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June 8, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Norway - Staff Report for the 1983 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1983 Article IV consultation with Norway. It is proposed to bring this subject to the agenda for discussion on Friday, July 22, 1983.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Knöbl (ext. 74984) or Mr. Arimo (ext. 76005).

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INTERNATIONAL MONETARY FUND

NORWAY

Staff Report for the 1983 Article IV Consultation

Prepared by Staff Representatives for the
1983 Consultation with Norway

Approved by L. A. Whittome and Subimal Mookerjee

June 7, 1983

I. Introduction

A staff team consisting of Messrs. Rose, Knöbl, Arimo, Hemphill, and Mrs. Schulze-Ghattas, with Mrs. White as secretary, (all EUR), held Article IV consultation discussions in Oslo from April 26 to May 6, 1983. The Norwegian representatives included officials from the Ministries of Finance and Customs, Commerce and Shipping, and Petroleum and Energy, and from the Bank of Norway. The mission also met with the State Secretary for the Ministry of Finance, Mr. Storvik; the Secretary General of the Ministry of Finance, Mr. Erichsen; and the Governor of the Bank of Norway, Mr. Getz Wold. Mr. Tvedt, Executive Director for Norway, attended the meetings as observer. Norway formally accepted the obligations of Article VIII, Sections 2, 3, and 4, from May 11, 1967.

II. Background

Over the past decade economic developments in Norway have been dominated by its emergence as a significant oil producer at a time of strongly rising oil prices. In the period 1974-77 economic growth in Norway was supported by the rapidly growing oil sector and by strongly expansionary economic policies designed to counteract the recessionary impulses coming from abroad. However, appreciation of the exchange rate of the krone and mounting domestic cost and price pressures led to a sharp worsening of competitiveness of the sector exposed to foreign competition (excluding oil) 1/ which, together with buoyant domestic demand and delays in oil production, resulted in an unprecedented deterioration of the current external balance and a sharp rise in net external debt.

The weakness of the external position led to a reorientation of economic policy in 1978. Emphasis was put on securing an improvement in the current account and on safeguarding employment by improving international competitiveness. Financial policies became more cautious; the rate of growth of the monetary aggregates was reduced, and the fiscal deficit (excluding oil taxes) was stabilized as a proportion of GDP, while rising oil taxes helped to bring the overall fiscal balance into

1/ For the sake of simplicity this sector is henceforth referred to simply as "the exposed sector."

surplus. A devaluation of the krone combined with an extended wage and price freeze succeeded in improving the relative cost position in 1978-79. Helped by a sharp rise in oil exports, the external current account has been in surplus since 1980, and external indebtedness has been reduced. However, following the wage-price freeze, inflation accelerated again in 1980-81 and has considerably exceeded that of Norway's main trading partners. Moreover, economic growth came to a halt in 1981 as a result of the international recession, cautious domestic policies, and a leveling off of oil and gas production. With overall output remaining flat over the past two years, registered unemployment has risen, though it remains low by international standards.

III. Recent Economic Developments

The economic stagnation that began in 1981 continued in 1982 when real GDP declined by over 1/2 per cent. The slight fall in output was due to a significant worsening in the real foreign balance; total domestic demand rose more strongly than in 1981, mainly because of a sharp rise in inventories which largely reflected an increase in oil platforms under construction. Other components of domestic demand remained sluggish, with a significant fall in fixed investment. The flat level of overall output masks an outright fall of output in the manufacturing sector. The oil and gas output, which had risen rapidly in the second half of the 1970s, has also leveled off since then and now amounts to 15 1/2 per cent of GDP.

Manufacturing output has been stagnant for several years, while the service sectors have been relatively buoyant. Output in the exposed sector fell by 4.5 per cent between 1974 and 1982, while it rose by nearly 30 per cent in the sheltered sector. These developments in output have found their reflection in the labor market. Employment in the exposed sector has fallen substantially, by 13 1/2 per cent between 1974 and 1982. The growth of employment in the sheltered sector (14 1/2 per cent over the same period), particularly in the public sector, has more than compensated for the decline in employment in the exposed sector. Registered unemployment has also been kept down through considerable government support to ailing industries (in particular shipbuilding, iron and steel, and textiles) and through special employment-creating measures. However, total employment has risen more slowly than the labor force and registered unemployment has risen from some 1 per cent of the labor force in 1980 to over 3 per cent in early 1983, a level regarded in Norway as a matter for serious concern.

The rate of inflation has remained high in recent years, largely as a result of strong wage-push. After the expiration of an extended wage and price freeze at the end of 1979, wage and price inflation rose sharply, peaking at about 15 per cent in late 1980-early 1981. A brief price freeze was reintroduced in August 1981 until the end of the year. Since then there has been a deceleration in the rate of increase, and in December 1982 consumer prices were 11 1/2 per cent higher than twelve months earlier.

Wage settlements in the spring of 1982, when labor market conditions were still relatively tight, resulted in a reacceleration in wage increases during 1982 to about 12 per cent, exceeding increases in main trading partners by a substantial margin. Thus the gain in international competitiveness of the exposed sector flowing from the depreciation and the wage-price freeze in 1978-79 was eroded by the rise in relative unit labor costs in manufacturing. By the end of the year competitiveness was back at about the level of end-1978 and almost 25 per cent weaker than ten years earlier.

With the rapid buildup of North Sea oil and gas production in the late 1970s, the strong rise in oil prices in 1979-80, and more cautious financial policies, the current account of the balance of payments moved into strong surplus that peaked at about 4 per cent of GDP (SDR 2 billion) in 1981. However, the surplus declined to 1 1/2 per cent of GDP (SDR 0.7 billion) in 1982. The volume of exports of goods and services declined by 2 1/2 per cent in 1982, while the volume of imports rose by almost 6 per cent. The volume of oil exports declined slightly, and traditional exports, a large part of which are cyclically sensitive, suffered from depressed foreign demand. The weakening in the competitive position in 1981 and 1982 contributed to a loss in export market shares and a steep rise in imports. Import volumes were also boosted by imports related to the development of the oil and gas sector.

The current account surplus has enabled the authorities to reduce Norway's external indebtedness over the past few years. The net external debt of the economy declined from over 46 per cent of GDP at the end of 1978 to less than 27 per cent (SDR 12.5 billion) at the end of 1982. Although the capital account of the balance of payments was under some pressure at the time of the Swedish and Finnish devaluations in October, the disturbance in the foreign exchange market was short-lived. Gross official reserves continued to increase during 1982, by SDR 0.9 billion to SDR 6.3 billion, equivalent to nearly six months of merchandise imports.

After several years of relative stability the nominal effective exchange rate of the krone (official weights) depreciated by about 5 1/2 per cent 1/ during 1982, mainly as the result of two discretionary changes.

