Evangelisches Studienwerk e.V.

*Schriftenreihe des Promotionsschwerpunkts*
*Makroökonomische Diagnosen und Therapien der Arbeitslosigkeit*

**No. 4/1999**

# Full Employment in the Age of Globalisation?

## Political-Economic Analysis of Effective Employment Policies in the Nineties. The Case of Norway.

by

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**Stuttgart-Hohenheim**
**ISSN 1436 - 1655**

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Lecture given at the University of Hohenheim, November 4, 1998,
an earlier version was presented at the Conference *Unemployment in Europe*,
Maastricht, October 16-18, 1997.

# 1 Introduction

On its way towards the year 2000 the Norwegian economy appears to be in top shape. "A successful economy in an ocean of unsuccessful economies"; this is the way Norwegian experts in self-diagnosis describe the situation. "Ein Volk steckt bis zum Hals in Schlagsahne" (a nation which is embedded in whipped cream up to its neck) writes DER SPIEGEL. Almost no European country fulfils the convergence criteria for the European Economic and Monetary Union to a higher degree than the non-member-country Norway. In 1997 the unemployment rate went down to 4.1% and is expected to decrease further in 1998. In 1996 the rate of inflation has reached a value of 1.3% which from a historical point of view is very low (Table 1).

The present situation is quite a new experience for the Norwegians. In the eighties the country was confronted with a severe economic crisis: a strong and long-lasting wage-price spiral caused a fall in international competitiveness and resulted in a tremendous reduction of the number of industrial jobs. The situation indicated that the "Dutch disease" affected this country which is blessed with vast natural resources.[1] In addition, the country suffered from adjustment problems brought about by the political situation. The growing globalisation lead to a change in the paradigm of Norwegian monetary policy in 1986. This brought about a "stabilisation crisis" which culminated in a big bank crash and a subsequent government take-over of the biggest commercial banks in the country in 1989/90. It was a crisis of economic and structural adaptation, which resulted in the highest unemployment rate after World War II to this Scandinavian welfare state. We are talking about a country which has this abundance of natural resources and which had made full employment a constitutional obligation.

But the "Norwegian miracle" of the nineties cannot only be explained by the fact that Norway really started to exploit its natural resources. Moreover, the resource boom caused by vast earnings from the exploitation of petroleum resources has also been used to explain the structural problems and the "lingering illness" of the same economy. We have to analyse whether the economic policy is aimed at using the revenues from the petroleum sector "productively" in order to promote employment and economic growth, and does not prevent any structural change in the economy.

[1] For a survey see Corden 1984.

The Norwegian economy is strongly dependent on foreign trade and economic integration. Nevertheless, in the 1994 referendum Norwegians rejected membership of the European Union. Many experts expected a serious setback for the whole economy. But actually, the traditional Norwegian export sector, heavily dependent on Western European markets, improved its international competitiveness, a fact that is quite contrary to the traditional concept of economic integration.

How can it be explained that Norway could return to full employment so fast, coping with the deepest economic crisis since the thirties so successfully?
How and to what extent can a small open economy like Norway - in the age of expanding internationalisation and diminishing effectiveness of national economic policy instruments - make use of policy strategies aimed at overall national goals of growth and full employment?
How can it be explained that the Norwegian economy, heavily dependent on export sales, experienced an upswing at the same time when the most important trading partners Germany and Sweden were experiencing their worst economic crises since World War II ?

All these questions cannot be sufficiently answered by traditional macroeconomic analysis. Important institutional, political and structural conditions have to be investigated and the results have to be put together like a "jigsaw puzzle". In this we may find out to what extent economic policy experiences gained in one country can be transferred to and used by another country.

In the following I will discuss some important hypotheses which might help us to arrive at some answers to the questions asked above. In the age of mass unemployment and discussions about the competitiveness of "Standort Deutschland", comparative studies of national economic policies could be of special interest.

## 2 Lasting high unemployment and policy recommendations

High unemployment in many OECD countries continues to be an issue in the professional and political discussion.[2] The unemployment rate of the European OECD countries has been 10% or even higher for a long period.[3] Especially Germany, the leading European economy, has suffered from mass unemployment for many years.

The discussion on the causes of high unemployment in the European countries focuses on labour saving technological change, competition from low-wage countries and the negative impacts of increasing globalisation on employment. More labour market regulation and trade protection may be popular remedies in this respect. But globalisation and increasing international competition is a process that is here to stay. Therefore, the unemployment problem has to be considered as a growing "adjustment gap" in the OECD economies, the gap between an increasing need to adjust to rapid changes and a decreasing ability and willingness to adapt.

Globalisation enforces competition. Job destruction is a natural consequence, and "the basic answer to employment problems lies in creating more new jobs"[4], especially in the private sector. A "balanced mix of macroeconomic and structural policies" is needed in order to strengthen the economy's ability to adjust to structural change and the capacity to innovate and to create new jobs.[5] An effective policy mix should cope with the following issues:

1. A stable macroeconomic environment including sound public finances, controlled inflation and stable growth in aggregate demand will provide a framework for sustainable growth of output and employment.
2. An enhanced creation and diffusion of technological know-how will create new jobs: a policy aimed at establishing a climate of competition, innovation and creativity is essential. It must give firms better incentives to innovate, reduce risks by developing information sharing and network access, adapt technologically oriented education and training for both enterprises and individuals.
3. A favourable entrepreneurial climate will encourage enterprise creation in the economy. Improve information and advice! Improve access to technology, training, credit and

[2] OECD 1994 and 1995a.
[3] OECD Labour Force Statistics 1997.
[4] OECD 1994.
[5] OECD 1995a.

guarantee schemes! Lower other entry barriers by removing regulations! New jobs will be created in small and medium sized innovative companies.

