

Information Memorandum

The Faroe Islands



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Landsbanki Føroya
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The following presentation of the Faroe Islands has been prepared by the Landsbanki Føroya on behalf of the Government of the Faroe Islands.

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foreign trade and resources in the subsoil. In early 2002, the educational system was officially assigned to the Faroe Islands and the State block grants from Denmark were reduced accordingly.

Certain matters of particular Faroese concern still fall within the jurisdiction of the Danish authorities in accordance with the agreement between the High Commissioner and the Faroese Government.

2) Joint matters

These are administered by the Danish Government according to the laws of the Kingdom of Denmark. Foreign policy, judicial matters and social legislation are primarily joint matters.

The provisions of the Act stipulate, however, that the administration of certain matters of common concern can be wholly or partly assigned to the Faroese Government or undertaken by the Danish and Faroese authorities jointly.

The Faroese Government now administers the social welfare system and the health services, etc. The legislative authority still lies with the Danish Government, but legislation has to be ratified by the Faroese Parliament for it to be applicable to the Faroe Islands.

To cover joint matters, the Faroe Islands receives State block grants from Denmark.

Areas that generally concern the Faroe Islands only, especially matters concerning Home Rule procedures, rest with the Department of the Danish Prime Minister. The Office of the High Commissioner is under this department. The main rule, however, is that Faroese matters managed by the Danish Government are handled by the relevant Danish ministry.

2.2 The Faroese Parliament and Government

The Faroe Islands is governed by the Løgting¹, which is the legislative body dealing with special matters and joint matters, etc. Laws passed by the Faroese Parliament pertaining to special matters are termed "Løgting Acts", and to enter into effect must receive the consent of the Løgmann, the Prime Minister of the Faroe Islands. Laws on joint matters passed by the Folketing must be ratified by the Løgting to be applicable to the Faroe Islands. These laws are termed "Danish Kingdom Law Recommendations".

The Faroese Parliament is elected every four years, however, a majority of the members of Parliament or the Prime Minister may call an unscheduled election. There is universal suffrage for those over the age of 18. The Parliament consists of up to 33 members of which 28 are directly elected from the various constituencies and up to 5 are distributed according to a special at-large system. There are 7 constituencies² comprised of geographical regions and at present there are six political parties represented in the Parliament. The last election was held on 27 April 2002 and the outcome is shown below.

In addition to being divided into the usual spectrum of political left and right, the electorate is also divided in accordance with the attitude towards the political relationship with Denmark, in particular to what extent the Faroe Islands should or should not be independent of Denmark.

The executive or administrative body is called the Landsstýri³. In June 2002, the Fólkaflokkurin, Tjóðveldisflokkurin, Sjálvsýrisflokkurin and the Miðflokkurin formed a coalition government. The principal goal of this government is to make the Faroe Islands more economically independent and self-supportive, so that the Faroese people, without economic or administrative restrictions, can decide their constitutional future.

In the election of 1998, independence was the major issue and the parties in favor of autonomy gained

¹ www.logting.fo

² Vágar, Northern and Southern Sreymoy, Eysturoy, Norðoyggjar, Sandoy and Suðuroy.

³ www.lf.fo

ment and yielded their seats to their alternates upon entering the government.

2.3 Currency

The currency of the Faroe Islands is the Faroese króna, issued by the National Bank of Denmark. Unique Faroese notes are in circulation in the Faroe Islands and are constituted by a currency board as defined by Danish law as equal in value to the Danish krone. The base of the Faroese króna is the amount of Danish krone deposited in an account in the Danish Central Bank at a ratio of 1 to 1. Though the notes used in the Faroe Islands are Faroese, the coins are the same as those in circulation in the remainder of the Danish Kingdom. Faroese and Danish notes are fungible in the Faroe Islands.

A new series of Faroese notes is being issued. A new 50-króna note was issued in the summer of 2001 and was followed by a 100-króna note in early 2003. The rest of the series, a 200, 500 and 1000-króna note is due out before the end of 2004.

Concerning the future of Faroese currency, the Danish people rejected the Euro in 2001. This essentially preserved the status quo for the short term. It is likely that a new referendum on the Euro will be held in Denmark within a few years.