IV. Economic Policies

While much of the relative shrinkage of the exposed sector and of the strong growth in the sheltered sector over the past decade can be seen as the consequence primarily of the development of the oil and gas sector and of the policy of spending most of the oil income domestically, the Norwegian representatives thought that this process may have been allowed to go rather too far. They felt that in the medium term oil and gas export receipts alone could not be relied on to pay for higher imports. Oil and gas output was not likely to rise much over the next few years, and developments in prices were uncertain. The Norwegian economy,

1/ With MERM weights the depreciation amounts to about 8 1/2 per cent.

therefore, needed a non-oil sector producing tradable goods and services of at least its present size. This was also desirable from the point of view of maintaining employment. Further expansion of employment in the public sector, which had risen strongly in the 1970s, was considered undesirable.

The main objective of the authorities is, therefore, to increase employment in the private sector, and they recognize that this may not be achieved in the short term. For this purpose they aim to strengthen or at least maintain the competitiveness of the exposed sector, and to restrain the growth of--in particular--labor costs in the sheltered sector. Strongly expansionary financial policies are considered inappropriate for this purpose, as they would only fuel inflation and endanger competitiveness.

1. Fiscal policy

Norway has a strong fiscal position in the sense that the government accounts, before loan transactions, have been in surplus since 1980; the central government surplus 1/ amounted to 3 per cent of GDP in 1982, compared with a deficit of 3 1/2 per cent in 1978. The main reason for the sharp swing in the government balance was strongly rising oil revenues. Excluding oil taxes, the central government deficit has fluctuated around 6 1/2 per cent of GDP 2/ in recent years. The Norwegian representatives said that this deficit reflected the intentional channeling of tax income from the oil sector into the domestic economy. Thus, central government spending in relation to GDP 2/ rose from 37 1/2 per cent in 1973 to 46 1/2 per cent in 1978, largely on account of a rapid increase in transfer payments. In particular, transfers to municipalities for the financing of increased spending on health and education rose sharply. Government support of ailing industries also rose strongly in the late 1970s. Since 1981 central government spending has been contained at some 49 per cent of GDP 2/, despite an expansion of special employment-creating measures. In the medium term it is the aim of the Government to reduce the growth in public expenditures in order to facilitate a transfer of resources to the private sector, and to reduce direct taxes to improve incentives and facilitate lower nominal wage increases.

The Norwegian representatives said that so long as the fiscal balance including oil revenues was in surplus (implying that not all oil revenue was being spent domestically), the size of the deficit, excluding oil revenues, was not of serious concern. They noted that this deficit had been stabilized at around 6-7 per cent of GDP since 1978, implying that the fiscal stimulus to domestic demand had not changed much in recent years, despite the weak cyclical position of the economy in 1981 and 1982.

1/ Fiscal data in this section are on an administrative (cash) basis. Revised estimates on a national accounts basis are given in Recent Economic Developments.

2/ Adjusted to exclude the oil and shipping sectors.

In the original budget for 1983, presented in October 1982, some tightening in the fiscal stance had been envisaged, in support of the aim of reducing cost and price inflation. The central government deficit, excluding oil taxes, was planned to decline by 1/2 percentage point from the then estimated level for 1982, to 5.7 per cent of GDP.

However, since October 1982 a number of stimulatory measures have been taken. Following the Swedish and Finnish devaluations in the fall of 1982, and taking into account the deteriorating situation in the labor market, additional selective industrial support and special employment-creating measures have been introduced. Moreover, a lower-than-anticipated rate of wage and price inflation has led to a downward revision of revenue estimates, while much of spending has been fixed in nominal terms. In the revised budget for 1983, made public after the conclusion of the consultation discussions, the central government deficit excluding oil taxes was put at 7.2 per cent of adjusted GDP, compared with 6.9 per cent now estimated for 1982. Including oil taxes, the fiscal surplus is expected to decline from 3 per cent of GDP in 1982 to 1 per cent in 1983, though the latter figure allows for a safety margin against a shortfall on estimated oil taxes of almost 1 per cent of GDP. The deficit of the municipalities is also expected to be larger than in 1982. The Norwegian authorities thought that such a limited relaxation of fiscal policy was warranted in light of the weak cyclical position of the economy.

2. Monetary policy

Since 1980 the Bank of Norway has moved cautiously toward a more market-oriented monetary policy in which greater emphasis has been placed on more flexible interest rates and on the rate of growth of broad monetary and credit aggregates. Although the official monetary objective was exceeded in 1981, the growth in broad money during 1981 and 1982 of 11 1/2 per cent and 10 1/2 per cent, respectively, was kept below the rate of inflation. Monetary policy thus contributed toward restraining inflationary pressures. Interest rates in the money market and bond yields were allowed to rise and become positive in real terms during 1982.

Market forces have been allowed to play a larger role in the domestic bond market through a partial deregulation of private issues since 1980, and bond yields have been allowed to adjust more to market conditions. However, the moves toward a more market-oriented approach in monetary policy did not go very far; the Norwegian money and credit markets have remained highly regulated and interpretation of monetary developments is therefore at times difficult.

The official intention had been to ease monetary policy somewhat in 1983, so as to allow for a moderate recovery in output during the year, while continuing to give attention to the control of inflation. In the original credit budget an increase in broad money of about 11 per cent during 1983 was considered to be compatible with these aims. In early 1983 the growth of bank advances, in particular by savings banks, accelerated at least in part as a result of reintermediation of credit that previously had been extended outside the banking system. The Norwegian representatives were concerned that, if credit expansion continued at the same rate, the growth of broad money would be excessive during 1983. More serious was the strong political pressure on the Government to bring interest rates down either through administrative action or additional credit expansion. Interest rates, particularly short-term rates, have declined somewhat from the high levels reached in 1982, though less than the rate of inflation. "Real" interest rates have, therefore, continued to rise. However, the Norwegian representatives pointed out that after-tax interest rates have continued to be negative owing to the deductibility of practically all interest costs from taxable income. This, together with the low rates of property taxes, has facilitated the high demand for credit by households. The authorities have, so far, resisted an administrative lowering of interest rates, and they hope that interest rates will come down on their own in the financial markets if the perception of a slowdown in inflation takes hold.

With the political pressure to reduce interest rates, the easing in fiscal policy that has been announced is expected to result in higher growth in the monetary aggregates during 1983, and in the revised budget a growth in broad money of 12 per cent is now envisaged, somewhat more than the projected growth of nominal GDP. While the Government has stated that it intends to ensure achievement of the revised monetary and credit targets, if necessary through direct regulation of bank credit, the Norwegian representatives were concerned that monetary policy may prove not to be tight enough to achieve the aim of a continued reduction in wage and price inflation.

3. Incomes policy

To achieve the desired improvement in competitiveness in a non-inflationary way, continued wage restraint is required. The present Government has made it plain that it wishes to avoid direct involvement in private sector negotiations. Instead it has again offered income tax reductions (amounting in real terms to about 1 per cent of disposable income) in the budget for 1983 as an incentive for moderation in nominal wage increases. The Norwegian representatives agreed that in the absence of a formal incomes policy it was even more necessary to follow cautious financial policies in order to achieve a sustained reduction in wage inflation. Offering tax reductions to influence wage settlements also required expenditure restraint to prevent the fiscal balance from deteriorating.

