FOR AGENDA

SM/82/48

CONTAINS CONFIDENTIAL
INFORMATION

March 5, 1982

To: Members of the Executive Board

From: The Secretary

Subject: Norway - Staff Report for the 1982 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1982 Article IV consultation with Norway.

This subject has been tentatively scheduled for discussion on Monday, April 5, 1982.

Att: (1)

Other Distribution:
Department Heads

CONTAINS CONFIDENTIAL INFORMATION

INTERNATIONAL MONETARY FUND

NORWAY

Staff Report for the 1982 Article IV Consultation

Prepared by Staff Representatives for the 1982 Consultation with Norway

Approved by Brian Rose and Subimal Mookerjee

March 4, 1982

I. Introduction

Article IV consultation discussions were held in Oslo from January 5-15, 1982. The Norwegian representatives included officials from the Ministries of Finance, Commerce and Shipping, and Petroleum and Energy, and from the Bank of Norway. The mission also met with the Governor of the Bank of Norway, Mr. Getz Wold, and the Permanent Secretary of the Ministry of Finance, Mr. Erichsen. Mr. Leiv Vidvei, the Alternate Executive Director for Norway, attended the meetings as an observer. The staff team consisted of Messrs. Ekhard Brehmer (Head), Jouko Hauvonen, Antero Arimo, Wayne Lewis, Josep Perejoan, and as secretary Mrs. Barbara Hinton (all EUR). Norway has accepted the obligations of Article VIII, Sections 2, 3, and 4.

II. Background

Since about 1973-74, when Norway started to emerge as an important producer of oil and gas, the main problem of medium-term economic policy has been to keep the traditional exposed sector viable so as to meet the widespread desire to preserve the present regional employment structure--a task that is considered important in view of the sparsely populated country with many one-factory towns. The competitiveness of the sector exposed to foreign competition, accounting for 17 per cent of total employment, was greatly damaged in the period 1974-77 when the development of the oil sector, expectations of rising oil wealth, and, not least, expansionary demand policies (adopted to bridge the period of weak foreign demand) produced mounting cost and price pressure. At the same time there was an unprecedented deterioration of the current external balance, resulting in heavy "mortgaging" of future oil revenue. These developments occurred although the Government tried to avoid too rapid a pace of development of the oil sector that would result in disruptive effects on the economic and social structure and eventually in too heavy a dependence on oil--a development considered risky and offering limited employment opportunities. From 1978 economic policy has been reoriented toward improving the current external balance and safeguarding employment by restoring international competitiveness. In 1978-79 a devaluation of the krone and a 15-month freeze of wages and prices succeeded in improving the relative cost position though by only half of the loss in 1974-77. The basic aim of policy since 1980 has been to avoid a resurgence of cost and price pressures.

III. Recent Economic Developments

In 1980-81 a considerable current external surplus was attained (the first registered since 1969) and the unemployment rate remained at about 2 per cent. However, by 1981 Norway had entered a period of stagnation and its rate of inflation had started to exceed that of its main trading partners. The improvement of the current external account in 1980, equivalent to 4.5 per cent of 1979 GDP, was due largely to sharp increases in the volume of oil and gas exports, and occurred despite increased demand pressure relative to that in other countries. In contrast, the further improvement of the current external surplus to 3.7 per cent of GDP in 1981 was attributable to domestic cyclical influences, while the volume of oil and gas exports declined for technical reasons. In both years, there was a noticeable improvement in the terms of trade because of the rise in oil prices and the strengthening of the U.S. dollar which benefited the oil, shipping, and pulp sectors. The performance of traditional exports has been disappointing. Not only did they rise very little in volume terms in 1980-81 but there was also hardly any gain in export market shares despite the improvement in cost competitiveness i[illegible]-79, largely because of an unfavorable commodity composition of e[illegible] for the stage of the international business cycle. In addition, [illegible]eign demand induced shipbuilding and some engineering firms to [illegible] their production and deliveries to the Norwegian oil sector, reducing its import requirements. Finally, the shortage of skilled labor may also have had an influence on export production.

In both 1980 and 1981 there was a net outflow of long-term capital, consisting largely of net repayments of central government debt, and total net external debt was reduced to an estimated 25 per cent of GDP by end-1981 from 44 per cent at end-1979. Debt service payments on long-term loans amounted to 17.5 per cent of exports of goods and services in 1981. Gross official reserves rose by SDR 2.2 billion over the two years to end-1981 to SDR 5.4 billion, equivalent to 21 weeks of merchandise imports.

The growth of real GDP was maintained in 1980 at a rate of 3.9 per cent, compared with a weighted average increase in Norway's main trading partners of only 0.9 per cent. The main expansionary factors were the increase in oil exports, and a substantial rebuilding of stocks. However, in 1981 real GDP almost ceased to grow as inventory investment was reduced, and the volume of oil exports declined. In both years there was a temporary upturn, though from a low level, of industrial fixed investment. Private consumption advanced by an average of only 1-2 per cent per annum due to slow real income growth (in 1981 due partly to higher indirect taxes offsetting part of the reduction in income taxation). There was a considerable increase in the personal savings rate in 1981, reflecting the restriction of consumer credit and the fact that the self-employed, having a high propensity to save, registered relatively rapid real income increases.

The sluggishness of production has its roots in the shortage of skilled labor and in the poor productivity performance of industry, particularly the exposed sector. This development is related to the low pressure for adjustment of the nonoil sector of the mainland economy 1/ to the long-term changes in the structure of demand. The lack of adjustment is associated with the general employment support (particularly in view of weak foreign demand for traditional products) and direct aid to ailing industrial firms and the fact that industrial fixed investment in mainland Norway appears to have been inhibited in recent years by low profits, unused capacity, and the uncertain outlook of the exposed traditional industries compared to the oil and related industries. While retraining of labor is supported, the industrial support and the protection given to agriculture and fisheries have hampered the geographical mobility of labor.

The increase in the inflation rate to 10.9 per cent in 1980, and further to 13.6 per cent in 1981, was the most worrisome development in the recent past, particularly since it coincided with a slowdown of inflation in Norway's main trading partners. The mounting inflationary pressures in both years were attributed principally to rising domestic cost pressure: the rise in unit labor costs in manufacturing accelerated to 8 per cent in 1980 and further to 10 per cent in 1981. In 1981 a number of other domestic factors also played a role, namely an increase in indirect taxes combined with a reduction in consumer subsidies (accounting for 2 percentage points of the 1981 price rise) and an unexpectedly large increase in profit margins in the sheltered and import-competing sectors following the lifting of the remaining price controls in early 1981. Demand pull factors did not play a role in 1981 when total domestic demand in mainland Norway fell considerably following sharp increases in the preceding years. The upward pressure on unit labor costs was partly a consequence of the release in 1980 of the pent-up pressures under the 1978-79 freeze of prices and incomes, weak productivity growth in the exposed sector in 1980-81, and higher wage drift. The wage pressure appears to have been related to the high income expectations in the nonoil economy (still accounting for 85 per cent of total output). These were generated by the present and prospective oil wealth, and the relatively high offshore wages paid by the foreign oil companies which do not consider themselves as participants in the Norwegian labor market. As a result, there was some slippage in cost competitiveness in 1981. The inflationary pressure has temporarily moderated somewhat in the second half of 1981 partly under the impact of the freeze of prices which was imposed from August to December 1981.