2.4 Foreign relations

In general, the Danish Government has the responsibility for the foreign affairs of the whole Kingdom, including the Faroe Islands. However, it has become common practice for the Faroese Government itself to conduct negotiations involving fishing and trade agreements with other countries, although assisted by the Danish Foreign Office.

The particular status of the Faroe Islands, as well as the unique structure of trade and industry, makes it difficult to share common interests and views with Denmark on a number of areas regarding international co-operation and bilateral or multilateral agreements. Therefore, various treaties and international agreements, which are subject to the consent of the Danish Parliament and which are of special Faroese concern, are to be submitted to the Faroese Parliament for review.

Because of this, Denmark's participation in international economic organizations does not automatically include the Faroe Islands. Negotiations are often conducted with the Faroe Islands at a later stage and this explains the time lag before the Faroe Islands joins various international organizations. For instance, Denmark subscribed to GATT in 1950 and the Faroe Islands in 1954.

Unlike Denmark, the Faroe Islands is not a member of the European Union. In 1974, the Faroese Parliament voted unanimously against applying for membership. Recently, some parties have sought to re-open the question to investigate the current conditions of membership, but discussions have not gained any momentum.

2.5 Agreements with Denmark

Because of the economic crisis in the first half of the 1990s, many agreements have been entered into between the Danish and the Faroese Governments.

The aim of the first agreements was to ensure the continuation of the two biggest banks at that time, Sjóvinnubankin and Føroya Banki, and to ease the Faroese exchequer's lack of liquidity. These agreements included restrictions on the economic policy of the Faroe Islands, e.g., the ability to borrow and / or guarantee loans.

The latest agreement entered into force on 10 June 1998. It deals with Faroese debt repayments, rescission of previous agreements, etc. The Danish Government also observed in this agreement the Faroese Government's objective to make the Faroe Islands a sovereign state.

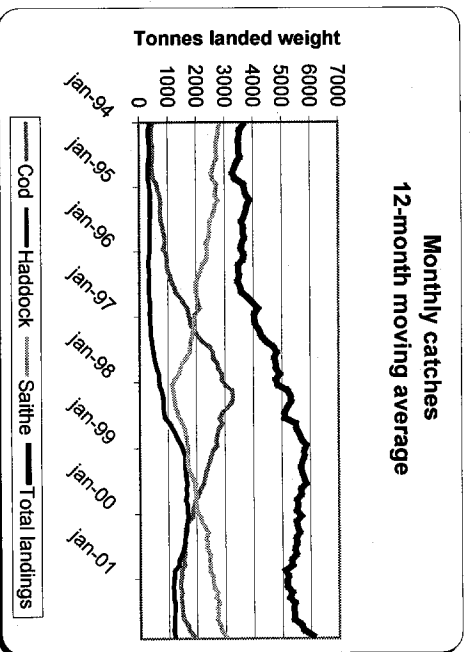
Three rounds of negotiations were held without reaching an agreement on how to settle the transition period between the present status and future independence.

Now, the Faroese Government is pursuing a new course. The plan is to take over as many special matters as possible within the Home Rule Act. In the current coalition agreement, the planned takeovers include the State Church, immigration and family-related judicial matters. The Danish authorities seem to be willing to follow through with this endeavor.

resources in Faroese territorial waters. Today, about 40% of the fish export value still comes from fishing in foreign and international waters, although most of the fishing in foreign waters is reimbursed by reciprocal rights in Faroese territorial waters.

After the transition period, a problem concerning surplus capacity became clear and this grew worse during the expansion of the fleet in the 1980's. In addition, the fleet was becoming increasingly more effective due to more efficient fishing methods partly because more modern fishing equipment was increasingly used. This increasing pressure, mixed with a deterioration of the fishing stocks from natural causes, resulted in a slump in catches, especially for cod, haddock and saithe, which make up most of the catch destined for human consumption.

Beginning in the early 1970s, the fishing industry also became increasingly subsidized and this twisted the market forces in unfortunate ways. Finally in 1992, the subsidies were replaced by a capital subsidy and later in 1998, removed altogether. Now the fishing industry relies very little on subsidies, although some indirect measures have been introduced instead.



Around this time, a condemnation plan was initiated whereby the ship owners were paid to give up their fishing vessels⁴. This resulted in a capacity reduction of around 30%. The intent of this plan was to increase the catch for each remaining vessel and in the end, increase the competitiveness and the total catch.