The Norwegian representatives said that wage negotiations in the spring of 1983 indicated that wage demands were affected by the recent increase in unemployment. The main objective of the unions had been to prevent a decline in real disposable incomes of lower- and middle-income groups, rather than to secure the real increases that wage earners had grown accustomed to. The reductions in personal income taxes had also probably helped to moderate wage claims. The main settlements in the private sector provided for a 0.7 per cent negotiated increase in wages (on an annual basis). Allowing for an estimated wage drift of 5 per cent during the year, wage earnings in the private sector are expected to rise by about 6 per cent during 1983, and unit labor costs by about 4 per cent. This increase in unit labor costs was thought to be in line with that expected for Norway's main trading partners and would thus not be sufficient to improve competitiveness. The Norwegian representatives felt that the allowance for the wage drift was a reasonable expectation, since it was only slightly less than that experienced during 1982, and the labor market was now much weaker. The settlement reached in the public sector provided for a similar increase in earnings, and was thus disappointing from the point of view of encouraging a shift of resources into the private sector.

The Government also stresses that wage negotiations need to take proper account of economic conditions in different sectors. Some 17 per cent of the industrial work force is employed in firms where the wage bill exceeds total value added. Through generous government assistance these companies have been kept alive, but this has hampered structural adjustment and has contributed to the poor productivity performance. The Government has recognized the need for increased competition to improve resource allocation. It has stressed that in industries that receive selective support, wages should increase by less than the average in manufacturing, and recently it has threatened to make future support subject to this condition.

4. Exchange rate policy

Exchange rate policy was changed during 1982. Since December 1978 the authorities had pegged the krone to a basket of currencies, generally based on bilateral trade shares, with only minor fluctuations around the base level. The U.S. dollar was assigned a fairly large weight, reflecting the role of the dollar in oil and shipping and the importance of these sectors for the Norwegian economy. With a strengthening U.S. dollar, the krone was pulled up against other European currencies, contributing to a deterioration of competitiveness of the manufacturing sector. In August 1982, the weights in the currency basket were revised to correspond more closely to those used by the authorities and the Fund in calculating the competitiveness of Norwegian manufacturing industry. Simultaneously, the krone was devalued by 3 per cent, which returned the new index to the level that would have obtained had the new weights been in effect since December 1978. In September 1982 the krone was devalued by an additional 3 per cent. The exchange rate changes, which roughly offset the increase in relative unit labor costs in manufacturing during 1982, reflected concern over the developments in the exposed sector. An important consideration influencing the size of the exchange rate changes in 1982 was the need to avoid an acceleration of wage and price inflation; the Government wanted to achieve a continuous fall in inflation. Thus, when the krone came under pressure following the Swedish and Finnish devaluations, Norway did not change its exchange rate further. Since the basket index was left unchanged, there was of course an automatic adjustment against other currencies, so that the average level of competitiveness remained unchanged. Even so, difficulties arose for some industries, which prompted the authorities to increase selective industrial support.

The Norwegian representatives felt, as noted above, that with the uncertainties concerning future oil exports, Norway did have a need to improve competitiveness in order to prevent a further shrinking of the manufacturing sector. However, the Government was reluctant to continue to use the exchange rate as a means to achieve this. Frequent changes in the rate could be self-defeating because of the effects on wages and prices. For the future, the authorities intend to keep the exchange rate of the krone fixed for longish periods and to adapt domestic policies as needed in order to cope with changed internal and external circumstances. Whether the desired improvement in competitiveness can be achieved without any change in the nominal exchange rate is, of course, uncertain, and the authorities do not categorically rule out such a change in the future.

5. Trade and foreign aid policies

The Norwegian authorities are firmly committed to the belief that agreed rules for competition are the best hope for promoting the growth of world trade, and for that reason they support both greater use of existing GATT rules and the extension of GATT to areas such as trade in services. They are concerned about the weakening of the multilateral framework which has in their view occurred more because of the ways in which general principles have been applied than because of the weakness of the mechanisms. A major task for the 1980s will be the integration of the developing countries into the multilateral system: access to markets is the key to achieving this goal.

The Norwegian trading system has remained very liberal except for trade in agricultural products and textiles. Imports of certain categories of textiles and garments are limited by global quotas imposed in 1978 under GATT Article XIX, although two thirds of actual imports in these categories are from the EC and EFTA and are therefore not subject to quotas. In 1981 less than 1 per cent of total Norwegian imports of merchandise was subject to quota regulations. It is hoped to replace the Article XIX quotas with bilateral agreements under the third Multifiber Agreement from the beginning of 1984, although agreements still need to be negotiated. Thus, while changes are in prospect, none of substance has occurred to date since the last consultation.

Imports from developing countries under the Generalized System of Preferences have increased rapidly since 1974, on average by more than 50 per cent per year in value terms compared with somewhat less than 10 per cent for all imports from developing countries. However, this rapid growth has been from a small base.

While subsidies to producing sectors are large in Norway, estimated at about 4 1/2 per cent of GDP in 1982, the authorities pointed out that more than half goes to agriculture and to fishing. The balance is concentrated in shipbuilding and more traditional sectors of manufacturing (iron and steel, textiles, glassware and wood products). The purpose of the subsidies is to maintain employment rather than to support the balance of payments.

The Norwegian authorities welcome the reduction in tariff barriers achieved in the postwar era (over 80 per cent of Norwegian imports are MFN duty-free) and support GATT procedures for further declines. They favor intensified efforts to reduce technical barriers to trade, quantitative restrictions, and other nontariff constraints. The Norwegian authorities are opposed in principle to the UNCTAD Liner Conference Code (though the alternative of a network of special bilateral arrangements might be even less desirable) and to subsidized export credits.

Norway's official development assistance (ODA) remained well above the UN target in 1982, when it amounted to 1 per cent of GNP. For 1983, Parliament has appropriated NKr 4.4 billion (SDR 0.6 billion), equivalent to 1.1 per cent of estimated GNP. The main principles of Norway's development aid have been kept unchanged and include the following: aid is extended almost exclusively in the form of grants; all aid is--in principle--untied; there is a fairly even balance between multilateral and bilateral aid; and low-income countries are favored.

