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The challenge of enlargement

Commission opinion on Norway's application for membership

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Foreword

1. The Commission's opinion on Norway's application for accession follows similar requests from a number of other countries. Negotiations on enlargement have already started with three applicants: Austria, Sweden and Finland.

2. The European Council addressed the question of enlargement at its meetings in Maastricht (9-10 December 1991), Lisbon (26-27 June 1992) and Edinburgh (11-12 December 1992).

The conclusions of the Maastricht European Council noted that 'a number of European countries have submitted applications or announced their intention of seeking membership of the Union. The European Council invites the Commission to examine those questions including the implications for the Union's future development and with regard to the European Council in Lisbon'.

Accordingly, the Commission presented a report on enlargement to the European Council in Lisbon.[1] The latter invited the institutions to speed up preparatory work needed to ensure rapid progress including the preparation before the European Council in Edinburgh of the Union's general negotiation framework.

The European Council in Edinburgh agreed that 'given the agreement reached on future financing and the prospects for early ratification of the Treaty on European Union by all Member States, enlargement negotiations will start with Austria, Sweden and Finland at the beginning of 1993. These negotiations will be based on the general negotiation framework of which the General Affairs Council took note on 7 December. They will be transformed into negotiations under Article O of the Treaty on European Union once it enters into force, and can only be concluded once the Treaty on European Union has been ratified by all Member States'.

The European Council invited the Council of Ministers to take decisions on the opening of negotiations on the same basis with Norway, as soon as the Commission's opinion on its application is available.

3. In preparing the present opinion, the Commission has assumed, in line with the conclusions of the European Council, that accession will, in accordance with Article O of the Maastricht Treaty, be to a European Union characterized by the establishment of economic and monetary union, ultimately including a single currency; the implementation of a common foreign and security policy, including the eventual framing of a common defence policy, which might in time lead to a common defence; the introduction of a citizenship of the Union and the development of close cooperation in justice and home affairs as well as the strengthening of economic and social cohesion.

The Commission would furthermore recall that the President-in-Office of the Council of Ministers said in his statement at the ministerial meeting opening the Conferences on the accession of Austria, Sweden and Finland to the European Union, that 'The acceptance of the rights and obligations by a

[1] 'Europe and the challenqe of enlargement', Brussels, 24 June 1992 (Supplement 3/92 — Bull. EC).

new member may give rise to technical adjustments, and exceptionally to temporary (not permanent) derogations and transitional arrangements to be defined during the accession negotiations, but can in no way involve amendments to Community rules'.

4. The fact that negotiations with the candidate countries will, to the extent possible, be conducted in parallel is particularly important in the case of EFTA candidates, not only in respect of the adjustments to the Treaties provided for in Article O, but also because of the numerous similarities in the questions to be addressed in the negotiations.

Introduction

1. On 25 November 1992, Mrs Gro Harlem Brundtland, Prime Minister of Norway, submitted to the Council of the European Communities the application of the Kingdom of Norway for membership of the European Coal and Steel Community (ECSC), the European Economic Community (EEC) and the European Atomic Energy Community (EAEC).

2. At its meeting of 7 December 1992, the Council decided to implement the procedures laid down in the Treaties (Article 98 of the ECSC Treaty, Article 237 of the EEC Treaty, and Article 205 of the EAEC Treaty).

3. In preparing this opinion, the Commission has concentrated its analysis on those areas where the impact of accession will be the greatest and which are likely to constitute the main subjects for discussion in the negotiations.

4. The present opinion also reflects substantial information on the situation of Norway obtained from the Norwegian authorities, with which the Commission has remained in close contact, notably through the Norwegian Mission to the European Communities and the Commissions's Delegation in Oslo.

General

Relations between the Community and Norway

1. Norway is geographically and historically a European country. Since World War II, Norway has played an active role, politically and economically, both within Europe and on the wider international level. In 1948 she became a member of GATT; was one of the founding members of NATO in 1949; became a member of the Council of Europe in 1950; was one of the founding members of EFTA in 1960.

2. Norway has made two previous requests to join the European Communities (1962 and 1967), together with the United Kingdom, Ireland and the Kingdom of Denmark on which the Commission expressed its opinion in 1967 and 1969.[1] This led to the opening of enlargement negotiations with those four countries in 1970. These were successfully concluded in 1972.[2] However, in the referendum held in Norway on their results, the outcome was a majority (53.6%) against accession. Consequently Norway did not ratify the Treaty of Accession.