1/ Defined as excluding oil and shipping.

IV. Economic Policies

The broad objectives of policy in the last two years, to prevent a resurgence of cost and price pressure and to achieve a further improvement of the relative cost position, were not attained partly because economic policy, particularly fiscal policy, was too expansionary. The Norwegian representatives said that the main challenge for economic policy in the medium term will be to maintain the presently reasonable external balance without sacrificing the full employment objective. The economic policies presented by the new Government 1/ in November 1981 aim at improving competitiveness, and withdrawing financial support from ailing industrial firms, as a precondition for preserving high employment and satisfactory economic growth in the longer term. The strategy for achieving these goals is composed of three principal elements: a moderation of wage increases that is compatible with an improvement of the relative cost position of industry, a stimulus to productivity growth and a tightening of fiscal policy. Beyond 1982, when fiscal policy is expected to become less expansionary, the Government intends to ease monetary policy, which together with the envisaged improvement of competitiveness is designed to facilitate industrial fixed investment and a structural renewal of the mainland economy.

a. Incomes policies and supply side policies

In 1980 the Government succeeded in moderating contractual wage increases with the help of fiscal concessions and a three-month price freeze prior to the April 1980 wage agreement. But since wage drift was above the limit agreed upon, the actual wage increase in 1980 (10 per cent) was larger than assumed at the time of the wage agreement (8.5 per cent). In 1981, despite a further lowering of income taxation, wage settlements could only be brought about through compulsory arbitration but the increase in wage rates was as high as in 1980. To avoid a reopening of wage contracts on the basis of the index clause, prices were frozen from August to December 1981, and income taxes reduced for the last quarter of 1981.

The prospects for moderating wage increases and improving the relative cost position in 1982 do not appear favorable despite the full adjustment of tax scales for inflation. Given the weak growth in industrial productivity in 1982 and the determination of other countries also to improve competitiveness in the light of the slow growth of world trade, a reduction in Norway's relative unit labor costs is estimated to require an average increase in wages of less than 7-8 per cent. Considering that this amount is nearly equal to the carry-over from 1981 and estimated wage drift, there is hardly any room for contractual

---

1/ The new Conservative Government took office in October 1981 following general elections. It has 53 of the 155 parliamentary seats and relies on the support of the Christian People's Party and the Center Party.

increases in 1982. Such a result will most probably be unacceptable to employees, so that there is likely to be a further increase in Norway's relative unit labor costs, now forecast at roughly 2-3 percentage points. Such an outcome would have to be seen against the background of the high inflation rate recorded in the recent past and expected in 1982 (10-11 per cent), the tight labor market, and the determination of the unions to defend the real disposable income of their members, which has declined for those in the higher pay scales over the last two years. In addition, departures from centralized wage bargaining will add to the overall wage pressure and make the outcome of the wage negotiations uncertain. The situation may become further complicated if no sector can be found that is strong enough to be a wage leader in 1982. The public sector is not expected to assume such a role and there is a risk that the traditional exposed sector, where wage drift tends to be held down by international competition, may not this time play a leading role in the wage determination process either. The oil sector (whose wage developments influenced those in the engineering industries) is insensitive to excessive wage demands because of the very low share of wages in their total costs, and the full deductibility of wages and other costs from earnings subject to the 85 per cent taxes on oil companies. Therefore, the Government has requested them to exercise wage restraint. In addition, the possibility of revising the oil tax system is being examined.

The authorities realize that an improvement of competitiveness has also to be achieved through structural renewal of the nonoil sector and a strengthening of its productivity growth. Mainly because of the Government's determination to preserve more or less the existing regional employment pattern the structural adjustment process in mainland Norway is seen to be inherently slow. Other obstacles are the shortage of skilled labor, the reduced geographical labor mobility partly due to the trend toward two-income families, and depressed foreign demand. Some stimulus to structural adjustment and productivity growth is expected to result from the envisaged withdrawal of financial support to ailing industrial firms but this reduction will be gradual and is not to come into conflict with the regional policy objectives. A positive effect on incentives to work and productivity growth and hence on cost competitiveness is expected to come from the envisaged reduction by NKr 7 billion (in 1979 prices) in personal income taxes (excluding adjustment of tax scales for inflation) until 1986, equivalent to more than 5 per cent of 1979 personal disposable income. The Norwegian representatives stated, however, that the disincentive effect of the relatively high tax burden was often exaggerated given the widespread constraints on overtime work in Norway and the efforts to supplement family income through extra work, including work in the "grey" labor market. The Government also envisages modifying or eliminating certain administrative rules hampering both competition (particularly in the sheltered sector) and productivity growth.

b. Exchange rate policy

In 1980 and 1981 the authorities continued their policy of keeping the krone relatively stable in terms of the basket of currencies of 12 major trading partners (adopted in December 1978). In 1980, when there was a net short-term capital inflow, upward pressure on the krone induced official spot market intervention. The MERM effective rate of the krone showed an average increase of some 2 per cent in 1980. In 1981, when there was a net outflow of short-term capital during the first nine months, some net spot market intervention sales were made until late in the year when the krone strengthened. The average MERM rate in 1981 was 3.4 per cent lower than in 1980, including a 14 per cent depreciation vis-à-vis the U.S. dollar and a 6.5 per cent appreciation vis-à-vis the EMS currencies.

The Norwegian representatives said that a devaluation of the effective rate of the krone is not warranted given the strength of the overall balance of payments and the need to bring down inflation. The absence of pressure for a devaluation in Norway, even at the time of the 10 per cent devaluation of the Swedish krona in September 1981, was seen as a sign of the strength of the Norwegian krone. No policy decision is required under the present weighting system in response to discrete exchange rate changes by other countries. This, and the flexibility of intervention policy, were considered important advantages of the prevailing basket system.