V. Outlook

Economic activity continued to decline throughout 1982, though leading indicators which have proved fairly reliable in the past suggest that the trough of the recession may now have been reached. A moderate recovery is projected for the second half of 1983; for the year as a whole, GDP is projected to rise by only 1-1 1/2 per cent, though it could remain flat if oil and gas output is 10 per cent below the present projection (in their official estimates the Norwegian authorities include such an amount as a "safety margin"). With little change in real disposable personal income, the volume of private consumption will grow only moderately. Public consumption is bound to rise more strongly than in recent years as a result of special employment measures. Except for large expenditures in the oil and gas sector, investment is likely to fall further, in particular in manufacturing, as a result of the still relatively weak competitive position and demand outlook. Even so, the market shares for "traditional" exports are expected to be maintained, implying an increase of 3 1/2 per cent in such exports. As recovery abroad gathers strength Norwegian exporters of traditional goods should benefit more than previously, since demand for many of those goods is cyclically sensitive. Total exports of goods and services are projected to expand moderately in 1983 (if no allowance is made for the safety margin on oil and gas output). Imports of goods and services have been rather sluggish in early 1983, and are projected to rise in real terms by 2 1/2 per cent, compared with 6 per cent in 1982. The increase is almost entirely accounted for by a sharp rise in imports related to investment in the oil and gas sector.

With little growth in output, unemployment is likely to rise somewhat further during 1983, though the rise in registered unemployment will be kept down through the special employment measures. With the slowdown in wage increases, and the dampening effect from international prices, the rate of inflation is expected to continue its decline. In April 1983 consumer prices were 9.1 per cent higher than a year earlier, and the rate of inflation is expected to fall to 6-7 per cent by mid-1984, still higher than the rates projected for major industrial countries.

Despite the recent fall in the price of oil, the external current account is officially projected to register only a small deficit and if the safety margin is not in fact needed, a moderate surplus of about 1/2 to 1 per cent of GDP is more likely. The capital account of the balance of payments may be dominated by substantial repayments of foreign debt by the Central Government. By the end of next year practically all such debt is expected to be repaid.

Although no recent official forecasts were available beyond 1983, the Norwegian representatives said that, with lower oil prices than assumed earlier, a move of the external current account into limited deficit could be envisaged over the next few years. In part this reflected increased imports related to the new development phase of the oil and gas sector, but also the relatively small size of the exposed sector. Staff estimates also suggest that, even with the present outlook for oil prices, 1/ the external current account is not likely to show more than small deficits over the next few years. Under these assumptions net external debt service would decline from 13 1/2 per cent of exports of goods and services in 1982 to 10 1/2 per cent in 1987, and the level of net external debt to GDP would also fall (see Appendix II). These estimates are, of course, highly tentative and very sensitive to the underlying assumptions; they should not serve as more than an illustration of a possible development. For example, if competitiveness were not maintained, or if demand in Norway were to rise much faster than abroad, the external position could be significantly worse than assumed here.

Looking beyond the mid-1980s, Norway's oil and gas output is projected to rise significantly toward the end of the decade; as recent experience has shown, the development of the price of oil is rather uncertain. The issues and problems caused for the restructuring of the economy by the volatility as well as the size of the oil sector have been analyzed in a recent report by a Royal Commission. The central ideas in the report are to spread over a longer rather than a shorter period the spending of oil income within the Norwegian economy, in order to smooth the adjustment pressures on the non-oil sector of the economy, and to shield the domestic economy from volatility in oil prices. These aims would be realized by releasing annually a relatively stable (in relation to domestic demand) portion of oil taxes into the ordinary budget, with the remainder to be invested abroad, in some suitable form, perhaps through the agency of a special fund. The report will be discussed by the Government and later in Parliament.

1/ The present assumption is that the price will be unchanged in nominal terms through 1984 and thereafter unchanged in real terms.

VI. Staff Appraisal

Despite the recent fall in the price of oil, Norway does not face an immediate external constraint, nor does it appear that there is much danger of a serious constraint arising in the medium term (assuming of course that the price of oil does not fall significantly). The current account of the balance of payments has been in surplus in each of the last three years and is likely to be close to balance or again in moderate surplus in 1983. On the assumption that oil prices continue at roughly the present level, and if the level of activity in the Norwegian economy were to increase no faster than elsewhere, it does not seem likely that the somewhat unsatisfactory competitive position in the exposed sector will lead to more than small deficits in 1984 and the years beyond. Practically all the Central Government's foreign debt will have been repaid by the end of next year and the foreign exchange reserves are very comfortable. However, for some years now performance in the area of inflation has been disappointing. While price inflation is now falling, it is likely to remain above the rate of inflation projected for major countries. There is thus no room for relaxation of the anti-inflationary effort.

Registered unemployment, at over 3 per cent of the labor force, is high by Norwegian standards and is likely to rise further in the near future. Unemployment would have been higher, but for considerable government support to ailing industries and special employment-creating measures. While these developments in the labor market are partially due to cyclical factors they are also clearly attributable in part to structural causes. The development of the oil sector has necessitated a substantial reallocation of resources and, while it has itself both directly and indirectly generated an increase in employment, it has also left the remainder of the exposed sector in a somewhat weak competitive position. Maladjustment has also resulted from rigidities in the labor market and in the allocation of resources which operate independently of the oil factor, e.g., in shipbuilding, in textiles, and in the sheltered sector.

It seems clear that, if the increase in employment is to be sufficiently large to achieve the Government's aims, and if it is to come about in a way consistent with the needed restructuring of the economy, it cannot be achieved in the short run. An increase in the size and efficiency of the exposed sector is needed to provide a margin of security in the balance of payments, but much of the needed increase in private sector employment will have to come from the sheltered sector. There is thus a need at least to maintain competitiveness vis-à-vis other countries, and also to restrain the growth of labor costs in the sheltered sector. In this connection the staff supports the Government's declared intention to reduce subsidies to ailing industries, though so far there has been little progress in this area.

The staff emphasizes the need to follow firm demand management policies if the medium-term aims of the Government are to be achieved. Norway has had a strong fiscal position with an overall surplus for several years now. In view of the very weak cyclical position, some fiscal counteraction has therefore been judged acceptable for 1983. The staff regrets the decision to increase support for particular industries, which runs counter to solving the longer-term problems of the Norwegian economy. The latest estimates call for a government deficit (excluding oil taxes) of something over 7 per cent of GDP. The staff feels that the deficit should not be allowed to increase any further because of the impact that a larger deficit could have on the rate of credit expansion.

In addition, the surplus including oil revenues, which in 1983 is likely to be reduced to no more than 2 per cent of GDP, may tend to be even lower next year with a possible fall in the yield from oil taxes and a possible reduction of income taxes in an attempt to achieve lower nominal wage increases. For this reason the staff attaches great importance to the utmost restraint on the expenditure side. Although the level of government spending as a proportion of GDP has not risen in the past two years, it has remained among the highest in the OECD countries.

Since 1980 the Bank of Norway has moved cautiously toward a more market-oriented policy in which greater emphasis is placed on the rate of growth of broad monetary and credit aggregates, and in each of the last two years the growth of broad money has been kept below that of inflation. But given the less strong fiscal position and the possibility of some revival of activity it will be advisable to follow a strict monetary policy--somewhat stricter than is implied in present official projections--if progress in reducing inflation is to be consolidated.