3. Thereafter, the Norwegian Government negotiated Free Trade Agreements (FTAs) with the European Community (together with the remaining member States of EFTA). These FTAs, signed in 1973,[3] provided for the progressive abolition, in respect of trade between the parties in industrial goods, of customs duties, quantitative restrictions and all measures of equivalent effect. The FTAs include provisions for rules on State aid and industrial competition, and a number of mutual concessions in the agriculture and fisheries fields. Also a bilateral joint Committee was set up to administer the Agreements.

4. In April 1984, the Ministers of the Community and of the EFTA countries met in Luxembourg and adopted a declaration laying down the guidelines for the continuation, deepening and extension of cooperation, within the framework of, and beyond, the FTAs, with the objective of progressively establishing a dynamic European Economic Area. This declaration was subsequently reinforced by the speech of President Delors to the European Parliament in January 1989, where he invited the EFTA States to reflect on the possibility of a more structured partnership.

The Norwegian Prime Minister Mrs Brundtland played a key role in the positive response given to this initiative by the EFTA Heads of Government during their meeting in March 1989 in Oslo, held under the Norwegian Presidency.

Negotiations culminated in the signature in Oporto, on 2 May 1992, of the Agreement establishing the European Economic Area (EEA).

5. Norway has thus already established a high level of integration with the Community and a significant part of the *acquis communautaire* will be applied on the entry into force of the EEA, covering the four freedoms (free circulation of goods, services, capital and persons), as well as such areas as social policy, environment, company law, consumer protection and competition law.

6. Moves for a further attempt to join the Community had already begun in 1987 with the publication of a government White Paper favouring closer contacts with the Community. The negotiations for the EEA Agreement led to further consideration of Norway's long-term interests, leading the government to the opinion that neither the FTAs nor the EEA would adequately safeguard Norwegian interests in the longer term. The realization

[1] Opinions of the Commission to the Council concerning the membership applications of the United Kingdom, Ireland, Denmark, and Norway according to Articles 237 of the EEC Treaty, 205 of the EAEC Treaty, and 98 of the ECSC Treaty, COM(67) 750 of 29.9.1967 and COM(69) 1000 of 1.10.1969.

[2] Documents concerning the accession to the European Communities of the Kingdom of Denmark, Ireland, the Kingdom of Norway and the United Kingdom of Great Britain and Northern Ireland, Special Edition of the *Official Journal of the European Communities*, 27.3.1972.

[3] Agreement between the European Economic Community and the Kingdom of Norway (OJ L 171, 27.6.1973) and Agreement between the Member States of the European Coal and Steel Community of the one part and the Kingdom of Norway, of the other part (OJ L 348, 27.12.1974).

that other EFTA countries had applied or were preparing applications for membership plus the impact of the dramatic changes in the European geopolitical landscape led to the renewed Norwegian decision in November 1992 to apply for full membership of the Community.

7. In her speech to the Norwegian Parliament (Storting) on 16 November 1992, Prime Minister Brundtland emphasized that the European Community had developed into the most important organization for cooperation in Europe. She said that '[Norway] is applying for membership of a Community that has developed its own rules and traditions. We wish to join the other countries in developing them further.

It is the countries that participate in the cooperation that will determine its further course, not those that remain on the outside. Given that decisions taken by the EC will have a profound effect on our country, we should also participate in this important new phase of European cooperation as we have done in EFTA throughout the entire post-war period.'

She also emphasized the importance of the EC's common foreign and security policy.

The Norwegian economy and the Community

1. The Norwegian economy is one of the most prosperous in Europe. Owing to a comfortable resource situation, notably in energy, Norway has benefited from one of the highest standards of living in Europe, with a GDP per capita over or close to the highest in the Community during the last 20 years. The strong economic performance has also allowed Norway to invest in good infrastructure as well as in a highly skilled labour force. Moreover, the exploration of oil off the Norwegian coast from 1971 onwards, has contributed to developing and maintaining a high level of technology.