4. More working-time flexibility – both short-term and lifetime – will increase labour market flexibility and make it easier to create new jobs. Working-time reductions may be integrated with programs for life-long learning.
5. Increased wage and labour cost flexibility will dismantle barriers to job creation. Decrease non-wage labour costs by reducing taxes on labour! Establish more wage flexibility and a wage formation system which pays more importance to local conditions in the wage formation process! Policies aimed at enforcing competition in the product markets will reduce the firm's ability to restrict output and employment and to exploit rent sharing with the "employed" insiders.
6. A reform of employment benefit systems may give stronger incentives to replace paid unemployment by paid employment. This includes policy measures to enforce job search, to restrict the duration of benefits and to lower the relative tax burden on paid work.
7. Active labour market policies will raise the employability of the unemployed, in particular the long-term and unskilled unemployed. Improve the functioning of the Public Employment Service and target training programmes to unemployed!
8. Improved skills and competence of the labour force becomes more important in an era of increasing global competition and rapid structural change. This includes areas of general school education, school-to-work transition, on-the-job training and life-long learning.

All these instruments may contribute to reducing unemployment as far as they are well designed, well targeted and co-ordinated. There has been and there is an ongoing debate on how to overcome unemployment in Europe[6]. Traditionally there has been little interest in the Norwegian case with few exeptions[7].

[6] Layard, Nickell, Jackman 1991. OECD 1994 and 1995a. "The Challenge of Full Employment in the Global Economy" 1997.
[7] Dølvik and Steen 1997. OECD 1997, 1998.

## 3 The recent development in the Norwegian labour market

Norway has been a full employment economy most of the time since the 1950s. In 1983-1992 the average unemployment rate was 3.8% compared to a rate of 9.4% for the EU-countries (Table 1).

**Table 1: Main economic indicators in Norway and other countries**

| | Average 1983-92 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | Average 2000-02 |
|---|---|---|---|---|---|---|---|---|---|
| ***GNP growth*** | | | | | | | | | |
| Norway | 2.7 | 2.8 | 5.0 | 3.3 | 5.3 | 3.4 | 2.5 | 2.5 | 2.5 |
| Mainland Norway | 1.8 | 2.8 | 4.3 | 2.7 | 3.7 | 3.7 | 3.0 | 1.2 | 1.7 |
| Trading partners | 2.6 | -0.2 | 3.0 | 2.5 | 1.9 | 2.9 | 2.7 | 2.5 | 2.5 |
| EU | 2.7 | -0.5 | 2.8 | 2.5 | 1.7 | 2.6 | 2.7 | 2.5 | 2.5 |
| ***Consumer price index (annual growth)*** | | | | | | | | | |
| Norway | 5.4 | 2.3 | 1.4 | 2.5 | 1.3 | 2.6 | 2.2 | 3.2 | 2.7 |
| Trading partners | 4.6 | 2.9 | 2.3 | 2.3 | 1.7 | 1.8 | 1.5 | 1.7 | 2.2 |
| EU | 5.1 | 3.1 | 3.0 | 3.1 | 2.5 | 2.0 | 1.7 | 2.0 | 2.2 |
| ***Unemployment (% of the labour force)*** | | | | | | | | | |
| Norway | 3.8 | 6.0 | 5.4 | 4.9 | 4.9 | 4.1 | 3.2 | 3.2 | .. |
| Trading partners | 6.7 | 9.3 | 9.4 | 8.8 | 8.9 | 8.7 | 8.0 | 8.0 | .. |
| EU | 9.4 | 11.1 | 11.6 | 11.2 | 11.3 | 11.2 | 10.7 | 10.2 | .. |

Source: Nasjonalbudsjett 1997, 1998 and 1999.

In the seventies and eighties when most other European economies met with high unemployment, the Norwegian economy continued to grow along a full employment path. It seems obvious that the earnings from the North Sea oil had a significant positive impact on aggregate demand and public revenues, and there is some statistical evidence for this hypothesis. [8]

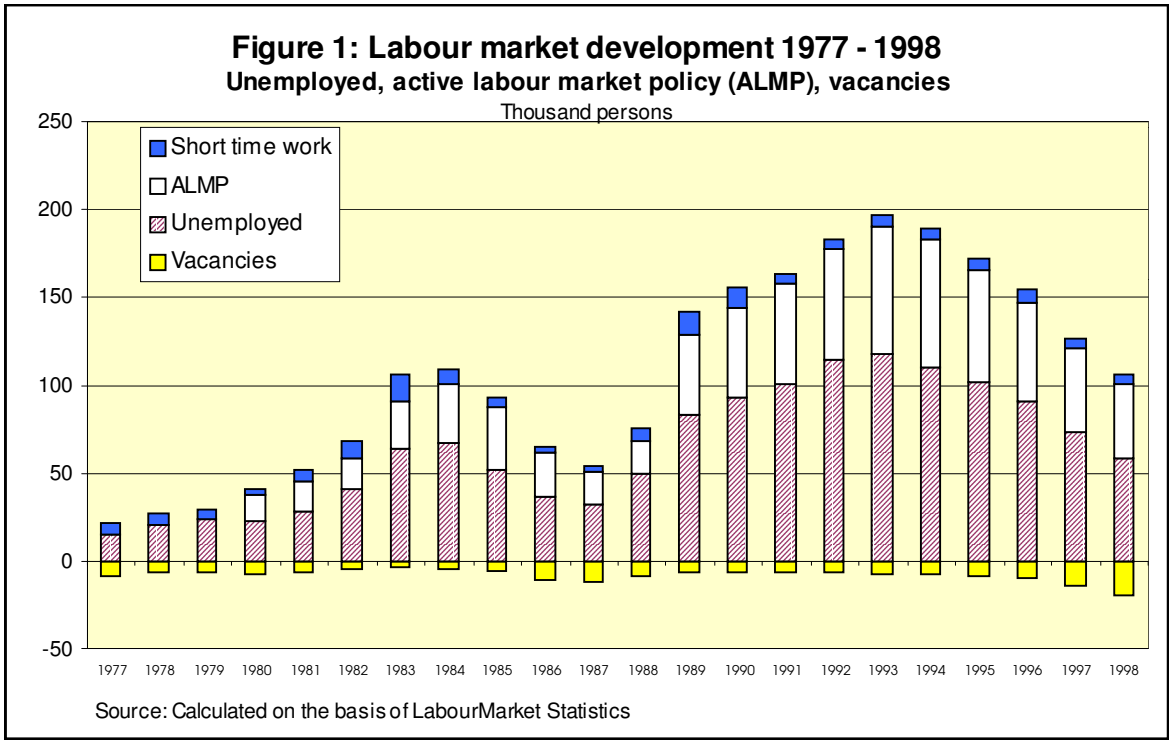
The overall growth rate of GNP in Norway has been 2.7% on average in the period 1983-92, which is the same as in the EU (Table 1). In the latest period 1993-1998 the Norwegian economy grew faster than the economies of its main trading partners. In the last 25 years there have only been two periods with a distinct growth in unemployment: the period 1980-84 and the period 1988-93. The unemployment rate reached its historical peak in 1993 with 118,000 registered unemployed people, which is 5.5% of the labour force.[9] Additionally there were about 72,000 people ”employed” in special labour market programmes (3.4% of the labour