Given the strong position of the krone, the staff representatives inquired into the possible role which exchange rate policy might play in containing inflationary pressures. The Norwegian representatives said that several important preconditions for adopting a "hard currency" policy are not fulfilled at present, namely, large price impulses from abroad, a sufficiently strong competitive position of industry, and decelerating domestic inflation. In view of the less favorable longer-term outlook for the balance of payments and the relative cost position (see Section V below) than had been assumed during the preceding consultation discussions (May 1980) the prospect for pursuing such a policy in the medium term has become more remote than before. For a hard currency policy to be successful, the prospect for moderating wage increases must exist, a requirement that has been difficult to fulfill in recent years. The authorities hope that the income tax cuts by 1986 will have a moderating impact on wage increases. This is not certain, however, as employees might view the income tax cuts as a benefit rather than as a trade-off against wage increases.

Regarding the possible role of exchange rate policy in promoting structural adjustment of the economy to changed market conditions, the Norwegian representatives said that in their experience structural adjustment proceeded more smoothly and more rapidly under conditions of improving rather than deteriorating competitiveness. An appreciation of the krone would have an adverse effect not only on ailing firms but also on viable firms which should absorb the labor resources to be released by the former firms. This would produce the undesired result of greater dependence of the economy on the oil sector.

c. Fiscal policy

Although under the impact of sharply rising oil tax revenue the public sector financial balance swung into considerable surplus in 1980-81 (3-4 per cent of GDP), public sector operations showed a rising expansionary effect, adding substantially to cost and price pressures in these years. This is indicated by the fact that the public sector deficit excluding oil revenue 1/ rose to about 6-7 per cent of mainland GDP in 1980-81, a high figure by historical standards given that the economy is fully employed. This development was facilitated by the upward trend in oil revenue. The increase in the adjusted deficit in 1980 and 1981 reflected the preponderance of policy objectives that tend to keep up or increase the fiscal stimulus, i.e., support of employment, improvement in social benefits, and fiscal concessions to moderate wage increases in 1980 and to avoid new wage negotiations in September 1981. The 1981 tax reform led to a lowering of the net tax burden (excluding oil taxes) and so placed a burden on the government accounts. The Norwegian representatives said that the reorientation of fiscal policy toward a less expansionary stance has met two major obstacles: (1) the high degree of automaticity of public expenditure increases as a result of the social programs and reforms of the 1970s and (2) the slowdown of the growth of the tax base of mainland Norway in real terms associated with the slow economic growth. Although the fiscal stimulus is predicted to decline in 1982, it will remain as expansionary as in 1980 (5.8 per cent of mainland GDP).

The Norwegian representatives said that the Government's commitments to reduce income taxes further by 1986, to improve competitiveness, and to make overall fiscal policy less expansionary (enabling an easing of monetary policy) can hardly be fulfilled simultaneously in present circumstances particularly in view of the prospective slow growth in the tax base in real terms. Large expenditure cuts would be difficult to achieve as large public investments in recent years created additional public consumption. In addition, too large cuts of public investment would not be wise in view of the desirability of completing current investment projects. Finally, noticeable cuts in subsidies as well as increases in indirect taxes and prices of public services would induce price and wage increases, particularly if the wage agreements would include index clauses. It would be difficult to achieve noticeable reductions in public expenditure unless the Government would take a fresh look at the system of transfers and the policy goals with respect to the social security and agricultural sectors. Without curbs of public

---

1/ This adjusted balance is taken as a summary indicator of the fiscal impact because oil taxes have no direct effect on domestic demand.

expenditure, and given the commitment to reduce taxes and the prospective slow real growth in the tax base, the Government budget (including oil revenue) is unlikely still to be in surplus by the mid-1980s.

Regarding the likely reaction of fiscal policy to an "excessive" wage agreement the Norwegian representatives said that the Government considered the 1982 budget compromise as final and any action directly related to the outcome of the wage negotiations was unlikely.

d. Monetary policy

One of the main problems facing the monetary authorities in 1980-81 was the excessive monetary expansion emanating from central government transactions including lending via state banks. Although this prompted a more restrictive stance of monetary policy than would otherwise have been warranted, monetary policy in these two years could not reach its main objective of helping contain the rate of inflation. The growth in money supply of almost 12 per cent per annum in 1980 and 1981 was about 2 percentage points above original forecasts and fell below the rate of growth of nominal GDP of mainland Norway in 1981, implying a reduction of the large overhang of liquidity created in 1978-79. The overshooting of the monetary forecasts was connected partly with the difficulty of controlling bank lending that is inherent in the present institutional limits to monetary management. In 1980 and 1981 such lending was NKr 2-3 billion per annum above the original forecasts although primary reserve ratios were raised, supplementary reserve requirements announced in May 1981 on "excess" lending to households and local authorities, and other measures to influence bank liquidity taken (sales of money market paper and forward exchange purchases by Norges Bank).

Apart from the small scope left for increases in primary reserve ratios and the exemption of banks in northern Norway from reserve requirements, monetary management was hampered by the considerable inflexibilities of the interest rate structure that persisted even after somewhat freer determination of bank lending rates was introduced in September 1980. In real terms, interest rates in the organized credit market in early 1982 were around zero. Another main problem for credit policy arose from rapid credit expansion by banks in the bond market following the liberalization of this market for most private sector issues in October 1980. This led to an overshooting of the original credit budget figure for 1981 by an estimated NKr 3 billion. The banks' purchases of private bonds were stimulated by the higher yield on such issues than on government issues and by the retention of the bond investment obligation for banks and life insurance companies (including both government and private bonds). Despite a 2 percentage point increase in the government bond yield in the first half of 1981 it was not high enough to crowd out private sector bond issues by government issues. To curb the growth in credit to the private sector via the bond market the bond investment obligation for financial institutions was reduced in January 1982 and, at the same time, the interest rate on government bonds was raised by another 1 percentage point.

In 1982 the task of exercising monetary restraint will again be aggravated by the continued large expansionary effect of central government transactions. For 1982 the Norges Bank has chosen, for the first time, as a strategic control aggregate the domestic liquidity supply to the public from central government transactions and from private bank credit. The target for 1982 is set at NKr 35-39 billion, the midpoint of which corresponds to 18 1/2 per cent of end-1981 money supply. Because of the expected liquidity withdrawal through the public's balance of payments transactions (which is difficult to predict) this would lead to an estimated reduction in the growth of money supply to 10 per cent, implying a further reduction of the liquidity overhang. The Norges Bank intends to achieve this target by open-market operations but this requires greater flexibility of interest rates than has been permitted in the recent past.

e. Other policies

Even though Norway has a large output of oil, gas, and hydroelectric power (which since 1976 has substantially exceeded its own rather high energy consumption) it aims at strict energy conservation, encouraged primarily through the price mechanism. Norway prices all of its oil and gas (whether exported or used domestically) at world market levels. The real price of electricity for other users than energy-intensive industries has been raised by an estimated 3.1 per cent per annum from 1979 to 1982 and will be raised at the same annual rate until 1985, when the Government's target of achieving parity between this price and the long-term marginal cost of new hydropower generating capacity is to be achieved. The Government has stated that it would neither raise the relatively low (real) price of electricity for firms with long-term contracts for electricity supply concluded prior to 1976, nor impose special taxes on industrial firms having their own hydroelectric power sources. Therefore the energy-intensive metallurgical and chemical industries, accounting for roughly half of traditional exports, will continue to enjoy their comparative advantage in this field. For environmental reasons the Government considers that the annual use of the hydropower potential should not exceed 125 Twh (terawatt hours), a level expected to be reached by the end of this century.