As a member of EFTA, Norway has long participated in European cooperation and trade. Norway has for a long time been among the 10 most important trading partners of the Community. In 1991, Norway was the seventh biggest supplier and the eighth biggest market for Community exports. Norway supplies approximately 3.5% of Community imports and is the destination of more than 2% of Community exports. The Community's imports from Norway consist, to a very large extent, of primary products (more than 70%), while Community exports to Norway are dominated by manufactured products. The Community is by far the main trading partner for Norway. In 1991, it accounted for almost 50% of Norwegian imports and 66% of its exports. Among the Community Member States, the UK and Germany are the most important suppliers of the Norwegian market and the most important destinations of Norwegian exports. The Community and EFTA, taken together, account for nearly 70% of Norwegian imports and 81% of its exports.

As of 1 July 1990, Norway changed her regime of capital movements to an essentially free one. According to the EEA Agreement, the remaining barriers, notably in the field of direct investments and real estate investment, will have to be abolished by 1 January 1995. In the monetary field, Norway demonstrated its strong interest to closer cooperation with the Community, when, in October 1990, as the first country outside the Community, she unilaterally pegged the Norwegian krone to the ecu. The ecu link included bilateral swap agreements with the Community's central banks, and lasted until 10 December 1992 when the Norwegian authorities were forced to let the krone float in the aftermath of the turmoil on international exchange markets.

2. The present economic situation in Norway seems to follow a relatively favorable development compared to most Member States of the Community. After a severe recession with negative output in the mainland[1] economy in 1988 and 1989, economic growth has recovered. In 1992, overall GDP grew by 2.6% whereas the mainland economy grew at a rate of 1.0%. Inflation is currently running below 2.5% and the current account shows a surplus of around 2.3% of GDP.

Despite this economic improvement, some signs of structural weaknesses in the Norwegian economy give reason for concern:

[1] By 'mainland' the non-oil sector is meant here.

● From 1987 to 1992 unemployment rose from 2.1% to 5.9%, in addition to 2.6% of the labour force benefiting from labour market measures.

● Expansionary policies have contributed to a deterioration in public finances. During the last four years, increased labour market measures, public investments and transfers to local governments have provided a total demand stimulus equal to 7% of mainland GDP. During the same period, public balance shifted from a surplus of 1.4% of GDP to a deficit of 3.2% of GDP in 1992.

● The total consequences of the financial crisis which emerged in the aftermath of the deregulations of the credit markets and the subsequent explosion of credits are still uncertain. Although the financial position of households and firms has improved recently, additional credit losses in the ailing banking sector are not excluded.

● Investments in the mainland economy declined by 35% from 1986 to 1992. Although to some extent explained by the recession and the overexpansion during the 1980s, the sharp decline continues to give reason for concern.

3. Structurally, the Norwegian economy is characterized by great reliance on natural resources and energy production.[1] This is reflected both in the size and the importance of the petroleum sector and the fact that a large share of the manufacturing industry is energy-intensive.

The heavy reliance on energy-intensive industries is explained by the abundance of relatively cheap hydroelectric power given Norway's many waterfalls. Norway's production of oil and gas equals about half of total Community production.

After the discovery and subsequent exploitation of oil resources in the 1970s, the importance of the petroleum sector has gradually increased, although varying depending on the price of oil. In 1991 it contributed to 16% of GDP, 32% of exports and to 11% of total public revenue. At present, its relative importance in terms of contribution to GDP is above that of manufacturing industry.

Several sectors are benefiting from the expansion in the petroleum sector, the most important being the construction of oil rigs, shipping and a number of service industries.

Developments in other industries in the last two decades reflect the increasing importance of, and revenues from, the petroleum sector. Contrary to most Member States of the Community, manufactured output has remained at its mid-1970s level. Employment in manufacturing has, however, declined, its share of total employment being reduced from 24% in 1974 to 16% in 1991. Resources were shifted to the sheltered sectors: since the mid-1970s only public services and the private service sector have incurred any growth in employment.

About 25% of value-added in manufacturing is provided by energy-intensive production, such as metals, chemicals, pulp and paper. Historically, these industries have benefited from low electricity prices. Electricity prices to Norwegian industries equal 25 to 50% of average Community prices: varying according to use. Exports of electricity, other than surplus electricity, are presently limited to 3% of national production. Both the ongoing deregulation of the domestic electricity market and the removal of the export limitations may increase prices for energy-intensive uses, thus necessitating improved cost and productivity performance.