[8] Eika 1996. Statistisk Sentralbyrå 1997:3. Eika calculated that the impact of the oil sector activities in 1973-1993 may have been about 50% of the overall growth in GNP.

[9] The unemployment rate calculated by the Labour market statistics is somewhat higher (6,0%).

force). An active labour market policy had a strong effect on keeping the official unemployment rate at a low level in the last recession.

From 1993 to 1997 unemployment declined markedly, and this trend is continuing in 1998 (Figure 1). In the same period, unemployment in the European Community is stagnating on a high level of 10.8% (1997).[10] The Norwegian unemployment rate is expected to be lower than 4% of the labour force in 1998 and 1999.[11]




What are the driving forces pushing the unemployment figures down towards a level which is very low compared to most other European countries?
Why does not Norway follow the conventional wisdom, considering more real wage flexibility, greater wage dispersal and lower employment insurances as necessary in order to get up employment?[12]

It is not easy to give clear and unambiguous answers to these questions. As far as I can see it, there are several important institutional, political and structural factors that are working together, determining the favourable development in the Norwegian economy.

[10] OECD Labour Force Statistics 1997.
[11] Statistisk Sentralbyrå 1998 and "Nasjonalbudsjett 1999".

If the labour force and the labour force participation rates had decreased during the recession, the low unemployment figures may be realised without creating new jobs.

But in fact, the recovery of the Norwegian economy has so far resulted in creating more than 200,000 new jobs in the period 1993-1997. The labour force increased by 7.2% and the labour participation rate went up from 68.2% in 1993 to 72.4% in 1997, which is highest rate in historical terms (Table 2). The employment growth in Norway 1993-1997 was higher than in most other OECD countries including the USA.[13] The figures indicate that the Norwegian economy is not hit by "hysteresis" to the same extent as other European countries.[14]

**Table 2: Employment development in Norway 1975 – 1997**

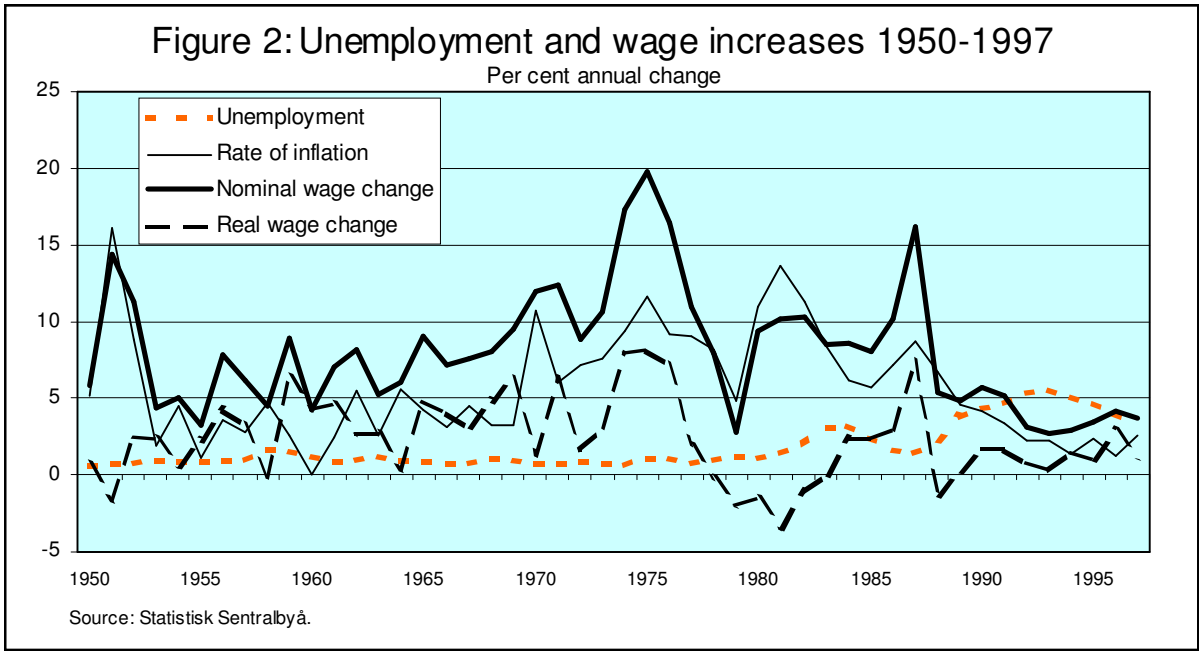
| | Cumulative changes in 1000 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Industry** | **1975-1981** | | **1981-1987** | | **1987-1993** | | **1993-1997** | | **1975-1997** | |
| | 1000 | %[a] | 1000 | %[a] | 1000 | %[a] | 1000 | %[a] | 1000 | %[a] |
| Manufacturing | -33 | -1.9% | -26 | -1.3% | -60 | -2.8% | +39 | +1.8% | -80 | -4.6% |
| Oil extraction and mining | +2 | +0.1% | +11 | +0.6% | +1 | --- | --- | --- | +14 | +0.8% |
| Public services[b] | +132 | +7.6% | +101 | +5.1% | +11 | +0.5% | +90 | +4.2% | +334 | +19.1% |
| Financing and other business services | +21 | +1.2% | +55 | +2.8% | -2 | -0.1% | +25 | +1.2% | +99 | +5.7% |
| Other sectors | +89 | +5.1% | +49 | +2.5% | -126 | -5.8% | +58 | +2.7% | +70 | +4.0% |
| Active labour market policy | +17 | +1.0% | +1 | --- | +54 | +2.5% | -24 | -1.1% | +48 | +2.7% |
| Unemployed | --- | --- | +5 | +0.3% | +82 | +3.8% | -34 | -1.6% | +53 | +3.0% |
| Labour force | +228 | +13.1% | +196 | +9.9% | -40 | -1.8% | +154 | +7.2% | +538 | +30.8% |
| Labour force in % of population | 62.2% (1975) | | 67.9% (1981) | | 71.3% (1987) | | 68.2% (1993) | | 72.4% (1997) | |