Approaching the mid-1990s, the cod stock turned out to be in better shape than previously estimated and the catch of cod increased gradually from 1993 to 1997. The export value, however, did not increase as much because a large portion of the export was unprocessed fish. Over a five-year period, this has changed partly because of more local processing, but more specifically because of a general increase in world market prices, especially for cod. In 2002, the prices were lower again, but the total catch was one of the best ever.

Statistically, total catches by Faroese ships in general increased from 1993 to 2002, but there were differences among the various species, as can be noted in Appendix G, Table 1. Year 2002 was even better than 2001 and this is visible in the export weight statistics as well, but the total value is about the same.

The general increase in prices and the overall growth in catches within Faroese territorial waters has resulted in an elevation of the export value. From 1998 to 2002, the total export value increased by 47%, while the landed weight increased somewhat less. This even understates the actual value increase, because the catch of the cheaper blue whiting has grown by a multiple of 13 since 1996.

3.2.2 Fisheries management

Quotas (TAC) were introduced by law in 1994, but by June 1996 the quotas were replaced by a new system of "Fishing Days". The new system focuses on viability and takes into account the differences in fishing gear and relative size of the vessels. The number of Fishing Days in a fishing year (commencing on 1 September) is set by law on the recommendation of an advisory board, comprised of representatives from in and around the industry. The recommendation is based on estimates of the fish stocks and the level of fishing effort. Each ship within each group thus gets a certain number of fishing days in which it may fish. Therefore, the TAC quota is a guiding factor rather than an exact amount. Fishing days are partly tradable.

The advantages of a fishing-days system compared to a quota system are mainly that vessels can take all their catch ashore rather than throwing fish overboard and furthermore curtails the fraudulent practice of landing fish under a false name. The disadvantages are mainly that the system is not efficient in protecting specific species and it does not take

⁴ Development of fleet. See Appendix G, Table 2 and 3.

about 75% of the home market is supplied by domestically produced products.

The annual production of mutton is on average 500 tonnes, which corresponds to 40% of the total demand. The production of beef and beef products amounts to around 110 tonnes. This is just a small percentage of the total consumption; meat imports, therefore, remain at a comparatively high level.

3.3.4 Construction

The construction industry in the Faroe Islands has had a very significant impact on the economy, compared to other countries. Most Faroese homes are spacious and the Faroe Islands has generally high private housing standards.

During the 1980s, many houses, roads, tunnels, harbours, etc. were built or upgraded all over the country. However, when the depression hit, only about 20 houses were built per year, compared to a couple of hundred previously. Worker compensation fell from DKK 348 million per year to DKK 98 million in 1995.

Now both private and public construction is booming again and compensation of employees has risen to DKK 344 million in 2002, up by 13% compared to 2001 (Appendix H, Table 3). Although the level of activity is still high, the growth in 2003 appears to have peaked and is expected to remain around the 2002 level. The previously referenced workforce shortage in the industry is not critical at present, even though unemployment figures remain very low.

3.3.5 Transport

Internal

The transportation facilities in the Faroe Islands are good. With the new tunnel to Gásadalur, which was finished in February, road connections now link all villages on each island and also between some of the islands.

In January this year, the first subsea tunnel in the Faroes was opened between Vágur and Streymoy. This is the first user-financed investment of its kind in the Faroe Islands. A second subsea tunnel is planned for between Borðoy and Eysturoy and the project is expected to start later this year.

Both passenger and cargo transport are provided on a daily basis to all but two of the inhabited islands and most villages. Ferries and helicopter services are available to the islands that are not directly linked to the road system, and bus service is the most common form of transport for the other areas. The public transport company, Strandfæraskip Landsins⁶, maintains most of these routes, while numerous private companies offer passenger and cargo services on request.