The specialization of the Norwegian economy is also reflected in the composition of exports and imports and explains the relatively low intra-industry trade with Community Member States. Norway imports a wide range of industrial products, in particular consumer and investment goods. As for exports, more than half of Norwegian exports are dependent upon developments in a handful of relatively unstable world market prices, notably the oil price.

4. The structure of the Norwegian economy does, to some extent, reflect the adaptation to comparative advantages. Petroleum revenues have, however, been used to maintain produc-

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[1] According to Norwegian estimates, the current level of oil production may be maintained until 2000. By 2010, gas production will dominate and the oil reserves are expected to be exhausted by 2030. The price of oil is currently USD 18/barrel. According to the Norwegian authorities, a decrease in the oil price of 10% will lower export income by 3.2% or 1.4% of GDP.

tion and income in declining industries, most notably in agriculture and shipbuilding. Furthermore, real wages have been pushed upwards as high public spending and rapid expansion of public employment have helped to slow the growth of unemployment. This wage development has helped to inhibit the expansion of the private sector. In addition, productivity in manufacturing has grown at a slower rate than in competitor countries.

The present structure of the Norwegian economy leaves the external balance, public finances and total economy very vulnerable to large swings in the oil price and the world market price of a handful of staple goods. Furthermore, the economy risks being exposed to declining terms of trade in the longer run. These structural imbalances show the limitations of a development which relies too heavily on the economic rents from natural resources. In the medium term, a revitalization of the mainland economy seems necessary to stabilize and preserve the high level of welfare in Norway.

5. In this context, structural policies are essential in order to reduce oil dependency and to create a competitive environment to stimulate growth and employment. While some institutional changes have been undertaken during the last decade, notably deregulation of financial and energy markets and changes in the tax system, considerable room for improvement remains in the areas of competition and subsidization.

When the EEA Agreement is implemented, domestic competition is expected to increase. EEA competition regulations may reduce market distortions, particularly in sectors such as transport, construction and trade. In order to comply with EEA rules the government is also currently preparing new national legislation on competition and will replace the Price Act of 1953 with a new Competition Law. Determined implementation of this law may help to improve efficiency and enhance competition.

However, the level of subsidies which has tended to protect ailing parts of the mainland economy, in both manufacturing and agriculture, is still relatively high compared with other industrialized countries. Direct subsidies including interest subsidies to households and direct support to agriculture amount to about 6% of GDP, which is about four times the OECD average, while subsidies to industries alone equal 3% of GDP.

Norwegian agriculture receives one of the highest amounts of support among OECD countries. Agriculture and related activities like food-processing and food-trade are also effectively sheltered from foreign competition through tariffs and quotas. While this reflects the strong regional policy tradition and the importance of agriculture in remote regions, reduced transfers and enhanced efficiency may prove necessary in the long run.

Furthermore, as the public sector employs about 25% of total employment, public sector efficiency is of major importance. Independent studies have shown that considerable efficiency gains may be realized in the public sector, among others in education, transport and regional policy. Such gains may be used to reduce the overall tax burden or to increase the supply of other public services.

Another important structural issue of major concern is the severe crisis in the financial sector. Following the deregulation of the credit markets in the 1980s, inflationary expectations, lax monetary policies and income tax systems that greatly favoured borrowing contributed to a substantial expansion of credits.

Due to an overoptimistic risk assessment and exceptionally fast credit expansion, extensive credit losses occurred once the economy began to decline.

In order to restore confidence in the financial system, the Norwegian Government has intervened with substantial rescue measures; between 1991 and 1992 the banks received around NKR 20 000 million, equivalent to 3% of GDP in public funds. By these measures, the Norwegian State became the far most important bank owner in the three major commercial banks.

A more efficient use of the resources in the financial sector is also particularly important in order to adjust to the likely increase in foreign competition implied by the EEA Agreement. At present, the conditions of sound competition in the banking industry risk being offset by the government measures as neither foreign banks, nor the domestic smaller healthier banks, so far are able to compete on the same terms as the commercial banks supported by the government.