Comments:
a change in % of the labour force at the beginning of the period.
b inclusive of private social services. Exclusive of people employed by active labour market policy measures.
Source: Calculated on the basis of Labour Market Statistics.

[12]OECD 1994, 1995. Rødseth 1997:158.
[13] OECD 1998:23.
[14] Røed 1997.

## 4 Crisis and recovery

Norway started exploitation of its vast oil and gas resources on the continental shelf in the early seventies. Everybody realised that the country was sitting on vast values of natural resources, which would generate high earnings in foreign currency dependent on the rate of extraction. A discussion about the time aspect, the dimension and the use of this "extra" source of income started already in 1973.[15] Some people were aware of the risk that a high oil income could lead to expansive public budgets. The possible consequence could be that wage and price inflation would dismantle the international competitiveness of the traditional "mainland industries". But at that time, there was no economic policy strategy aimed at facing the new challenges of this "nouveau riche" country. No "Oil fund" was established until more than twenty years later.[16]




In the international recession in the seventies, Norway deliberately pursued an anti-cyclical budget policy, financing the budget deficit by future oil revenues. Strong wage increases in the years 1974-1977 (Figure 2) contributed to a deterioration of the international competitiveness of the tradable goods sector. This started an ongoing "de-industrialisation process" in the mainland manufacturing industry. The number of industrial jobs decreased by 28% in the period 1975-1993 (Table 2). Until 1986 the public services sector and other sheltered indus-

[15] "Petroleumsvirksomhetens plass i det norske samfunn" 1973. Noreng 1984. Hanisch 1996.
[16] Hanisch 1996:182.

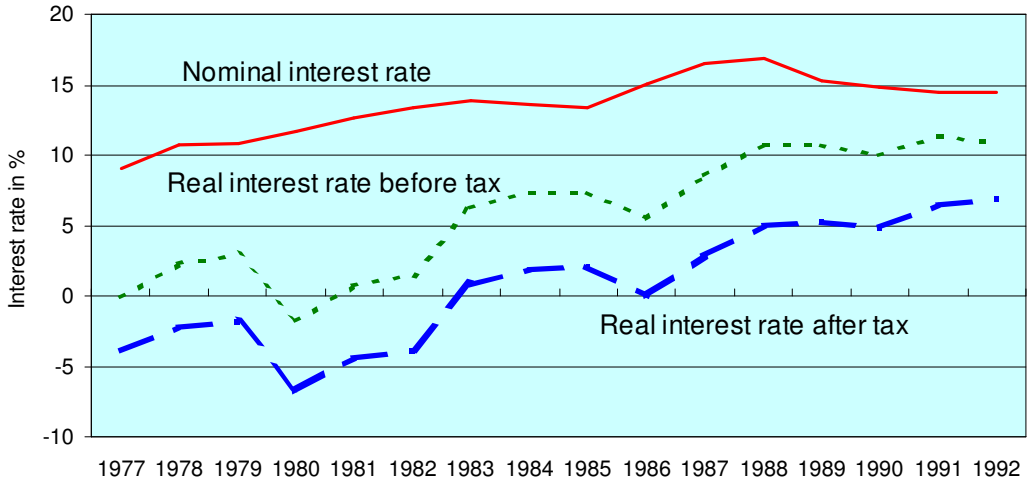
tries expanded strongly and the employment growth in these sectors more than compensated for the downsizing of the manufacturing sector. The labour force grew and in particular women's labour force participation rate increased.

Today we can state the fact that the Norwegian government did not work out a consistent and long-run oriented industrial and macroeconomic policy before 1986. The economic policy in the seventies and eighties was myopic and did not have a theoretical foundation in spite of a growing acknowledgement that "the weakening of the international competitiveness of the mainland manufacturing industry has gone too fast".[17] The macroeconomic policy mix in the period 1975-1986 was characterised by different measures of crisis management such as changing exchange rate regimes, devaluations, price and wage freezes, huge subsidies to key industries (i.e. shipbuilding, textiles)[18] and a gradual deregulation of credit markets.