Interest rates, which as in many other countries are a politically sensitive issue, have come down somewhat from the high levels reached in 1982, and may fall further as inflation slows down. The staff would, however, advise against attempts to force them down either by additional credit expansion, or by administrative action, which could easily lead to additional distortions.

More generally, the staff feels it might be worth re-examining the operation of monetary and credit policy both to see whether it could not be simplified, and also to see whether the credit markets, and in particular interest rates, could not be made more flexible by relaxing or removing the present administrative restrictions.

The Government has made it plain that it wishes to avoid direct involvement in private sector wage negotiations. In the staff's view, that makes it even more necessary to follow cautious financial policies, and to seek to improve public understanding of the relationship between the cost of labor and employment, and also of the need for wage differentials appropriate to the encouragement of structural adjustment. In this context, the staff welcomes the intention of the Government to make industrial support dependent on taking proper account of this need.

The recent wage settlements in the private sector are on the high side in view of the desire to improve competitiveness. The staff believes that the Government must maintain a firm stance on increases in wages in the public sector, and in this context the recent agreement with the public sector unions seems a generous one. Restraint on wage claims in the private sector would be encouraged if the Government were clearly seen as adopting a cautious line in its settlements in the public sector.

The Norwegian krone is fixed against a currency basket, and the value of the krone is maintained within a narrow, though unspecified, band. Following the adjustments in 1982, the general objective of the authorities is to try to keep the rate of the krone fixed for longish periods, adapting domestic policies as needed should internal or external circumstances change. The staff agrees that such an exchange rate policy is appropriate for Norway.

The staff notes with satisfaction that Norway's trading system has remained substantially open, and that the excellent record on foreign aid has been maintained.

The Norwegian external position does not give grounds for particular concern, and in the circumstances, the staff recommends that the next Article IV consultation be held not later than January 1985.

Fund Relations with Norway

Date of membership:	December 1945
Status:	Article VIII, as from May 11, 1967
Present quota: Proposed quota:	SDR 442.5 million SDR 699.0 million
Fund holdings of Norwegian kroner:	SDR 94.2 million or 21.3 per cent of quota as of April 30, 1983. Norway has never made use of Fund resources. In December 1975, Norway agreed to lend to the Fund the equivalent of SDR 100 million for the 1975 oil facility. The final repayment of the loan was made on May 12, 1983.
Norway's holdings of SDRs:	SDR 294.5 million or 175.5 per cent of net cumulative allocation, as of April 30, 1983.
Gold distribution:	205,399 fine troy ounces (four sales)
Last consultation:	The staff report for the 1982 Article IV consultation with Norway (SM/82/48, 3/5/82) was considered by the Executive Board at EBM/82/41 (4/5/82).
Exchange system:	Since December 12, 1978, the Norwegian krone has been pegged to a basket (currently 14 currencies; until August 2, 1982, 12 currencies) of Norway's most important trading partners. The exchange rate is managed so as to allow only small fluctuations around the base level of the krone in relation to the basket. There are no taxes or subsidies on purchases or sales of foreign exchange. On April 30, 1983, the exchange rate of the Norwegian krone against the SDR was SDR 0.130106 per Norwegian krone.

Norway: Illustrative Medium-Term Debt Scenario

	1982	1983	1984	1985	1986	1987
	Actual			Projected		
Current account, in per cent of GDP	1.4	1/2	-1/2	-1 1/4	-1 1/2	-1 3/4
Net external debt, in per cent of GDP	26.8	25	23 1/2	23 1/4	23	22 3/4
Debt service, net, in per cent of exports of goods and nonfactor services 1/	13.6	16 1/4	12 1/4	9 1/2	9 1/2	10 1/2
Debt service, gross, in per cent of exports of goods and nonfactor services 2/	22.2	25 1/4	20 1/2	16 3/4	16 1/2	16 3/4

Source: Staff estimates. The main assumptions behind this scenario are as follows:

Exports and imports of goods and services are broken down into oil and non-oil trade. For 1983 the estimates reflect official Norwegian forecasts, excluding the 10 per cent safety margin on oil exports. For the period 1984-87, both Norway and other industrial countries are assumed to grow at an annual rate of 3 per cent with a corresponding annual increase in the GDP deflator of 6 per cent. Norway's competitive position is assumed to remain unchanged. The volume of oil exports is supply determined. Oil production is expected to rise somewhat after 1985, while oil prices are assumed to remain unchanged in nominal terms through 1984, and thereafter to remain unchanged in real terms. Prices of non-oil exports and imports are assumed to move in line with world inflation. External debt and debt service are projected on the basis of the current account estimates.

1/ Net interest payments on total debt plus net amortizations on medium- and long-term debt (public and private).

2/ Interest payments on total debt plus amortizations on medium- and long-term debt.

Norway: Basic Data

Area: 323,890 square kilometers

Population: 4.1 million (end-1981)

GDP in 1982: NKr 363 billion; per capita SDR 11,365

	1979	1980	1981	1982	1983 1/
Demand and supply (volume changes in per cent)					
Private consumption	3.2	2.3	1.3	1.3	1.3
Public consumption	3.5	4.7	5.2	1.0	3.5
Gross fixed investment	-5.0	-0.8	15.1	-8.4	8.7
Stockbuilding 2/	2.8	2.8	-4.6	4.5	-2.3
Total domestic demand	3.7	4.6	1.0	3.0	1.4
Excluding oil and shipping	(4.8)	(6.1)	(-2.5)	(4.6)	(-1.0)
Exports of goods and services	2.6	2.1	0.2	-2.6	-0.1
Imports of goods and services	-0.7	3.3	1.9	5.9	2.6
Gross domestic product	5.1	4.3	0.3	-0.6	0.2
Excluding oil and shipping	(4.3)	(2.6)	(0.8)	(-0.1)	(1.3)
Selected economic data (annual percentage change)					
Consumer prices	4.8	10.9	13.6	11.4	...
GDP deflator	6.6	14.5	14.9	11.0	...
Manufacturing sector					
Output	2.1	0.9	-0.6	-2.5	-0.8
Output per man-year	3.8	1.7	1.1	0.8	1.8
Unit labor costs	0.2	8.1	10.6	10.6	5.7
Oil and gas production (million t.o.e.)	40.3	50.5	49.1	49.9	...
Unemployment rate (in per cent)	2.0	1.7	2.0	2.6	...
Public finance (cash basis; in per cent of GDP 3/)					
Central government					
Revenue (excluding oil revenue)	40.5	41.9	42.7	42.4	42.2
Expenditure	47.1	48.6	49.1	49.3	49.4
Balance, excluding oil revenue	-6.6	-6.7	-6.4	-6.9	-7.2
Balance, including oil revenue 4/	-3.0	1.2	3.3	2.8	1.0
Local government balance 4/	-1.1	-1.3	-0.9	-0.5	-0.9
Money supply (percentage contributions to growth)					
Central government	11.9	11.7	10.5	9.4	9.4
Commercial banks, etc.	7.0	7.2	10.4	8.5	8.2
Total domestic sources	18.9	18.9	20.9	17.9	17.6
Net sales of foreign exchange to public	-5.4	-6.6	-9.3	-7.4	-5.6
Increase in broad money (M2)	13.5	12.3	11.6	10.5	12.0