6. Decisions on public expenditure and revenues are highly centralized. Although 70% of the public sector activity is undertaken by local government, the majority of its activities are regulated by law or by tied transfers from the State. Unlike in Finland and Sweden local government has no freedom to set local taxes. The Parliament decides the income of local government by deciding the level of taxes and transfers.

Individual rights to social security are obtained through annual premiums, where accumulated premiums determine the size of age pensions etc. However, the system as such is a 'pay as you go' system and is thus not self-financed. It is currently running large deficits, financed through the fiscal budget. The Parliament sets the level of individual benefits. Overall, benefits have improved during the last two decades.

A major tax reform was implemented in 1992, broadening the tax base and reducing marginal tax rates. As the new system implies less variation in effective taxation of returns on various kinds of investment, distorting effects of taxation are reduced. However, the marginal tax on wages, including employers' and employees' social security contributions remains high. It differs from 44.5% on low wages to 63.8% on high wages. In northern Norway the marginal tax is 16.3% lower.

Public expenditure increased from 48% of GDP in 1981, to 59% of GDP in 1992, which is about 10% above the Community average. Most of the increase is due to a rise in public consumption and transfers to households. In particular, social security benefits, such as unemployment benefits, rehabilitation benefits and disablement pensions, have grown rapidly over the last years. Public sector employment rose by 2% per year from 1988 to 1992.

During the 1980s, the general government balance showed considerable surpluses, but deteriorated gradually from 1989 on, as fiscal policy turned expansionary to counter the recent recession. In 1992, tax reliefs of nearly 1% of GDP were included in the reform. By 1992, public sector deficit and public debt equalled, respectively, 3.2 and 43.5% of GDP. Baseline medium-term projections recently undertaken by Norwegian authorities show that public sector finances may deteriorate further in the next five years. The overall tax burden is already among the highest in Europe. In addition, one tenth of public revenue depends on the fairly volatile world market price of of oil.

Clearly, the scope for further expansionary policies is certainly limited, and altogether actions to strengthen the financial position may prove fruitful.

During the last five years, the main policy response to the surge in unemployment has been to increase public spending in order to prevent domestic demand from declining as well as to increase employment in the public sector. However, as public deficits have grown, it has become more and more obvious that there are certain limits as to how much further the present strategy can be pursued. Hence, a reorientation of fiscal policies towards a revitalization of the private sector in the mainland economy, e.g. by lowering indirect wage costs and reducing public expenditure, could provide a good foundation for employment growth in the longer run.

7. The objective of the Norwegian monetary policy is to create a foundation for sustained growth through low price and wage inflation. From 1986 to late 1992, exchange-rate stability was the operational target for this policy, which proved successful. Inflation fell from an average of 9.5% in 1980-86 to 4.2% in 1989, and is presently running at 2.3%.

The ecu link in October 1990 continued the aims of the fixed exchange-rate policy with regards to lower inflation, but with a stronger European orientation.

Until August 1992 the Norwegian krone remained very stable towards major currencies. However, in the aftermath of the turmoil on international exchange markets and the subsequent flotation of the Swedish and Finnish currencies, the Norwegian authorities decided to let the krone float on 10 December 1992. This decision was linked to the fragile state of the banking sector and the high debt of the private sector and their capacity to face the very high nominal and real interest rates which have been required for some time. Since the floating began and until present, the krone has depreciated around 3% against the ecu.

Nevertheless, the reasons for returning to a fixed exchange-rate system remain strong. Given the relatively high imports of consumer goods, domestic consumer prices tend to immediately reflect exchange-rate movements with subsequent adjustments in nominal wages, also reducing real wage flexibility. On the other hand, the structure of exports, concentrated on a few goods where world market prices are highly volatile, complicate the conduct of such a policy, as it implies a higher volatility in terms of trade than in the EC countries. This reinforces the need for greater flexibility in other fields of economic policies and for diversification and reduced dependency on oil.