In 1984, when unemployment had reached a historical peak, a new "home-made" recovery period started that led to a temporary reduction in unemployment (Figure 1). Traditionally, Norwegian monetary policy had been based on direct credit market regulations combined with keeping interest rates stable at a low level. But in the eighties, credit markets had to be gradually liberalised. At the same time there was no political support to leave interest rate determination to the market.[19] It was quite a disastrous policy mix of free credit market supply and public interest rate administration that led to a huge stimulation of loan financed domestic demand, especially in the building and construction sector.[20] Because Norwegian income tax law permitted everyone to make use of unlimited tax exemption of interest expenditures, the real rate of interest after tax was zero or even negative until policy reforms had to be conducted after 1986 (Figure 3).

[17] Statistisk Sentralbyrå 1984:41. A critical investigation of post war economic development is presented in "En nasjonal strategi for økt sysselsetting i 1990-årene" 1992, ch. 1 and ch. 4.
[18] See also Nordvik 1996:42ff.
[19] Indeed, professional economists advocated flexible interest rates in order to carry out an efficient monetary policy. See "Rentepolitikk" 1980.
[20] Hanisch 1996:196ff.

**Figure 3: Lending rates 1977-1992**
nominal, real and after tax interest rates




Source: Statistisk Sentralbyrå and "Penger og kreditt i en omstillingstid" (NOU 1989:1)

In 1986 Norway was hit hard by a steep fall in crude oil prices. Public revenues decreased and trade balance deficits increased quickly. The social democratic government came back into power and decided to make a radical change in the macroeconomic policy assignment. From now on monetary policy was aimed at stabilising the exchange rate of Norwegian currency rather than stabilising the rate of interest. In fact, this policy was aimed at importing price stability from abroad. Labour market organisations had to accept the government's new policy strategy as a framework for future wage negotiations.

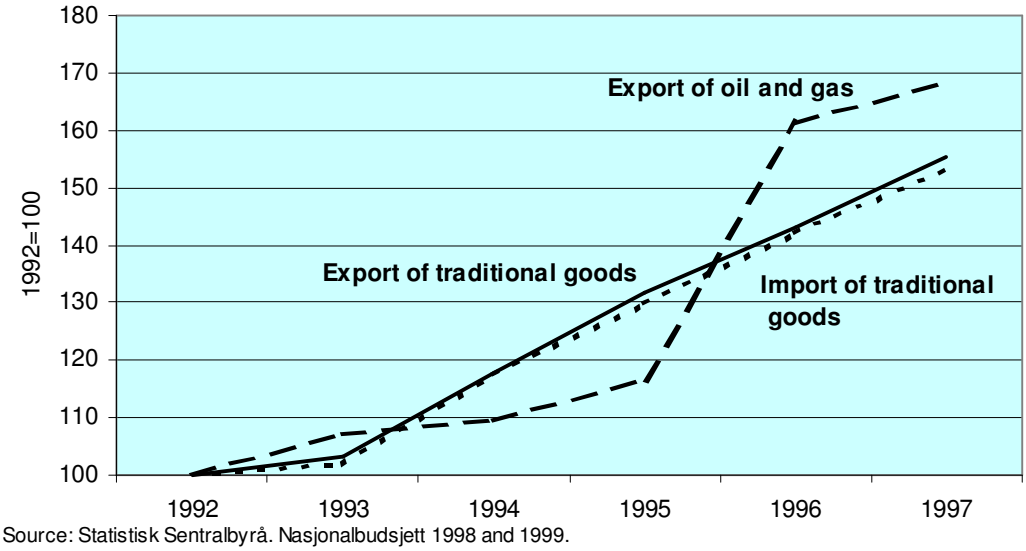
Domestic rates of inflation declined quickly at the same time as nominal interest rates increased (Figures 2 and 3). Real estate prices went down while interest expenditures increased, reinforced by a tax reform which reduced the tax exemption effects. Many companies as well as private households became insolvent. Several banks immediately lost their equity capital. In 1990/91 Norway went through a real bank crash when the government was forced to take over the largest commercial banks of the country.[21]

[21] "Bankkrisen" 1992.

In all these years, employment in the manufacturing sector declined steeply while employment in the public and private services sector grew even faster, at least until 1987. In the period 1988-1993 unemployment increased and reached its highest level after 1945. The employment share of the manufacturing sector reached a bottom value of 14.5% (1995), which is one of the lowest rates in Western Europe. But in 1996/97, the decline of industrial employment stopped. After that, industrial employment has been slightly increasing, which may indicate that the industrial sector in Norway – through downsizing and structural changes – has achieved a satisfactory level of productivity and international competitiveness. A new period of growth and expansion has started.

The recent recovery period of the Norwegian economy started in 1993. As shown by the employment figures, the Norwegian economy has gone from a long period of deindustrialisation to a period of industrial reconstruction and re-industrialisation. As a result of the accelerated export growth in mainland industries, the trade balance deficit for "traditional goods" (exclusive oil and gas) has been stabilised at around 22% of the aggregated export value excluding oil products. Traditional exports are growing slightly faster than traditional imports (Figure 4). Therefore, at the same time when oil revenues are reaching a top level the economy's dependence on the offshore sector is not increasing further. Traditional exports are growing in step with traditional imports because the mainland industry has strengthened its competitiveness during the last years.

**Figure 4: Exports and imports 1992-1997 (1992=100)**




Source: Statistisk Sentralbyrå. Nasjonalbudsjett 1998 and 1999.