External

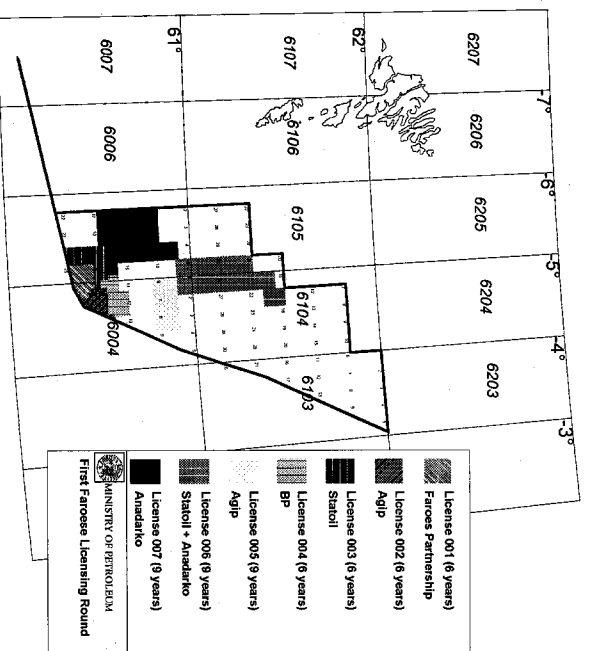
Three airline companies⁷ from the Faroe Islands, Denmark and Iceland, handle the air services to and from the Faroe Islands. Depending on the season, there are two to four daily flights to Denmark (Copenhagen and Billund), two to five flights a week to Iceland and two to four flights per week to Aberdeen. In the summer, there are two flights to Norway (Oslo/Stavanger) as well as to London. Just below 157,000 passengers traveled through Vágur Airport in 2002, which is 0.7% fewer passengers than in 2001. So far this year the number of passengers has increased by 7.8%, due to general increased demand and increased oil activity on the Faroe Shelf.

During the summer, the Faroese ferry Norröna⁸ offers weekly services to Denmark, Iceland, Shetland and Norway. In March of this year, the old Norröna was replaced by a brand new DKK 700 million combined cruise and cargo ship that can carry roughly 1,500 passengers and 800 cars. This project is the biggest single investment of its kind ever to take place in Faroese history. The winter schedule has been revised to offer new service to Bergen and Shetland in addition to the normal service to Denmark. Almost 41,000 passengers traveled to the Faroe Islands by sea in 2002; 4,000 were in transit to another country.

⁶ A timetable of the routes for the ferries and buses is available at www.ssl.fo and for helicopter services at www.atlantic.fo/default.asp?sida=102.

⁷ The three companies are: Atlantic Airways (www.atlantic.fo), Maersk Air (www.maersk-air.com/en) and Air Iceland (www.airiceland.is).

⁸ www.smyril-line.com



On 17 February 2000, the first licensing round was opened. The area offered for licensing lies to the southeast of the Faroe Islands and covers approximately 14,000 km². It is divided into 56 whole blocks and 26 partial blocks. The licensing round closed on 17 May and 17 oil companies submitted 23 applications. On 17 August, seven licenses were awarded to 12 oil companies, organized into five consortia.

Three consortia, represented by Statoil, BP and Amerada Hess, drilled their first wells in the summer of 2001. Statoil concluded their operations on the first of September 2001 with essentially a dry well, as only traces of oil were found. BP finished drilling shortly thereafter. Although some oil was found, it was not of commercial quantities.

The Amerada Hess group then started drilling the *Marijn* well in license area 001. On 19 November 2001, the Ministry of Petroleum and the Environment announced that oil and gas had been found in significant volume, but it was not possible to say if it was enough to start production. Later studies have brought no significant clarification. In the summer of 2003, ENI Agip drilled one well in area 002, but it came up dry. Four wells remain to be drilled before 2006.

The influence of the oil industry is beginning to emerge. Oil companies have established offices in Tórshavn where housing prices jumped in anticipation of potential oil prospects. With time, expectations have become more realistic, the exuberant talk has moderated and circumstances have normalized.

There are also other visible activities apart from oil company initiatives. The offshore base was placed in Runavik and proved reliable and effective during the exploration activities. This has led to and will undoubtedly continue to lead to further activity, both directly and indirectly. So far, the harbor facilities in Runavik have been expanded, and the various companies servicing the oil industry have established a presence there.

The same goes for air transport for the oil industry, which is performed via Vágar Airport. A temporary offshore terminal was built and hosts the helicopter transportation (mostly personnel) that will take place between land and the offshore installations in Faroese waters.

It is hard to estimate the outlook for future activity. The *Marijn* drilling site did not strike oil in the expected sediment and, therefore, the oil companies have had to review their plans. It is still unclear when Amerada Hess will follow up on the promising find they had in 2001.