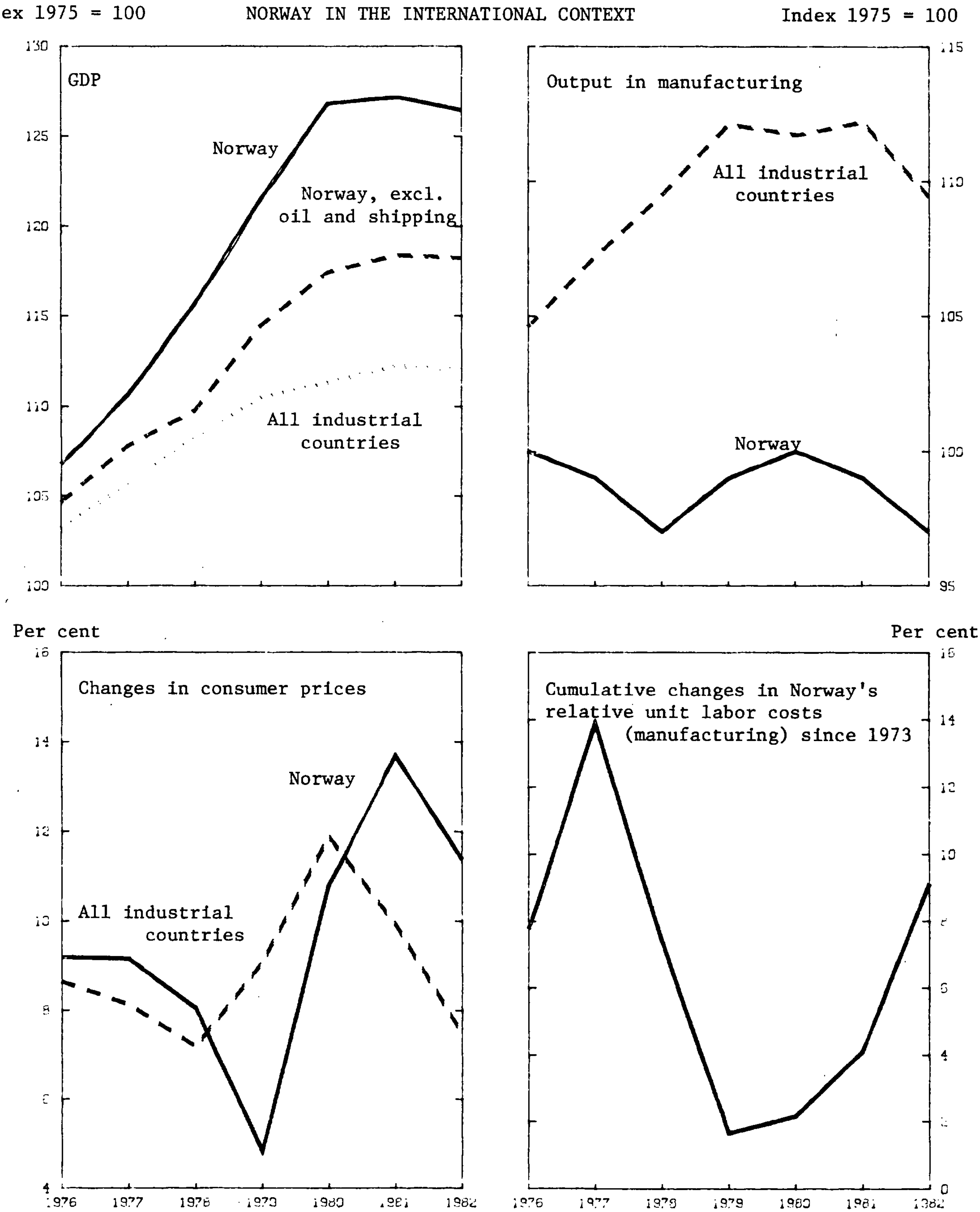
	1979	1980	1981	1982	1983 1/
Balance of payments (NKr billions)					
Exports, f.o.b.	70.0	92.9	107.0	114.9	117.7
Imports, c.i.f.	-70.4	-84.5	-90.5	-100.7	-107.1
Trade balance	-0.4	8.4	16.5	14.2	10.6
Net services and transfers	-4.9	-2.9	-3.3	-9.1	-12.5
Current balance	-5.3	5.4	13.2	5.1	-1.9
(In billions of SDRs)	(-0.8)	(0.8)	(1.9)	(0.7)	(-0.2)
(In per cent of GDP)	(-2.2)	(1.9)	(4.0)	(1.4)	(-0.5)
Public sector long-term capital	7.9	-3.4	-6.3	-8.8	...
Private sector long-term capital	3.6	-1.0	1.9	10.1	...
Short-term capital and errors and omissions	0.4	6.4	-6.3	-2.2	...
Reserve valuation changes and SDR allocations	-0.2	2.7	2.8	7.8	...
Change in official reserves (increase-)	-6.4	-10.4	-5.3	-12.0	...
Reserves (end-period) in billions of SDRs	3.2	4.8	5.4	6.3	...
Reserves (end-period) in weeks of merchandise imports	16	19	21	23	...
Competitiveness indicators (annual percentage change)					
Relative unit labor costs	-5.3	0.5	1.6	3.3	...
Relative export unit values	-3.6	-5.3	2.6	4.0	...
Volume of traditional exports 5/	7.8	0.5	0.9	-2.3	3.5
Terms of trade	5.2	9.6	6.7	2.9	-5.2
Net external debt (in per cent of GDP)	43.4	33.0	26.7	26.8	...
Exchange rate (end-period)					
Norwegian kroner per SDR (end-period)	6.49	6.61	6.76	7.78	...
Effective rates (December-on-December change in per cent)					
New official weights	-1.5	1.2	3.7	-5.6	...
MERM weights	1.4	-0.6	-0.6	-8.6	...

1/ Official forecast of May 1983. The forecast incorporates a 10 per cent safety margin on oil output.
2/ Change in per cent of previous year's GDP.
3/ Excluding oil and shipping.
4/ In per cent of total GDP.
5/ Traditional exports exclude ships and oil rigs, and oil and natural gas.