Norway's official development assistance (ODA), virtually all of which is extended in the form of grants, rose to an estimated 0.92 per cent of GNP in 1981, from 0.85 per cent in 1980. The budgeted amount for ODA for 1982 corresponds to 1.05 per cent of estimated GNP. Except for aid in kind, Norwegian foreign aid is untied.

V. Prospects

The outlook for 1982 appears less favorable than developments in 1980-81, although unemployment will remain low and the external balance will be preserved. Real GDP is expected to show the first decline since 1958. The main depressing influence is expected to come from the continued sluggishness of the volume of exports of goods and services. This will result from a decline in the volume of oil exports (with production in the main Ekofisk field declining faster than production in other fields is rising) and from a slow growth of 4 per cent in the volume of traditional exports, about in line with the growth in export markets. With the slow growth of exports and following the completion of some large projects, fixed investment in the nonoil industry is assumed to decline considerably. In keeping with the restrictive goals of incomes policy real private consumption is assumed to rise by no more than 1 per cent, about the same rate as assumed for the growth in real personal disposable income. However, the Norwegian representatives said that wages may rise 2-3 percentage points faster than the 7-8 per cent increase compatible with maintaining cost competitiveness. There is expected to be a considerable recovery of inventory investment of Norwegian goods. The resulting revival of domestic demand, including increased deliveries of ships and oil sector equipment from abroad, will induce a recovery in the volume of imports. This, together with the sluggishness of exports of goods and services, is expected to result in a negative contribution of the real foreign balance to the growth of GDP. With the overall terms of trade expected to show little further improvement, the current external surplus is thus predicted to decline sharply from SDR 1.8 billion in 1981 to SDR 0.3 billion (0.6 per cent of GDP) in 1982.

Looking beyond 1982 the Norwegian representatives said that the current external account in 1983-85 is now expected to be in a much less favorable position than forecast at the time of the last consultations (May 1980) leaving less scope for capital exports than had previously been foreseen, given also the considerable debt repayment obligations. The current account may well shift to a deficit during this period due to the expected strong revival of investment in the oil and gas sectors, a substantial scaling down of estimated oil revenue, and a less favorable outlook for traditional export markets and relative unit labor costs than previously assumed. There are several factors responsible for the more than NKr 70 billion (SDR 10 billion) lowering of the forecast oil tax revenue for the four years 1982-85 from a total of NKr 170 billion estimated in the previous Government's medium-term survey of April 1981. They include unforeseen delays in the start-up of new oil fields, a sooner than expected fall-off of production in the main field, an increase in estimated (tax deductible) interest costs, and a lowering of the assumed world oil prices (implying a real decline in 1983 and 1984 and an increase to the 1981 level in 1985).

Government plans regarding the future development of the oil and gas sector will be developed in the next two years or so. The estimated recoverable oil and gas reserves south of the 62nd parallel (4-5 billion tons of oil equivalent, t.o.e.) and the successful exploration activity north of this parallel (where production will not take place until the late 1990s) suggest that the Norwegian oil era will extend well into the next century. By controlling the development and opening up of the oil and gas fields the Government indirectly controls the pace of oil and gas production but it has never limited the production in existing fields.

In 1974 the authorities expected that an annual production of 90 million t.o.e., then forecast to be reached by 1990, would be consistent with a moderate rate of oil and gas production. Since then, however, there has been a constant scaling down of future production estimates (mainly because of technical delays in the start-up of oil fields) so that production for 1990 is presently estimated at only 60-65 million t.o.e., compared to 49 million t.o.e. in 1981.

VI. Staff Appraisal

Once Norway emerged as an important producer of oil and gas in the mid-1970s, the main economic policy problem has been to keep the traditional exposed sector viable, so as to maintain full employment with an acceptable regional balance. The authorities have tried to solve this problem partly through employment support, which has been an important element of expansionary public sector operations and has been facilitated by the rapid rise in oil tax revenue. Among the unwelcome consequences have been a reduction of labor mobility and slow adjustment of the nonoil economy to changes in the structure of demand. These latter factors in turn made the task of restoring competitiveness, pursued since early 1978, more difficult.

In 1980-81 Norway achieved a better performance than the economies of most other industrial countries. The current external balance shifted into considerable surplus while unemployment was kept low. But in 1981 the economy began to stagnate and in 1980-81 there was a resurgence of cost and price pressure due to domestic influences, just as inflation moderated abroad. This prevented further improvement of competitiveness. In both years market shares of traditional exports showed hardly any response to the improvement in cost competitiveness in 1978-79.

The increase in the public sector deficit (excluding oil revenue) to 6-7 per cent of GDP in 1980-81, largely a consequence of employment support, improvements in social benefits, fiscal concessions intended to moderate wage increases, and the 1981 tax reform, added considerably to inflationary pressure. Monetary policy could not adequately contain inflation because of the large monetary expansion emanating from the central government sector, the inadequacy of instruments to control private bank lending, and the failure of government bond yields to rise enough in late 1980 and in 1981 to prevent an excessive expansion of private bank credit via the bond market to the private sector.

The staff believes that the Government's objectives of improving competitiveness and withdrawing support to ailing industrial firms are essential for preserving high employment and securing satisfactory growth. To achieve these goals the Government aims at a tightening of fiscal policy, moderating wage increases, and stimulating productivity growth. If carried out consistently, this policy would strengthen the position of the traditional industries, and would be in line with the legitimate desire of the Government to avoid too heavy a dependence of Norway on the oil sector, as well as to minimize the conflict between improving competitiveness and preserving regional balance.

However, a wage increase in 1982 ..w enough to be compatible with the maintenance of competitiveness is unlikely to be achieved, given the efforts of the unions to obtain higher wage increases to maintain the real disposable income of their members, the tight labor market, and the return to decentralized wage bargaining. While the relative cost position is likely to deteriorate in 1982, the authorities do not intend to devalue the effective rate of the krone, which has been permitted to fluctuate only within narrow limits. The staff agrees that a devaluation would neither be warranted from an overall balance of payments point of view nor would it be helpful in reducing the rate of inflation. Moreover, the loss of cost competitiveness is not expected to be large enough to give rise to undue concern in the short run.