The seismic and other data obtained from the drilled wells is still being interpreted and it is impossible to predict what will be on the agenda for 2004.

3.3.9 The financial market

Four banks and one investment bank service the financial market in the Faroe Islands. Savings traditionally were deposited in banks, but lately asset management and investment banking have grown in importance. Because there is no securities market yet in the Faroe Islands these investments are made abroad. The industry's domestic assets are loans to businesses, households and the public sector.

The Faroese financial market has experienced much turbulence in the last decade. In 1992 and 1993, huge write-offs were demanded in bank assets. Through the Financing Fund of 1992,¹¹ the Faroese government injected new capital into Sjóvinnubankin and Føroya Banki with loans provided by the Danish Government. Altogether, the injection amounted to about DKK 3 billion, resulting in the banks becoming publicly owned.

¹¹ The Financing Fund's board of directors consists of five members appointed by the Faroese Minister of Finance.

fund, which provides for up to six months of paid leave after childbirth.

During the economic crisis of the early 1990s, the Faroe Islands experienced an unemployment rate of around 20%, which is now dramatically lower. The rate gradually fell and is hovering around 3%.

In 2001 and 2002, total wage payments increased by 13.8% and 4.4%, respectively. The wage situation in 2003 was greatly influenced by the 5-week-long strike amongst unskilled workers, but the amount paid over the first six months this year is only 0.5% above the 2002 level.

From 1989 to 1995, the population in the Faroe Islands decreased by 9% from 47,838 to 43,393. The workforce was reduced by 12%. Most moved to Denmark. The net emigration eased the pressure on the unemployment insurance fund and lowered the actual unemployment figures.

Population in the Faroe Islands (end of year)						
Age	1989	1991	1995	1997	1999	2001
0-14	11,660	11,578	10,324	10,502	10,821	11,146
15-64	30,995	29,982	27,056	27,560	28,439	29,574
over 64	5,385	5,734	6,013	6,228	6,149	6,276
Total	47,840	47,294	43,393	44,290	45,409	46,996

The table above shows that people of working age moved abroad during the crisis, while those of pension age remained. In 1996, the net emigration stopped and the movement pattern reversed to that prior to 1990 – although at a slightly higher rate of immigration.

Because of the emigration in the early 1990s, a relatively large part of the potential Faroese workforce is situated outside the Faroe Islands. This has benefited the Faroese economy as shortages of labour have appeared and still might do so for the future. It is hard to say, however, exactly how many of those located outside will return if their skills become needed.

3.5 Prices

The consumer price index has been revised as of the beginning of 2001. The weights are based on a survey of household consumption from 1998. The old

index used weights from 1972. The year-on-year inflation in 2001 was 0.3% and in 2002 it was 2.4%, which is a relatively modest inflation rate in a boom period. The price level is shown in Appendix H, Table 6.

3.6 Foreign trade

The Faroe Islands is an independent customs area. Import duties and the rules pertaining to import and export are determined by the Faroese Government. In this respect, the other parts of the Danish Kingdom are considered "foreign".

Over the last ten years, the trade balance has been positive with the exception of year 2000. During the depression, imports plunged while exports remained stable. During the upturn, import and export gradually rose, but the surplus became smaller. Considering the situation in the aquaculture industry, lower prices for fish in general and large imports of vessels¹⁷, the outlook is that 2003 will end in the red.

Around 97% of the registered export is in fish products. The import is widely spread between ordinary consumer goods, goods for production and investment goods. In 2002, 80% of the export and 63% of the import was with EU countries. Outside the EU, Norway is the main business partner. (See Appendix E, Table 2.)

When the Faroe Islands declined membership in the Common Market in 1974, a trade agreement was concluded instead. The trade agreement was fundamentally a free trade agreement and as such reported to GATT by the EU. As a condition of the 1991 trade agreement, the Faroe Islands in 1993 implemented a value-added tax regime and excise duties replaced the fiscal import duties. The value-added tax now stands at 25%.

At the end of 1998, a new agreement was concluded between the Faroese Government and the EU, invalidating the following sections of the trade agreement: price arrangements, reference ceilings for export, restrictions on salmon, statistics control and other product specific agreements. Thus, some 95-97% of all Faroese exports are listed as free trade.

¹⁷ The new *Norrøna* alone will pull around DKK 700 million in the negative direction.