# 5 Norwegian economic policy regime in the nineties

Full employment has been the superior economic policy objective in Norway in the post-war period.[22] In Norway, a special "social democratic economic policy paradigm" has a long tradition. The policy contains the following key elements:[23]

- Centralised wage bargaining.
- Strong labour unions.
- Close relationship and co-operation between labour union and labour party government.
- Society agrees on full employment as the overall goal of economic policy.
- Strong emphasis on income policy as a key element of managing the economy.
- Co-operation between labour market organisations.
- The government plays an active “third part” in income policy agreements.
- Society prefers an egalitarian wage policy.
- Extensive use of active labour market policies.
- Macroeconomic planning by the use of annual "national budgets" and long-term programmes.[24]

The "Oslo School", founded by the Norwegian Nobel Price winners Ragnar Frisch and Trygve Haavelmo and their disciples delivered the theoretical basis for the policy.

The "corporatist compromise" is a very decisive constituent part of the Norwegian economic policy system. All the time after 1945 and until the nineties, there has been political consensus that international competitiveness of the export sector has to be preserved and improved.[25]

**Some key elements in the new policy strategy after 1986**

In 1986 a new Labour Party government took over and - facing a severe crisis in the Norwegian economy caused by a steep fall in oil prices - introduced a new economic policy paradigm:

- From now on, monetary policy was subordinate to the overall goal of a stable exchange rate.

[22] See Moene and Wallerstein 1997:26.
[23] Schewe 1990, Hanisch 1996.
[24] The ”National Budget” is the annual official document of the government's economic policy programme for the coming year.
[25] Nordvik 1996:35.

- The Central Bank of Norway was allowed to adjust the interest rate in order to stabilise the exchange rate.
- The government made it clear that no further exchange rate devaluations would be carried out.
- Since monetary policy was assigned to preserve exchange rate stability but not domestic price stability, import of price stability from the main trade partner countries in Europe became a policy objective. Income policy had to adapt to the exogenous rate of inflation.

The "new" policy was a revival of the well-known "Scandinavian model" of inflation and wage determination in a small open economy.[26] This policy change in 1986 was necessary but not sufficient to bring the Norwegian economy back to a full employment path based on international competitiveness of the core mainland industries. As we have shown above, in 1986/87 there were still high rates of price inflation and strong nominal wage increases in combination with extremely low real interest rates due to the old income tax system. So, the economic policy reformation process had to continue. At least three other reforms were decisive in re-establishing industrial competitiveness and growth: (1) a tax reform, (2) a corporatist income policy based on a "Solidarity Alternative" agreement, (3) the establishment of the "Government Petroleum Fund".

**(1) Tax reform**

The Norwegian government carried out a radical reform of the income tax system, mainly in 1992. The aim was "that the income tax system has to contribute to a resource allocation that is more effective than before".[27] The marginal income tax rate was reduced to a maximum rate of 49% (including social fees). The taxation rate for all capital income was put down to 28%. Many tax deduction and tax allowance rules were abandoned. The tax reform led to a significant change in the taxpayer incitement structure: saving in both bank deposits and real investments became much more profitable than before. The unproductive investment of borrowing money in order to get tax exemption became costly.

[26] Aukrust 1977.
[27] Statistisk Sentralbyrå 1993:40. See also OECD 1995b:37.

**(2) Solidarity Alternative Agreement**

A new policy agreement was shaped in 1992[28], the so-called “Solidarity Alternative" agreement.[29] As the title indicates, the policy strategy programme focuses on employed peoples' solidarity with the unemployed. The agreement was a powerful revival of the corporatist policy of compromise. In fact, it is the left-wing Norwegian Confederation of Trade Unions who is most vehemently defending the new income policy agreement.

The primary goal of the economic policy deal is to gain full employment by restoring and then maintaining international competitiveness of the exposed mainland industries. The institutional assignment of the economic policy strategy is based on both co-operation and the dividing up of responsibilities. In institutional terms, the policy strategy of the "Solidarity Alternative" is based on the co-operation of four core institutions in the Norwegian political economy: the government, the Confederation of Norwegian Business and Industry, the Norwegian Confederation of Trade Unions and the Central Bank of Norway.[30]

- The government has to carry out a counter-cyclical fiscal policy in order to stabilise the economy throughout the business cycle.
- Monetary policy carried out by the central bank has to guarantee and defend a stable exchange rate of the domestic currency.
- Income and labour market policies have to contribute to low price and cost increases in order to preserve sufficient international competitiveness and employment in the mainland industries. Central wage bargaining has to guarantee low nominal wage increase.
- Other industrial policy measures have to be designed in order to improve the resource allocation in the economy.
- Stable exchange rates together with moderate wage increases will give exposed industries both favourable and stable working conditions to compete in international markets.
- Additionally, stable exchange rates contribute to stabilising real wages.

The labour market organisations agreed that the new income policy based on the "Solidarity Alternative" agreement has to be followed up for a period of several years.