CHART 1

NORWAY

NORWAY IN THE INTERNATIONAL CONTEXT



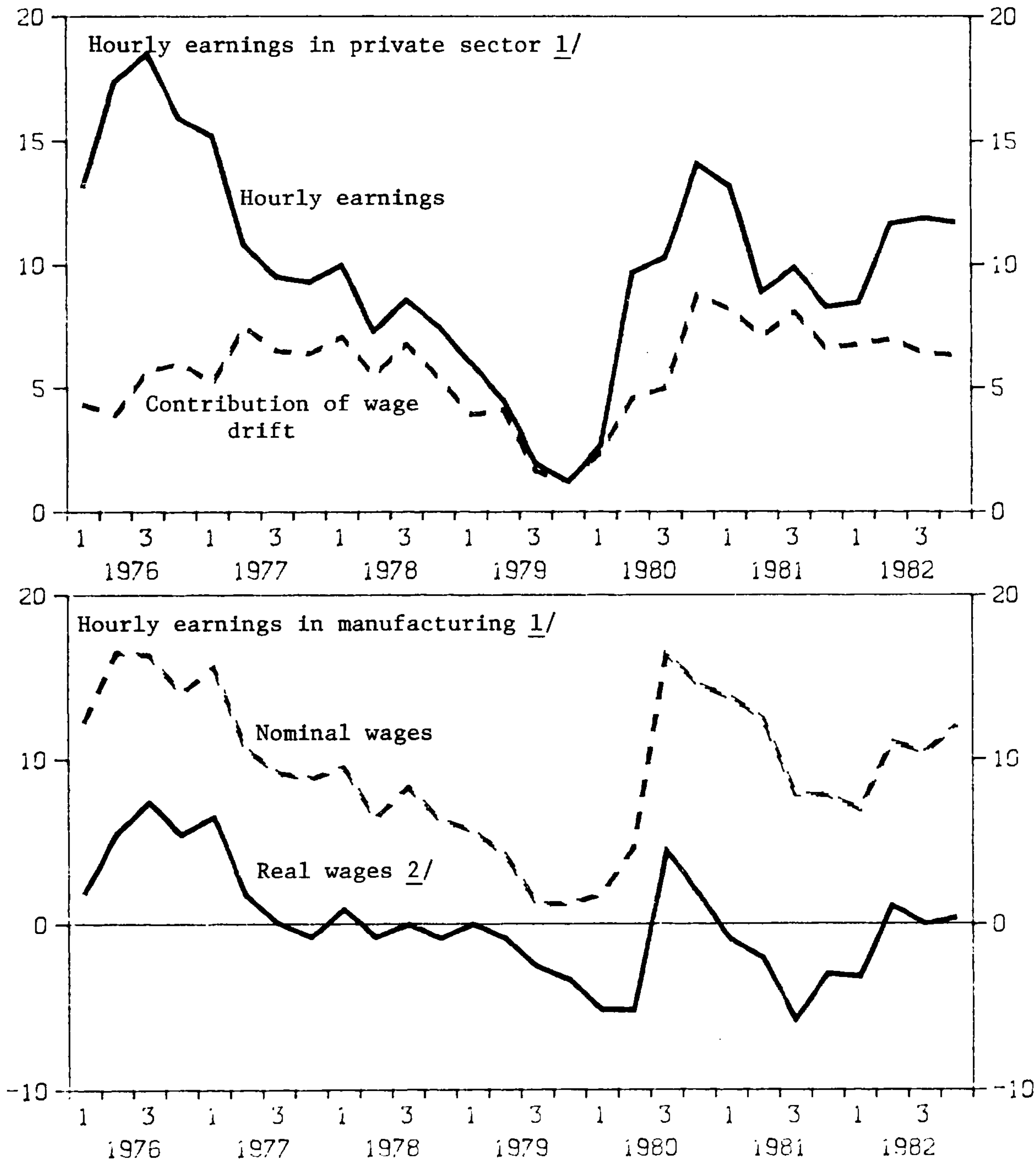
Sources: Central Bureau of Statistics, Monthly Bulletin of Statistics, Statistisk ukehefte, National Accounts 1970-81; and IMF, Data Fund.

CHART 2

NORWAY

WAGE DEVELOPMENTS

(Percentage change from corresponding period of previous year)



Sources: Ministry of Finance, Revidert Nasjonalbudsjett (Parliamentary Report No. 88 (1982-83)); and Central Bureau of Statistics, Monthly Bulletin of Statistics.

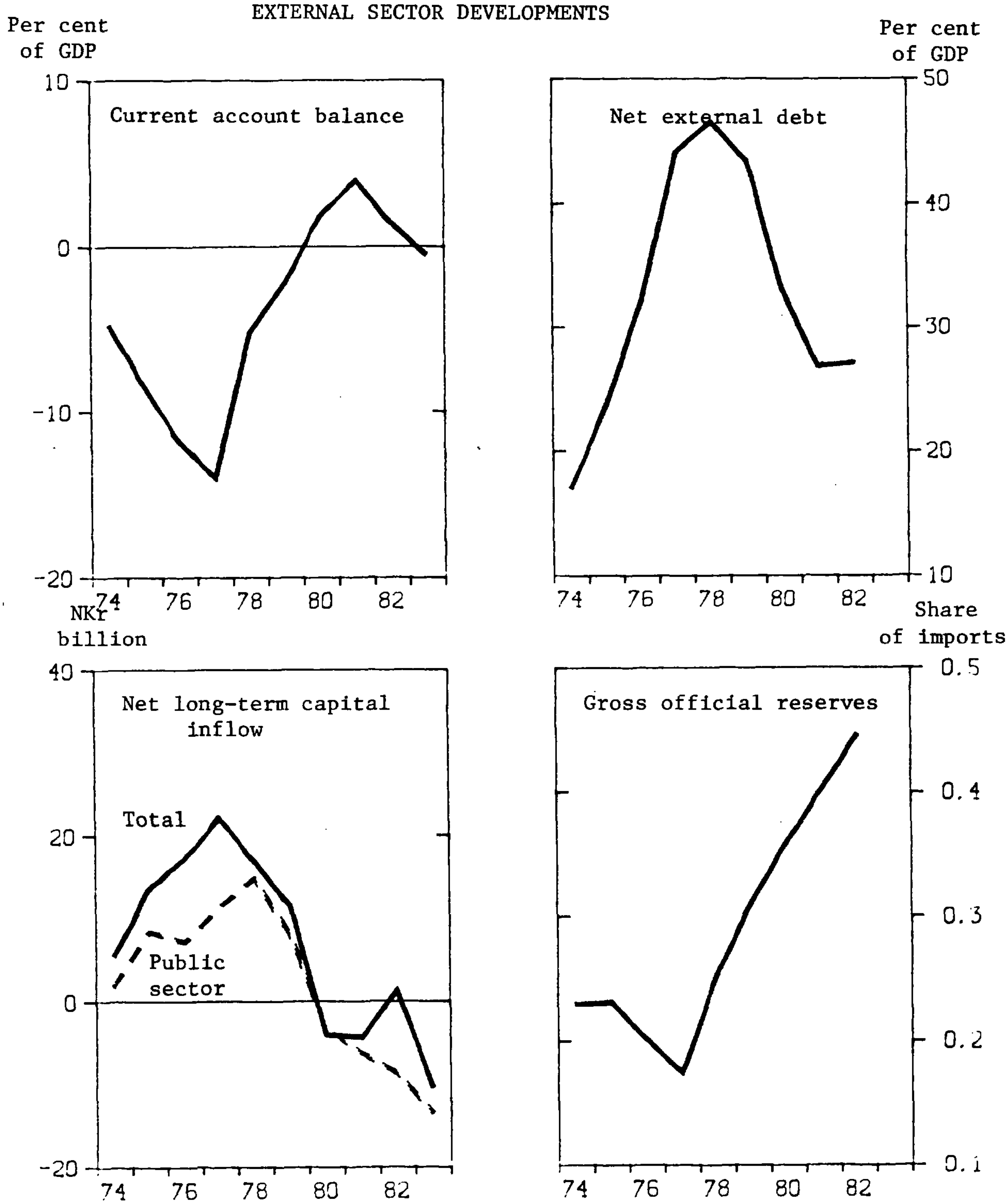
1/ Adult men.