4. PUBLIC FINANCE

4.1 Financial system

The annual budget is presented to the Faroese Parliament before October and must be approved before 1 January of the following year. In practice, approval occurs before Christmas.

Beginning with the 1991 fiscal year, the Budget Act was considerably changed compared to preceding years in order to obtain a better governing instrument. Blanket approvals for government investments and certain other expenditures are not permitted. Instead, government investments and other expenditures have to be approved in the budget for the year in question.

The accounts and bookkeeping of the government exchequer are audited by an audit department, as well as by an external chartered accountant. Once audited, the books are passed on to a committee, consisting of members selected by the Faroese Parliament, which is responsible for the finances of the government.

The government Treasury introduced a new accounting system in 1997. Supporting documentation is required to a much higher degree than previously. This makes it easier to track and monitor the government's income and expenses.

4.2 Public income

The Faroese Government fixes and collects duties, taxes, income taxes, customs duties, production and vehicle taxes, whereas municipal government income derives mainly from income taxes.

Two classes of income are defined: wage income, etc. is defined as A-income while business income, etc. is defined as B-income.

4.2.1 A-income

A-income has to be transferred to an account in a financial institution, post giro or the exchequer. Upon receipt of an individual's wages from an employer, the receiving bank automatically deducts and transfers the appropriate withholding tax to the exchequer via the Customs and Tax Administration

centralized tax system. Each tax payment is calculated based on the income up to the date of the latest wage payment, converted into annual income. Adjustments are made after the close of each year; excess tax is refunded, extra tax owed is collected.

The highest tax rate (government and municipality combined) is between 53 and 60%¹⁹, although the tax ceiling is 50%, excluding payments of about two percent to different funds.

Income tax levied by the Tax Administration is calculated on a sliding scale, thus with various allowances the highest marginal rate at present is 37%.

A gross tax system was introduced in 1997. This means that instead of providing for tax deductions, specific subsidies are allowed to compensate for certain expenses.

Municipal taxes are assessed using the same calculation of income as that of the Tax Administration, except that a flat tax rate is used. The economic situations of the municipalities differ greatly and for the year 2002 municipal taxes ranged from 13 to 23%. On average, the tax is 19%.

4.2.2 B-income

B-income is based on a business' annual accounts and is, therefore, collected by the Treasury the year after the accounting year.

Corporate taxes before 1999 were 27%, but were lowered to 20%, except for companies in the oil industry. The tax rate for these companies remains at 27%. Of the tax amounts, 62% is paid to the national treasury, and the remaining 38% to the local municipal authorities.

¹⁹ Depending upon which municipality one resides.

From 1992 to 1997, the debt to the Kingdom of Denmark increased from DKK 500 million to DKK 5,594 million. According to the agreements with the Danish Government, the Faroese Government injected DKK 2,500 million into the Financing Fund of 1992²⁰ and rearranged foreign debt elsewhere with loans from the Danish Government (Appendix A, Table 1; Appendix F, Tables 1 and 3).

According to the agreements with the Danish Government, Faroese budget deficits would not be financed by the Danish Government, but by the Faroese Government. In December 1994, the Faroese Government for the first time issued bonds for public sale. In addition to meeting the liquidity demands of the Treasury, the aim was also to create a bond market in the Faroe Islands. This would give the Faroese population an additional opportunity to place extra liquidity and work as a credit rating for the Faroese Government. The bonds are so far registered with the Danish Securities Centre and quoted on the Copenhagen Stock Exchange.

On 10 June 1998, the Faroese and the Danish Governments entered into an agreement on government debt. The repayment regime agree upon was based on the settlement reached in connection with the banking crisis, the anticipated development of the Faroese economy in the future and the possibility of hydrocarbon exploitation in Faroese waters.

A long-term settlement was reached, containing these premises: 1) the total debt of the Treasury to the Kingdom of Denmark was devalued by DKK 900 million; 2) DKK 500 million was converted to an interest free loan without any repayment requirements (if hydrocarbon exploitation is not initiated within twenty years, the debt will be forgiven); 3) the remaining debt, with a nominal value of DKK 4,023 million, shall be repaid via a twenty-year annuity with yearly payments of DKK 323 million.

