on local government, social services and job-creation schemes. As usual, the budget will be revised in May, and the non-oil budget deficit may well widen further. It is unclear at present which priorities a Labour-led government would pursue, but the Economist Intelligence Unit expects fiscal policy to continue to be expansionary in 2006, whatever the complexion of the government, leading to a widening of the non-oil deficit.

Monetary policy

Norway's monetary policy aims for low and stable inflation. Norges Bank (the central bank) operates with an inflation target. The inflation rate as measured by the consumer price index adjusted for taxes and energy prices (CPI-ATE) is to be kept within 1 percentage point either side of a central target of 2.5%, within a timeframe of one to three years ahead. Norges Bank has been pursuing a loose monetary policy since 2003. The most recent reduction in interest rates, on March 11th 2004, cut the main deposit and overnight lending rates to 1.75% and 3.75% respectively. Norway's intervention rates are now 25 basis points below those of the European Central Bank (ECB). Given the rate reductions and the government's expansionary fiscal policy, the Economist Intelligence Unit expects inflationary pressures to start to build in the domestic economy during 2005, as employment growth is forecast to pick up. To counter this, they expect monetary policy to be tightened in both 2005 and 2006.

There is currently little political desire in Norway to tie the krone to the euro. Indeed, only the Conservative Party favours EU membership, while the other 7 parties are either divided on the issue or against it (Centre Party). However, even if the country were to move closer towards joining the EU in the near future, Norway's divergent business cycles would still count heavily against its participation in EMU. Asymmetric shocks stemming from fluctuating oil prices would be very hard to contain within the EMU framework. Meanwhile, staying out of the euro may have an adverse impact on foreign direct investment in Norway.

RELATIONS WITH THE EU

EEA

Relations between Norway and the European Union are based on the Agreement on the European Economic Area (EEA), which replaced the 1973 EU-Norway Free Trade Agreement. The EEA Agreement has been in force since January 1994 and extends the Internal Market legislation, with the exception of agriculture and fisheries, to Norway, Iceland, and Liechtenstein. The EEA treaty gives the above three countries the right to participate in the Internal Market and to be consulted by the Commission on new legislation, without assuming the full responsibilities of membership. All new Community legislation in areas covered by the EEA treaty is integrated into the agreement, with the EEA EFTA states required to implement such legislation nationally.

Norway is the EU's sixth largest trading partner, only the USA, China, Switzerland, Russia and Japan have more trade with the EU. Norway's trade in goods and services with the EU amounts to more than NOK 800 billion per year, a value that corresponds to almost half of Norway's GNP. Norway's **energy resources** are well important for the EU. Two thirds of Norway's oil production goes to the EU market, accounting for 15 per cent of the EU countries' consumption. Norwegian gas accounts for 15 per cent of the total gas consumption in the EU.
On top of this is the yearly **fish exports** to the EU where the salmon alone is worth NOK 7-8 billion. The export of salmon, mackerel, herring, shrimps, and crustaceans is covered by a special 'salmon agreement' between the EU and Norway, which maintains the original tariff rates for these species (while other fish products receive tariff reductions or duty-free status). However, due to complaints from Scottish and Irish salmon farmers the European Commission decided on the 22 April this year to implement punitive duties on the import of Norwegian salmon. The reason for this was that the import of Norwegian salmon to the EU had increased in a way that influenced the prices and which the Scottish and Irish fish farmers could not compete with. This means that, from April 27 and six months onward, the existing protective duties will be replaced by an anti-dumping duty of 16 percent on average. Norway has considered these import restrictions unjustified and has just recently submitted the case to the WTO. The salmon issue shows that Norway is still facing economic challenges in its relations with the EU, in spite of the EEA Agreement.

EEA Financial Mechanism
In 2004 the EEA EFTA States agreed to establish an EEA Financial Mechanism, that will last until April 2009, with the motive to contribute to the reduction of the economic and social disparities in the enlarged EEA. With this mechanism the EEA EFTA States provide an annual multilateral contribution of 120 million euro to the ten new Member States as well as Greece, Portugal and Spain. In addition to the multilateral part, Norway makes a bilateral annual contribution of 113.4 million euro (total amount of 567 million) towards a *Norwegian Financial Mechanism*. The Norwegian contribution fund projects from the ten new EU Member States only and particular the states around the Baltic Sea (Poland and the Baltic States).