2/ Deflated by the consumer price index.

CHART 3

NORWAY

EXTERNAL SECTOR DEVELOPMENTS



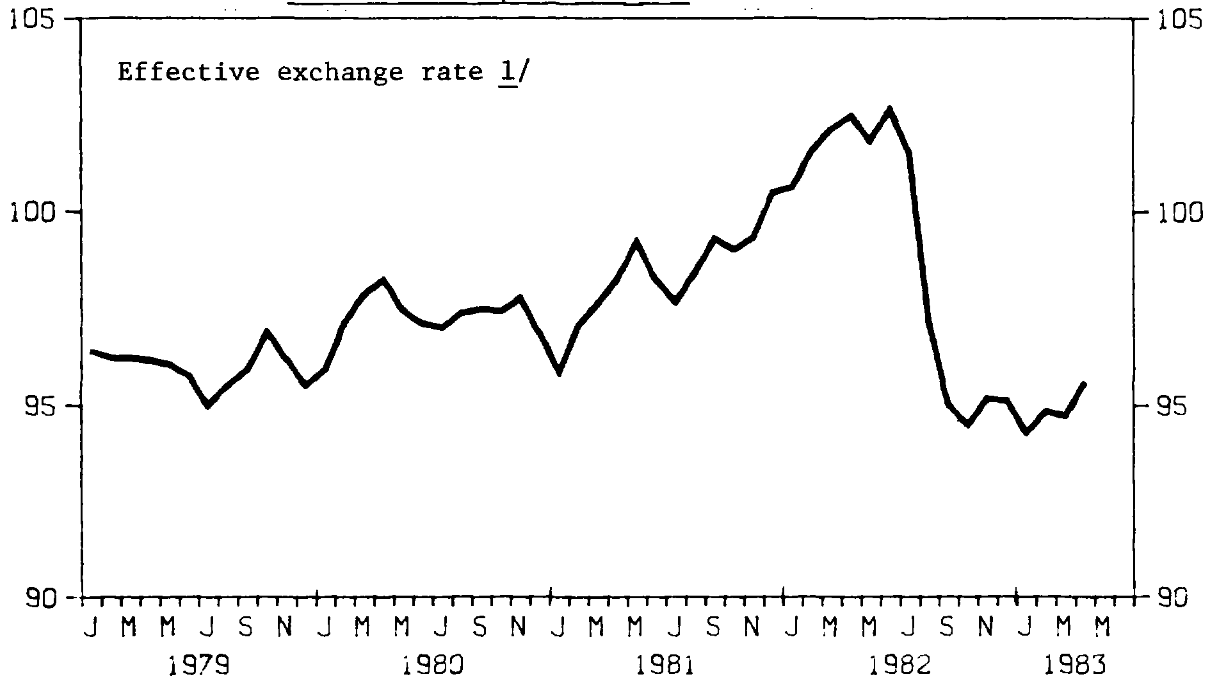
Sources: Ministry of Finance, Nasjonalbudsjettet, and Revidert Nasjonalbudsjett 1983; Bank of Norway, Annual Report; and IMF, International Financial Statistics.

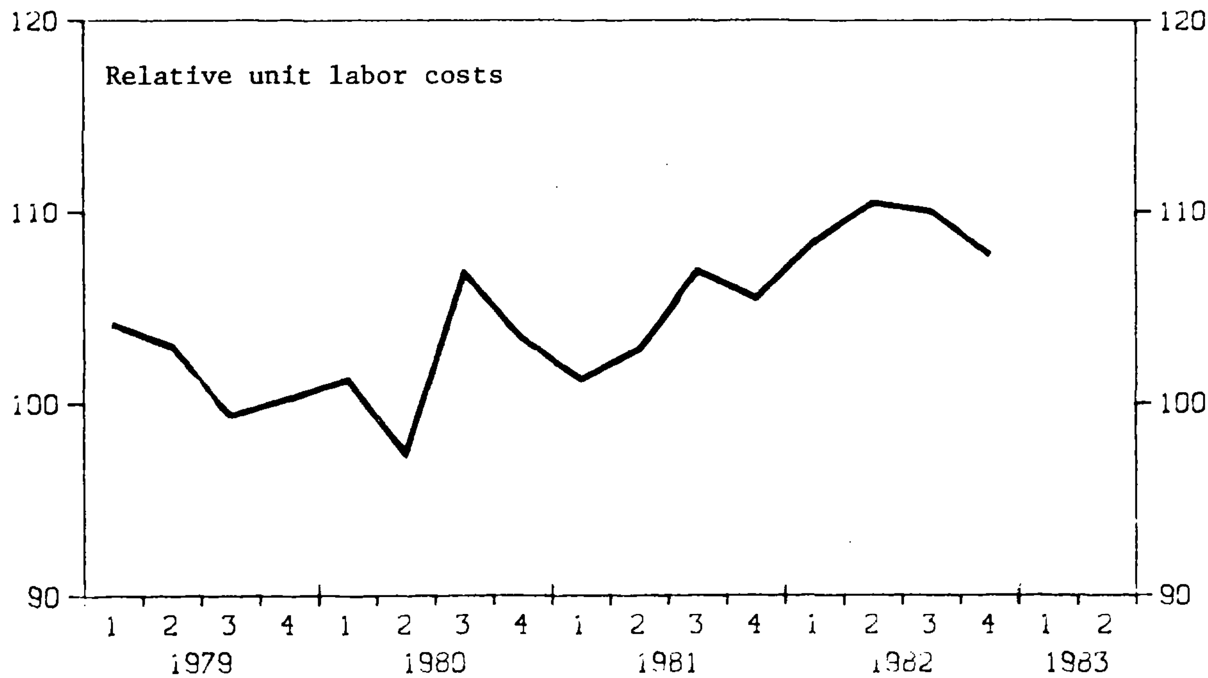
CHART 4

NORWAY

EFFECTIVE AND REAL EXCHANGE RATE INDICATORS

(Index numbers, 1975 = 100)





Sources: Bank of Norway, Economic Bulletin; and IMF Data Fund.

1/ Calculated on the basis of the new official basket weights.