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[28] A short look at the history is presented in "Nasjonalbudsjett 1998", ch. 4.
[29] Its theoretical and political foundation is worked out in the report of the income policy committee: "En nasjonal strategi for økt sysselsetting i 1990-årene" 1992.
[30] See "Nasjonalbudsjett 1998": ch. 1 and ch. 4.

| Table 3: Government Fiscal Budget and Government Petroleum Fund 1997 - 1998 (billions of NOK) | | | |
|---|---|---|---|
| | **1997** | **1998** | **Pct. of GDP[1)]** |
| Total budget revenues | 473.3 | 499.0 | 43.6% |
| **Net revenues from petroleum sector = transfer to the petroleum fond[2)]** | **85.0** | **87.1** | **7.8%** |
| Revenues excl. petroleum sector | 366.2 | 386.8 | 33.7% |
| Expenditure excl. petroleum sector | 389.0 | 405.0 | 35.5% |
| **Non-oil budget deficit covered by transfer from the petroleum fond** | **- 22.8** | **- 18.3** | **2.1%** |
| Dividend and interest on the petroleum fund | 3.3 | 5.0 | 0.3% |
| **Petroleum fund surplus** | **65.5** | **73.9** | **6.0%** |
| Source: National budget and fiscal budget 1998.<br>[1)] GDP = NOK 1,085.1 bn (1997). [2)] Revenues excl. government expenditures on petroleum activities. | | | |

**(3) The Petroleum Fund**

Compared to other European economies, Norway is faced with a special problem: how can the increasing trade balance surplus from oil and gas exports in the next twenty years be managed without recurring to a new period of cost inflation and de-industrialisation? Therefore, a "Government Petroleum Fund" was established by law in 1990. The fund was taken into use as an integrated part of the fiscal budget in 1996.[31] Annual fund revenues are government's net cash flow from the petroleum sector plus interest income from the fund deposits. Then, the non-oil-budget deficit is covered by transfers from the oil fund.[32] Table 3 shows main figures of the fund. The annual fund surplus is to be invested in foreign bonds and equities. The petroleum fund is expected to reach a peak around the year 2020 when accumulated net revenues are predicted to amount to 140% of GDP. Thereafter, depletion of oil resources and growing public pension payments will successively drain the fund of capital.

**Results of the new policy regime**

As we have shown above, the results from implementing the "Solidarity Alternative" look very impressive so far.[33] Price, production and employment effects are significant:

- Wage increases have successfully been restrained.
- Consumer price inflation has successfully been restrained.
- Growth in the mainland industry has accelerated.

[31] See "The National Budget 1998", ch. 2 and 6.
[32] In fact, the fund accounts show three core economic indicators: (a) overall state budget surplus, (b) non-oil-budget surplus (i.e. state budget surplus excluding all net revenues from the petroleum sector), (c) accumulation of public financial wealth which is to be invested in foreign bonds and stocks.
[33] See also OECD 1997:5. OECD 1998:1ff.

- Many new jobs have been created.
- Export market shares have increased.
- Structural trade balance deficits in the mainland sector are about to decrease slightly.

**Table 4: International cost competitiveness of Norwegian industry**
**Selected indicators, annual change in %**

| | 1981 - 88 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 |
|---|---|---|---|---|---|---|---|---|---|---|
| Relative earnings per worker, common currency | 0.9 | -2.2 | -1.8 | -1.5 | -2.3 | -3.7 | -2.6 | 3.7 | 0.7 | 2.1 |
| Relative price of capital goods, common currency | 1.9 | -2.2 | -5.2 | -2.3 | -0.4 | -1 | -0.9 | 4.8 | .. | .. |
| Relative interest rate, common currency | 1.8 | 1.6 | -0.3 | -1.2 | 2.7 | -2.1 | -1.3 | 1.7 | 0.3 | 0.1 |
| Relative consumer price deflator, common currency | 1.1 | -0.2 | -2.5 | -3.6 | -0.1 | -2.6 | -2.2 | 2.4 | -0.7 | 1.4 |
| Effective foreign exchange rate | 1.7 | -0.2 | 0.7 | 1.8 | -1 | 2.1 | 1.4 | -2.3 | 0.1 | -0.6 |
| Source: "Etter inntektsoppgjørene 1998", Table 5.1. | | | | | | | | | | |

In fact, the new income policy agreement did not bring about lower real wages for the workers (Figure 2). Quite surprisingly, real wage growth was stronger in the period 1991-1997 than in previous years when the nominal wage and price growth was much higher.[34]

The economic policy regime of the "Solidarity Alternative" focuses on the international cost competitiveness of the mainland industries. The change in relative earnings per employee is an important indicator of international competitiveness. In the 1988-1994 period, the Norwegian relative wage rate decreased by 13% as a result of moderate wage agreements (Table 4).[35] However, relative wage growth in 1995-1997 changed to positive which may indicate that the wage policy according to the "Solidarity Alternative" agreement is under pressure.[36]

[34] "Nasjonalbudsjett 1998".
[35] Indicators in table 4 are defined as "relative" changes, i.e. differences between the percentage change in Norway and the percentage change in trade partner countries.
[36] "Indeed, while the Solidarity Alternative framework has served the country well to pull the economy out of protracted stagnation and restore full employment, under current conditions it seems set to face increasing difficulties in forestalling a rise in the rate of inflation." OECD 1998:3.

# 6 Conclusion and further challenges

As many experts point out, the case of Norway is special in several matters. With its vast petroleum resources, the country earns high-income flows from the oil and gas exports – in the private sector as well as in the public sector. Therefore, the government is not faced with financial restrictions in order to offer the mainland sector a favourable macroeconomic environment.[37] The huge earnings from the North Sea give rise to big current account surplus in many years. While other countries may envy Norway the favourable economic situation, the Norwegian government is faced with special policy dilemmas and challenges to the national political economy.