Norwegian funds are also being used to prepare the Western Balkan countries for EU membership in the future. This year they granted NOK 750 million to support political, economic, and social development in the Balkan states. NOK 271 million was granted to promote peace, reconciliation and democracy in Moldova, the Caucasus and Central Asia.
Norway is also making considerable efforts for the benefit of Europe in northwestern Russia, where they spend more than NOK 200 million a year to support democratic and sustainable

development. Through cooperation with the Barents and the Baltic Sea and the bilateral cooperation with the EU, Norway aims to promote the further integration of Russia into European cooperation. In addition on the 14 April this year the Norwegian government presented a report on Northern regional policy, which emphasised Norway's future strategy towards challenges in the High North. The report foresees enhanced cooperation with Russia, US, Germany and Britain with regard to exploiting energy resources and protecting the environment in the Barents region. The Norwegian government will also emphasise strengthening industrial cooperation in the Barents region.

Functional cooperation

Norway has also negotiated an association agreement with the EU to implement the Schengen acquis. This agreement, which entered into force in March 2001, extends the extradition provisions of the Schengen acquis to Norway and Iceland. In 2001, Norway also signed up to the Dublin Convention on asylum applications, thereby assuming the obligation to co-finance Eurodac. The country has a cooperation agreement with Europol and applied to participate in Eurojust cooperation in 2003. Norway has been activately seeking a way to be associated with the process of CFSP/ESPD policy formulation and is today associated to the ESPD through NATO. Norway participates in EU joint actions, such as the police mission in Bosnia.

At the EU Defence Ministers meeting held in Brussels on 22 November 2004, Norway together with Finland and Sweden issued a declaration of intent concerning the establishment of Nordic Battle Group which would be offered to the EU for an initial standby period of six months from 1 January 2008. The agreement of a joint Nordic EU emergency force was reached at a meeting of the Nordic defence ministers in Finland on 10 May 2005 and to which Norway will contribute up to 150 troops.
In Norway this has been a quite sensitive issue with the Socialist Left Party and Agrarians opposing the decision. The main doubts expressed is whether Norway is free, on the basis of international law and an independent political assessment, to decide how far Norwegian forces may or not be committed to participate in a joint Nordic force which is to be deployed in an EU operation. The Norwegian government has however pointed out that the agreement leaves them free to decide case by case whether to deploy its troops.

EU membership

Norway's accession to the EU has been on the cards since the early 1970s. The country has twice applied to join the EC/EU—first in 1972, then in 1994—but the electorate rejected both attempts in national referenda. Following the popular rejection of membership in 1994, the then government declared that there would be no new legislative initiative in this respect for another 10 years. However, there is growing appreciation in each political party (save the anti-EU Centre Party) that Norway must strengthen its ties with the Union if it wishes to have a voice in the future development of the enlarged EU and EEA.

While EU accession remains unlikely in the short- to medium-term, **t**here are powerful reasons for Norway to seek closer cooperation with the EU. The Bondevik government published a white paper in February 2002, which set out the 'Norwegian Government's European Policy Platform'. This document identifies developments in the EU, NATO, and Russia, and relations with the US as core foreign policy priorities for Norway, which the country seeks to achieve through closer cooperation with the first two organisations and the Nordic Council. Cooperation with Nordic neighbours is aimed at extending Nordic initiatives to the Baltic and Barents Sea

regions and addressing regional concerns, such as the impact of Russian nuclear waste on the environment.

The government's white paper lists three core challenges faced by Norway in its relations with the EU:

- Norway cannot influence internal EU developments due to its non-member status;
- Enlargement is likely to shift the EU's centre of gravity farther to the east, which could further isolate Norway from the European mainstream;
- Finding a long-term solution for Norwegian energy, fish, agricultural producers will be vital in the enlarged EEA.

Negotiations on the EEA Agreement have covered the Norwegian application of transitional periods between the EU and new member states; the EU's provision of reciprocal concessions to Norway in return for its loss of free access in fish products to the markets of the new member states; and the adaptation of quotas to compensate for the increased size of the EU's Internal Market.

Nevertheless, Norway's generous contribution for common European matters indicates very clearly Norway's continuing interest in the development of the European Union. However, the question of the country's own accession to the EU remains outstanding and unlikely to be addressed before this year elections in September, even though the possible EU membership has once again become a topical question in the Norwegian public debate.