On the other hand, however, a more serious problem is that withdrawal of support from ailing firms might be delayed. This would aggravate the task of tightening fiscal policy which would be all the more required should cost competitiveness deteriorate. Failure to do so would conflict with the need to contain income expectations and wage drift so as to promote the expansion of "growth" industries. A tightening of fiscal policy is already made difficult by the Government's commitment both to lower the tax burden further by 1986, and to maintain the present level of welfare, and by the slowdown in the growth of the tax base of mainland Norway in real terms. In the view of the staff, the Government could overcome these difficulties by modifying the high degree of automaticity of public expenditure increases, spreading the envisaged income tax reductions beyond 1986, and increasing somewhat indirect taxation, including that on the use of low-priced hydropower, provided this will not trigger any index clauses in wage contracts.

By reducing the effect on domestic liquidity of central government transactions and of credit expansion by private banks the authorities hope to reduce the growth in the money supply to 10 per cent or below nominal GDP growth. To achieve this target there is a pressing need in the view of the staff to raise the legal maximum for primary reserve ratios and to enable the central bank to conduct open market operations in longer term bor 's, requiring more flexible interest rates which at present are aroun zero in real terms. The lowering of the bond investment obligation for financial institutions, and the increase in the interest rate on government bonds in early 1982, were steps in the right direction.

Prospects for 1982 indicate a continuation of stagnation, and a decline in the current external surplus to an estimated 1 per cent of GDP, partly under the impact of a further drop in the volume of oil exports and sluggish growth of traditional exports. In the period 1983-85 the current external balance is likely to shift into deficit with the expected revival of investment in the oil sector and the substantial scaling down of previously expected oil revenue. Such deficits would be economically justifiable and easy to finance.

Fund Relations with Norway

Date of membership:	December 1945.
Status:	Article VIII.
Quota:	SDR 442.5 million.
Fund holdings of Norwegian kroner:	SDR 260.4 million or 58.9 per cent of quota, as of January 31, 1982. Norway has never made use of Fund resources outside the reserve tranche. In December 1975, Norway agreed to lend to the Fund the equivalent of SDR 100 million for the 1975 oil facility. The amount outstanding as of January 31, 1982 was SDR 31.5 million.
Norway's holdings of SDRs:	SDR 200.3 million or 119.4 per cent of net cumulative allocation, as of January 31, 1982.
Gold distribution:	205,399 fine troy ounces (four sales).
Last consultation:	The Staff Report for the 1980 Article IV consultation with Norway (SM/80/186, 7/28/80) was considered by the Executive Board at EBM/80/133 (9/8/80).
Exchange system:	Since December 12, 1978 the Norwegian krone has been pegged to a basket of 12 currencies of Norway's most important trading partners. Since then 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 January 31, 1982, the exchange rate of the Norwegian krone against the SDR under Rule O-2 (b) was SDR .147937 per Norwegian krone.

Norway: Basic Data

Area: 323,890 square kilometers   Population: (mid-1981) 4.1 million

GDP in 1981: NKr 327 billion; per capita SDR 11,800

	1978	1979	1980	1981	1982 1/
Demand and supply					
(volume change in per cent)					
Private consumption	-1.6	3.2	2.2	1.3	1.1
Public consumption	5.3	3.5	4.7	4.9	3.0
Gross fixed investment	-11.2	-5.0	-0.7	16.5	-1.1
Stockbuilding 2/	-2.2	2.8	2.6	-4.9	1.4
Total domestic demand	-5.6	3.7	4.6	1.0	2.4
(Excluding oil and shipping)	-1.6	4.8	5.6	-3.0	2.8
Exports of goods and services	8.4	2.6	2.2	1.0	-1.8
Imports of goods and services	-13.5	-0.7	3.6	1.9	6.0
GDP	4.5	5.1	3.9	0.7	-1.1
GDP excluding oil and shipping	2.0	4.3	2.2	1.0	1.7
Selected economic data					
Annual percentage change in.					
Consumer prices	8.2	4.8	10.9	13.6	10-11 3/
GDP deflator	6.4	6.6	14.3	14.6	9.3
Manufacturing sector					
Output	-1.8	2.1	1.3	-1.3	0.8 4/
Output per man-year	--	3.8	2.4	0.6	1.4 4/
Unit labor costs	8.1	0.2	8.2	10.0	
Broad money (change during year)	11.4	13.6	11.8	11.6	9.9
Oil and gas production (million tons o.e.)	31.9	40.3	50.5	49.1	
Unemployment rate (in per cent)	1.8	2.0	1.7	2.0	
Public finance (NKr billions) 5/					
Central government financial balance	-8.1	-5.4	3.5	8.2	10.1
Loan transactions	8.1	8.9	8.6	6.5	6.6
Central government net financing requirement	16.2	14.3	5.0	-1.7	-3.5
Financial balances (in per cent of GDP)					
Central Government	-3.8	-2.3	1.2	2.5	2.8
(Excluding oil taxes) 6/	(-6.3)	(-5.9)	(-6.6)	(-7.2)	(-6.6)
Public sector	-1.7	-0.6	4.0	3.1	2.8
(Excluding oil taxes) 6/	(-5.2)	(-5.5)	(-5.8)	(-6.6)	(-5.8)

1/ Official forecast of December 1981 unless otherwise stated.
2/ Change in stockbuilding as per cent of previous year's GDP.
3/ Unofficial forecast.
4/ Manufacturing and traditional mining.
5/ 1981 and 1982 figures are October 1981 estimates.
6/ In per cent of GDP excluding oil and shipping sectors.

Norway: Basic Data (Cont'd.)