8. In summary, the accession to the Community of Norway, one of the most prosperous countries in Europe and relative to its population the richest on natural resources, will not create insurmountable problems from an economic point of view. Currently, inflation is lower and the financial position of the public sector is performing better than in most EC countries. In recent years monetary and exchange-rate policies were successful in achieving inflation performances well in line with future EMU requirements. These performances will have to be confirmed following the decisions of the authorities to abandon temporarily the link to the ecu. However, structural weaknesses in the mainland economy give reasons for concern as the macroeconomic equilibrium is now highly dependent on oil resources and therefore oil prices. To some extent, the reduced importance of traditional activities relative to the oil sector reflect expected market mechanisms. But economic policy, in particular insufficient competition and strong expansion of public expenditure and employment, has also contributed to this development. In order to provide a solid foundation for the economy and employment and to preserve the high standard of living of the Norwegian population in the longer run, measures oriented towards the revitalization of the mainland economy have appeared more and more necessary. The Norwegian authorities have already undertaken steps in this direction, by a comprehensive tax reform and the deregulation of important markets. The implementation of the EEA would be another important step to enhance competition. Fiscal policy could also contribute to this goal. As in other Nordic countries, high public expenditure and fiscal pressures reflect a marked preference of the Norwegian population for social equity and consumption of public goods. The effective costs of the consequent policy in financial terms and in terms of crowding out private initiatives have been partly hidden and partly attenuated by the existence of the oil revenues. The revitalization of the economy necessitates that these costs should be better taken into account. Measures in this direction would also greatly enhance the framework in which monetary cooperation can be re-established with the Community in due time.

Impact of accession

Agriculture and forestry

1. The total agricultural area of Norway is approximately 1 million ha or 3% of the total area. Productive forests cover 7 million ha. The remaining 75% consists of mountains, glaciers, lakes and built-up areas. The share of the total active population employed in agriculture is 5.4% (103 000 persons working on 96 000 farms), which is about the same as the Community average. However, agriculture only accounted for 1.8% of GDP in 1990 (EC: 3%).

2. Geographical location and climatic conditions play a significant part in determining basic agricultural patterns. A large part of Norway has Arctic and sub-Arctic characteristics. Agricultural production is limited by the length of the growing season, which is about 190 days in the southern parts and only 100 days in the northern parts of the country and in mountainous regions in southern Norway. Climatic conditions have a strong influence on yields and increase the risks associated with crop production.

Only 5% of the agricultural area is used for wheat production. The most important crops are grass forage (55%) and feed grains (30%).

3. Norwegian farm structure is characterized by a large number of small farms. The average area of arable land per farm is considerably below the Community average (10 ha compared with 16.6 ha for the EC). 87% of the farms have less than 20 ha arable land. Mountains, fjords, lakes and forests divide the farmland into scattered, relatively small plots, some of which are very hilly. This limits the potential for structural rationalization. It also results in high costs in agricultural production.

The farm structure is also a result of strong historical and cultural traditions associated with farm ownership In Norway. The farmland cannot be purchased without a special concession. The purchaser must be assessed as suitable and must agree to live and work on the property for at least five years after taking it over.

4. For meat and dairy products Norway is nearly self-sufficient. However, Norway produces no sugar, oilseeds, wine or protein feeds. Wheat production is not possible in most parts of the country. A considerable proportion of the wheat, fruit and vegetables consumed in Norway is imported.

The overall level of self-sufficiency as regards agricultural products, calculated on an energy basis, is about 50%, which is the lowest in Europe.

5. The policy instruments used by Norway are in some respects similar to those used by the Community, although there are also major differences. In Norway, the agricultural marketing cooperatives are responsible for regulating the market, and the farmers themselves incur the costs for surplus production in the form of marketing fees. Border controls are largely based on quantitative restrictions. Both internal producer prices and the level of direct support in Norway considerably exceed corresponding prices and support levels in the Community. The Community would have to verify, in the course of negotiations, compatibility between the support Norway gives and the Community's relevant policies and legislation, including State aid policy. However, the Community shares Norway's objective of maintaining agricultural activities in marginal areas.

The level of support in Norwegian agriculture, as measured by producer subsidy equivalents (PSEs), is relatively high. In 1990, PSE percentages in Norway were higher than in the EC for all major products. The average PSE in Norway was 77%, as compared with 49% in the Community.

6. Current producer prices in Norway are up to twice those in the EC. The costs of input factors are also considerably higher in Norway than in the Community.

The reduction in grain prices would result in a shift in livestock production from rural areas to central areas which are dominated by grain production today.

Norwegian food processing enterprises are small in international terms. A considerable