If all oil export revenues are spent "at home", domestic demand pressure will lead to wage and price increases and deteriorate the competitiveness position of the mainland industries (the option may be called "internal revaluation"). If not spent at home, the continuing net inflow of foreign currency will push the exchange rate of domestic currency upwards (the option may be called "external revaluation"). In order to face this policy dilemma and to keep sufficient competitiveness in the mainland economy, the government established the "Petroleum fund" as part of the state fiscal budget in 1996[38] (Table 3). Fund deposits have to be invested in bonds and stocks abroad. This capital outflow will reduce the upward pressure on the exchange rate value of the Norwegian currency and reduce public expenditures. Due to the "Solidarity Alternative" agreement, the monetary policy is aimed at defending a stable exchange rate. This means that appreciation pressure on the exchange rate has to be accommodated by lower interest rates and vice versa. In this way, the monetary policy may cause pro-cyclical effects. Therefore, the Central Bank of Norway advises the government to change the monetary policy target. Monetary policy should aim at stabilising the rate of domestic inflation instead of stabilising the exchange rate.[39]

As a result of the policy reforms, income distribution is changing and thus bringing along another challenge to the new Norwegian economic policy paradigm. High productivity and good marketing performance in private companies generate high profits. Capital owners and business leaders in top management positions are not restricted to benefit from growing company earnings. On the contrary, the organised wage earners are submitted to the agreement of

[37] Holden 1996. Rødseth 1997.
[38] "The National Budget 1998", ch. 6.
[39] Norges Bank 1997.

low wage increases due to the "Solidarity Alternative". Additionally, recent income tax reforms favour people with high shares of capital income. Not surprisingly, the income distribution has become more unequal in the last years.[40] In the longer run, this may lead to erosion of the egalitarian income distribution which has been an essential constituent of the Norwegian social democratic society.

Full employment is the main objective of the "Solidarity Alternative" agreement. But full employment, when realised, is going to challenge just the same policy agreement. Even though the “natural” (or "equilibrium") rate of unemployment is lower in Norway than in most other countries[41], an increasing labour shortage in industries such as manufacturing and health and social services at least gives rise to an accelerating wage drift. A new business cycle may start and lead to demand-pull- and cost-push inflation.

The Norwegian model has proved effective in regaining industrial growth, high employment and low inflation. But "the crucial test of Norwegian wage setting and income policy"[42] is to manage bottlenecks in the labour market in the long run without returning to a new period of wage inflation, unemployment and industrial decline.

How can the Norwegian government face the challenges in the present period of huge "extra earnings" from the oil sector? In order to avoid a new vicious circle of inflation and following de-industrialisation in exposed industries, at least one of three alternative policy strategies has to be pursued:

a) Increasing taxes, decreasing public expenditure and investing budget surplus abroad, managed by the Petroleum Fund can reduce the overall demand pressure in the economy. [43]

b) The rate of oil and gas extraction in the North Sea can be reduced. Lower annual export surplus will reduce the demand pressure in the mainland economy.

b) Imports of both goods and labour from other countries can be increased. Increased imports will reduce the demand pressure in domestic commodity and labour markets.[44]

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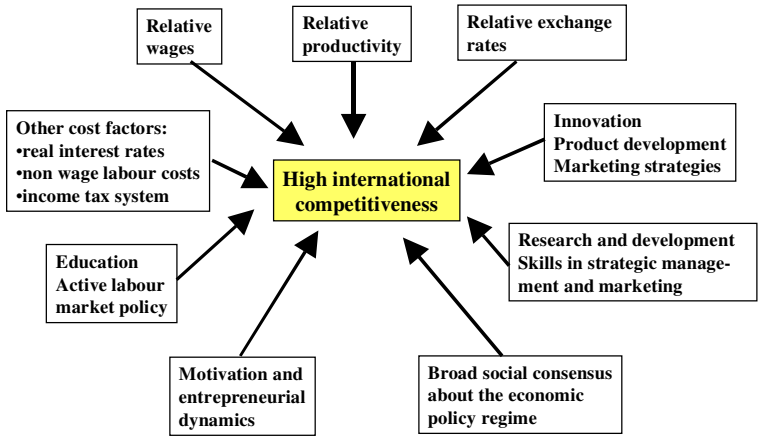
[40] Epland 1997.
[41] OECD 1997:63f.
[42] Holden 1996.
[43] Tax increases will reduce wage earners disposable income and thus weaken labour unions' support of the solidarity alternative agreement.
[44] In fact, Norway has started to import qualified workers in the health sector (nurses and doctors). There is also a growing scarcity of high skilled engineers and computer specialists.

The three strategy alternatives are not mutually exclusive. A well co-ordinated mix of all three strategies may be more realistic and appropriate.

Apart from these special demand pressure problems following the huge revenues from the oil sector, the Norwegian "mainland economy" seems to be in good shape and able to face the globalisation era. Social consensus and policies of "corporatist compromise" based on the "Solidarity Alternative" agreement are important determinants. Further policy reforms in the eighties and nineties promoted deregulation and competition and thus contributed to make Norwegian companies competitive both at home and in foreign markets.

A solidary income policy seems to be a necessary prerequisite to get the Norwegian economy back to continuing industrial growth and full employment. But it seems too simple to explain the employment growth and the creation of all the many new jobs only in income policy terms. Other social, institutional and political factors have to be investigated further in order to give a more comprehensive explanation of the Norwegian case. Income policy based on solidarity is not a sufficient prerequisite to maintain a full employment economic growth!

**Figure 5: Economic policy strategy towards national competitive advantage in the global economy**




Income policy alone cannot explain the Norwegian employment and industrial growth miracle. Further research will have to analyse other factors that may have an effect on the

special dynamics governing Norwegian industrial activity outside the oil sector. This includes modern leadership and management styles, increasing marketing efforts in all the numerous small and medium sized firms which are going international, as well as other behavioural factors such as peoples' positive attitude towards challenges of the new globalisation era. Strategic trade policy, industrial policies and labour market measures aimed at promoting efficiency and flexibility in the labour market would also have to be analysed. Figure 5 shows a tentative model of an overall strategy towards national competitiveness in a global economy. Like a jigsaw puzzle, the elements of this model represent different policy parameters. They have to be investigated and put together to a consistent economic policy programme.

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