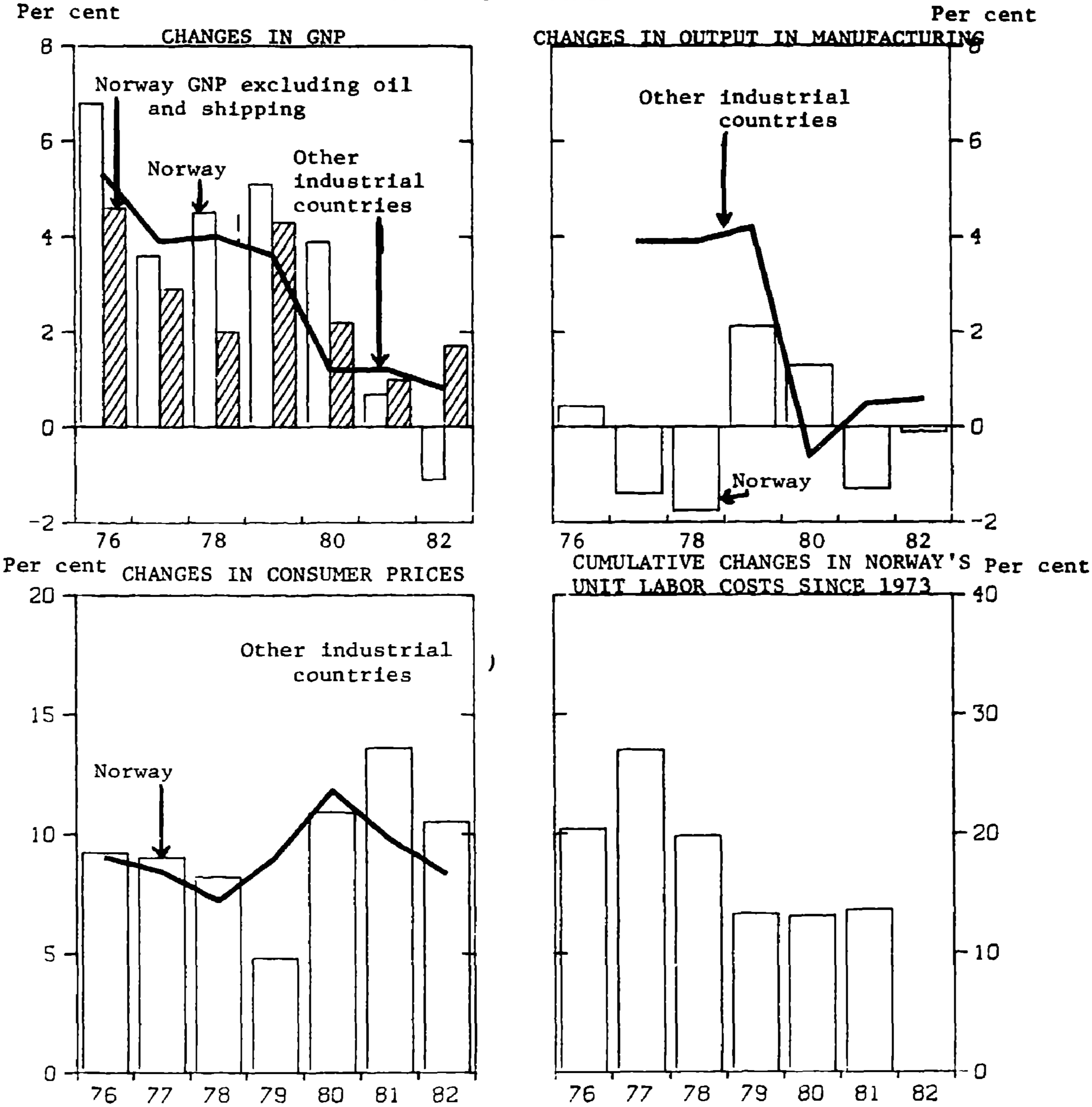
	1978	1979	1980	1981	1982 1/
Credit budget (NKr billions) 2/					
Total credit supply to private and municipal sectors	26.4	26.5	32.3	34.5	47.7
Net capital from abroad	3.4	1.7	1.6	3.0	11.8
Domestic credit	23.0	24.8	30.7	31.5	35.9
Commercial and savings banks	(5.8)	(8.4)	(8.5)	(9.0)	(9.6)
Bond market	(2.1)	(1.6)	(5.3)	(9.0)	(9.0)
Other	(15.1)	(14.8)	(16.9)	(13.5)	(17.3)
Balance of payments (NKr billions)					
Exports, f.o.b.	57.9	70.0	92.9	105.7	106.3
Imports, c.i.f.	62.0	70.4	84.5	90.4	101.3
Trade balance	-4.1	-0.5	8.4	15.3	5.0
Net services and transfers	-6.9	-4.8	-2.9	-3.2	-2.9
Current balance	-11.0	-5.3	5.5	12.1	2.1
(In SDR billions)	(-1.7)	(-0.8)	(0.9)	(1.8)	...
(In per cent of GDP)	(-5.2)	(-2.2)	(1.9)	(3.7)	(0.6)
Public sector long-term capital	14.8	8.5	-3.4	-6.8 3/	-10.2 3/
Private sector long-term capital	2.1	3.1	-1.0	1.3 3/	5.7 3/
Short-term capital, including errors and omissions	4.6	0.2	7.1	...	
Valuation changes and SDR allocations	-4.7	-0.2	2.8	...	
Change in net official reserves (increase -)	-5.8	-6.3	-10.5	...	
Gross official reserves, end-period					
In SDR billions	2.2	3.2	4.8	5.4	
In weeks of imports	13	16	20	21	
Competitiveness indicators (annual percentage change)					
Relative unit labor costs	-5.6	-5.4	-0.2	0.4 4/	
Relative export unit values	-9.9	3.6	4.6	-2.4 4/	
Volume of traditional exports	8.2	8.6	--	--	4.0
Traditional export markets 5/	5.9	10.6	-0.5	0.5	4.6
Terms of trade (excluding ships)	-0.1	6.2	15.9	10.1	
Net external debt (NKr billions, end of period)	99.0	103.6	93.3	81.1	
(In per cent of GDP)	(46.5)	(43.4)	(32.9)	(24.8)	
Exchange rate					
NKr per SDR: period average	6.56	6.54	6.43	6.77	
NKr per SDR. end-period	6.54	6.49	6.61	6.76	
MERM effective rate					
Average change (in per cent)	-5.8	0.2	2.3	-3.4	
Change during the period	-6.6	3.1	-3.4	0.5	

1/ Official forecast of December 1981 unless otherwise stated.
2/ Data for 1981 reflect forecasts of December 1981.
3/ Estimates of October 1981.
4/ First three quarters of 1981, change from 1980 average.
5/ Nonoil market growth estimated by Fund staff.