4.6 The municipalities

The Faroe Islands at present have 47 municipal councils, which vary in size and population from 20 to 18,000 inhabitants. Some of them have a debt of DKK 90,000 per inhabitant while others have modest or no debt at all. For those who have large debts,

interest and installments are a large part of the municipal budget.

The temporary debt solidarity agreement of 1995 expired in 2001 and was replaced by individual solutions. Some of the municipalities needed assistance from the "Municipalities Loan and Guarantee Fund"²¹. Twelve municipalities co-operated in a refinancing plan in 2000 with a five-year loan from FKI, a special loan association with a guarantee from the above-mentioned fund.

In 1995, the Faroese Government set up a committee to make a proposal for a new municipal system and the report was published in 1998. It recommended a system of 7 to 9 municipalities with clearer distinctions between the national government and the local municipalities.

There has been much discussion following the report and the view on merging municipalities is controversial, but sentiments seem to be moderating. Two municipalities, for example, merged in 2000 and others have decided to follow.

The long-term goals for creating larger municipal areas are to provide a basis for decentralizing public administration and to strengthen local government.

²⁰ Founded with the purpose to restructure the banks.

²¹ A fund was set up into which one percent of the municipal councils' tax income from 1994 to 1996 was paid. In 1996, the fund had on deposit from the municipalities DKK 98 million and loans outstanding of DKK 14 million.

5.2.2 Expenditures

From 1989 to 1997²⁶ total expenses decreased every year even with growing interest expense. In 1998, expenses also dropped due to lower interest payments²⁷ and the abolition of the capital subsidies. In 1999, expenses started to increase and the general increase per year was about 5%. In 2001 and 2002, expenses jumped to about 9% and the level seems to be holding in 2003 (Appendix H, Table 1).

Almost half of the expenses in the budget are wages. According to agreement, wage raises in 2002 increased expenses by more than DKK 60 million and judging from the private agreements already concluded, it is expected to be at least as much in 2003.

5.3 Policy

The current economic policy is expansive. The Government has been reluctant to restrict public spending and supported expansion through tax cuts, investments and expenditures. The expenditures are mainly in infrastructure, social welfare, health care and administration. For 2003, however, the Government has set a goal to cut expenses by 1%.

The Government has been working on privatizing some of the publicly owned companies to finance the reduction of debt and to help launch the expected Faroese stock exchange. Atlantic Airways, Faroese Telecom and some companies owned by the Business Development Fund are amongst the candidates.

5.4 The balance of payments

Since 1993, the BoP has been positive with a consequent decrease in the net foreign debt. The main reasons have been a surplus in trade, the Danish grant, lower interest payments and wage transfers from Faroese working in foreign countries.

In the year 2000, however, the trade balance was in deficit. The current account still shows a big surplus, yet at a lower level. The trade balance is going to be negative in 2003 as well, but the BoP will more than likely remain positive.

5.5 Summary

The Faroe Islands has a history of cyclical booms and busts. In the 1980s the economy became overheated because of subsidies, over-investment, poor political management, etc. This led to general over-consumption, of which much was financed by foreign loans.

When a down turn in the fishing industry emerged in the late 1980s, much of the industry went bankrupt and the repercussions affected the entire economy. A banking crisis was precipitated by liquidity shortages and as income fell, the Faroese Government had to tighten fiscal policy. This resulted in falling demand and, consequently, considerable economic decline.

The turning point came in the mid-1990s when catches and, later, prices increased. Improved general competitiveness and a pick up in private consumption and investment, became the drivers of an amazing economic recovery.

Since 1998 the economy has boomed again, thanks to developments in the fishing sector and the aquaculture industry, private and public consumption and a growth in investments. Unemployment has fallen from 20% to below 3% in 2003, despite net immigration of the workforce, which before had left the Islands.

5.6 Outlook

The outlook for the Faroe Islands is mixed. As the economy shifts into lower gear, the consequences are two-fold. The signs of economic overheating and the subsequent risks are disappearing. This should keep the BoP positive because consumption and investment will decrease. On the other hand, the public budget surplus and the BoP will be threatened and worsened by the current crisis in aquaculture, the cut in the Danish grant and possible further cuts in public expenditures.

²⁶ Assuming exception of the capital injections into the banks in 1992 and 1993.

²⁷ The lower interest payments were a result of the agreement of 10 June 1998 with the Danish Government. The agreement lowered the interest rate and the repayments.