CHART 1

NORWAY

NORWAY IN THE INTERNATIONAL CONTEXT



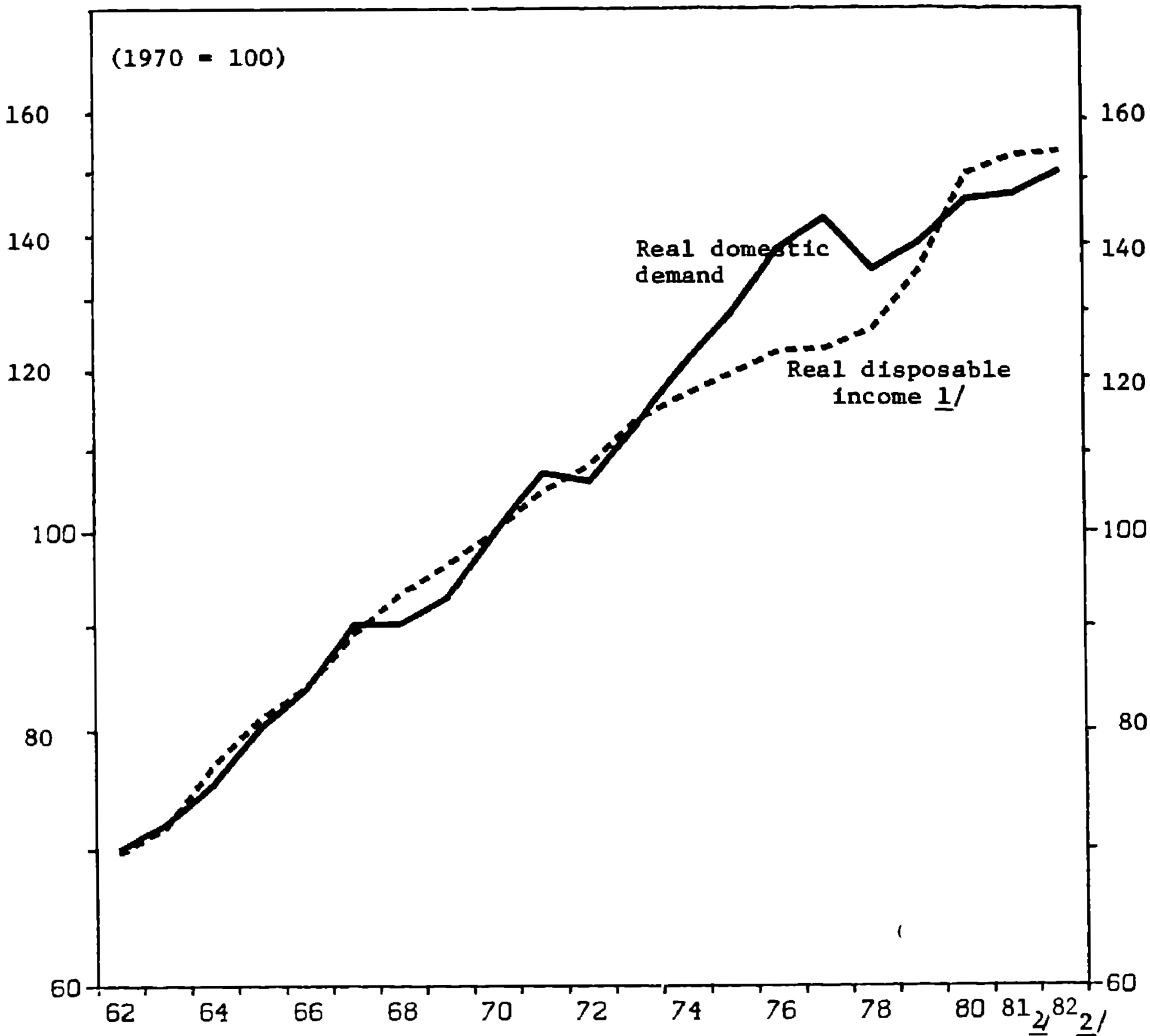
Sources: Ministry of Finance, National Budget; Central Bureau of Statistics, Monthly Bulletin of Statistics; and IMF, Data Fund.

1/ Excluding oil.
2/ Relative unit labor costs in manufacturing, adjusted for effective exchange rate changes.

CHART 2

NORWAY

AGGREGATE DOMESTIC DEMAND AND DISPOSABLE INCOME



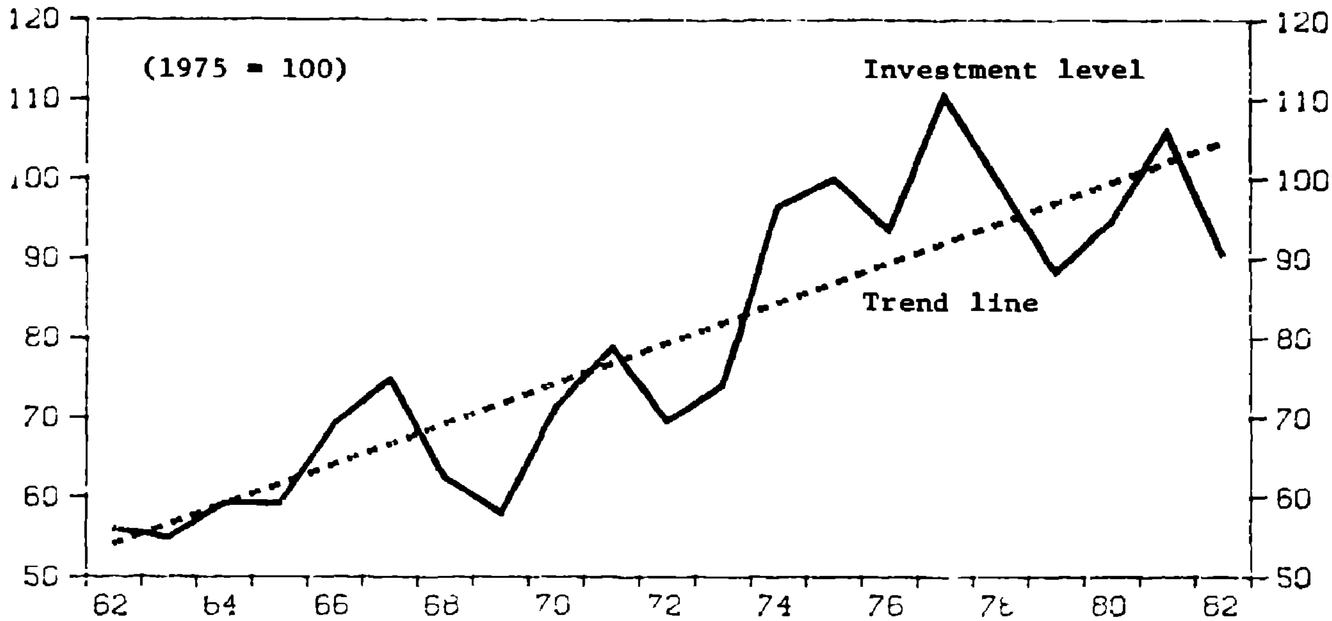
Sources: Central Bureau of Statistics, National Accounts; and Ministry of Finance, National Budget.

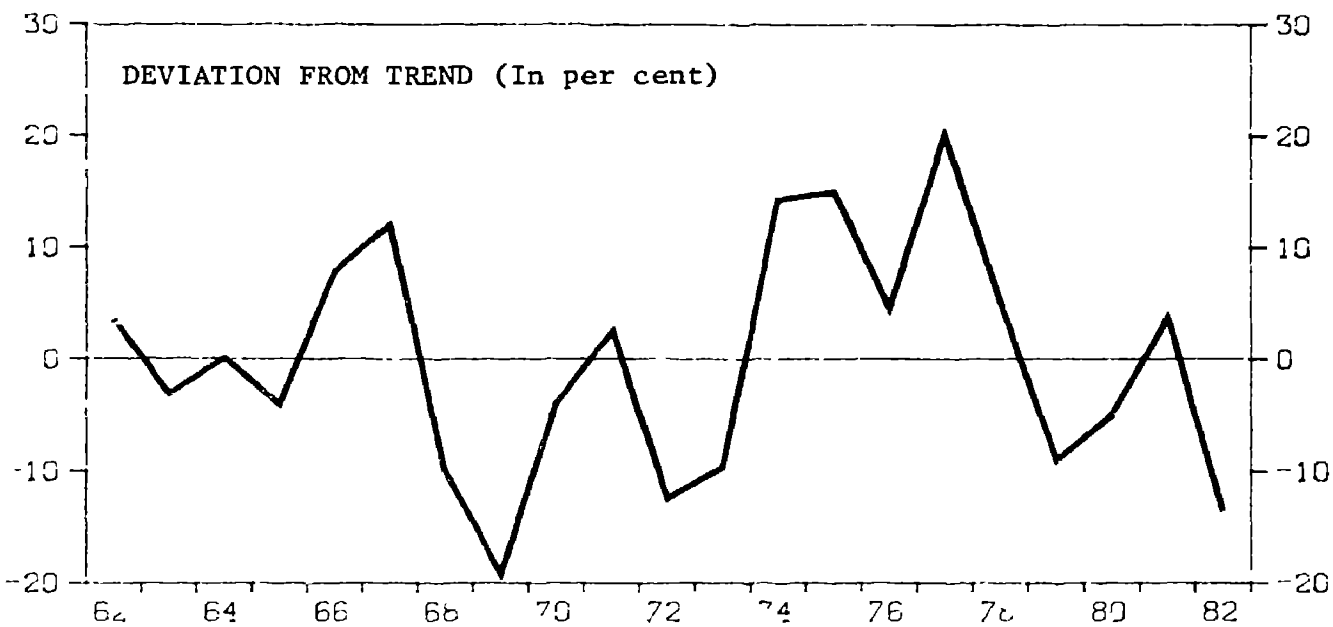
1/ National disposable income deflated by the implicit price deflator for total domestic demand.
2/ Official forecasts of October 1981.

CHART 3

NORWAY

GROSS FIXED INVESTMENT IN INDUSTRY
(1975 = 100)



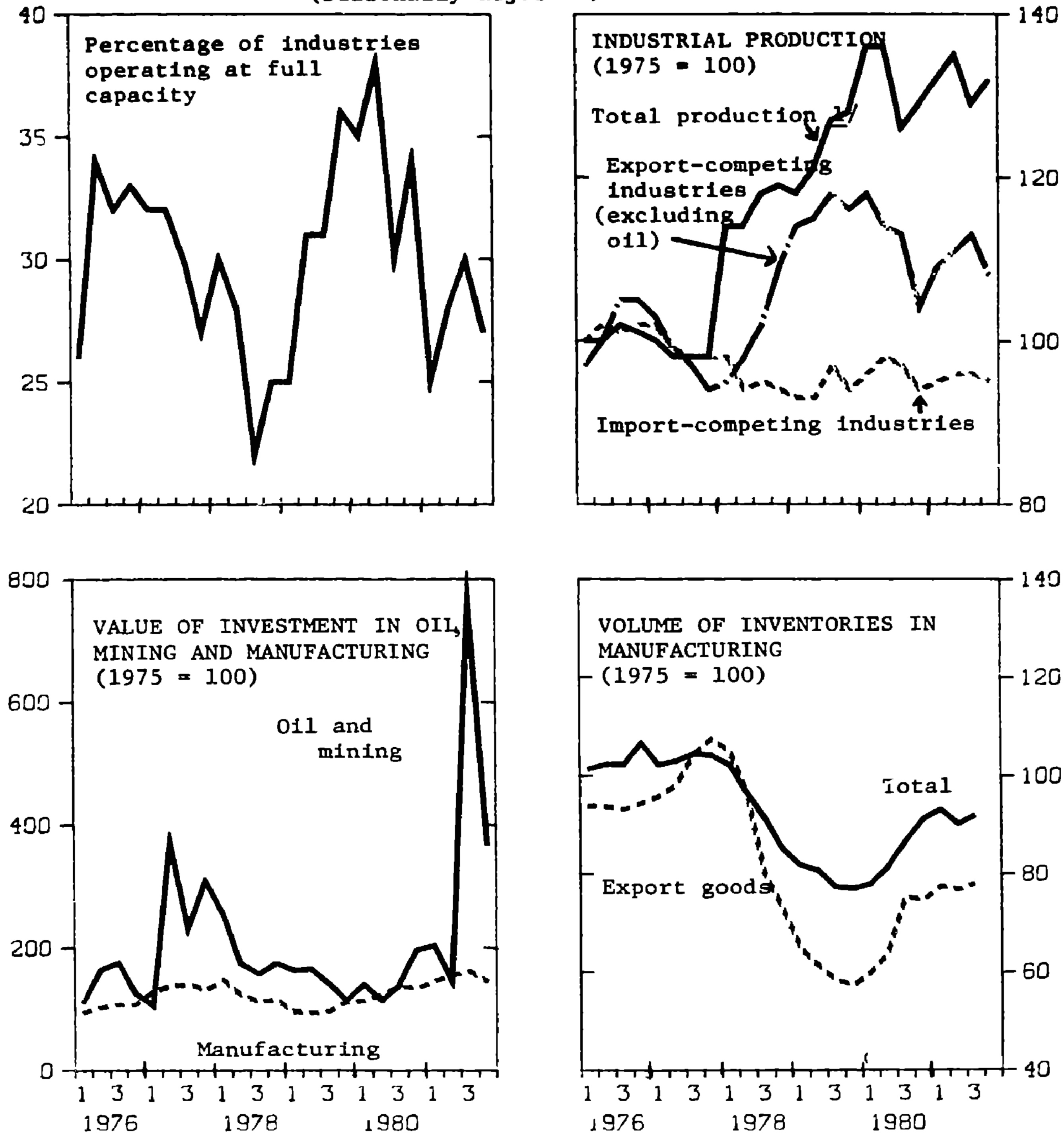


Source: Central Bureau of Statistics, National Accounts; data provided by the Norwegian authorities; and staff estimates.

CHART 4

NORWAY

INDICATORS OF INDUSTRIAL ACTIVITY
(Seasonally adjusted)



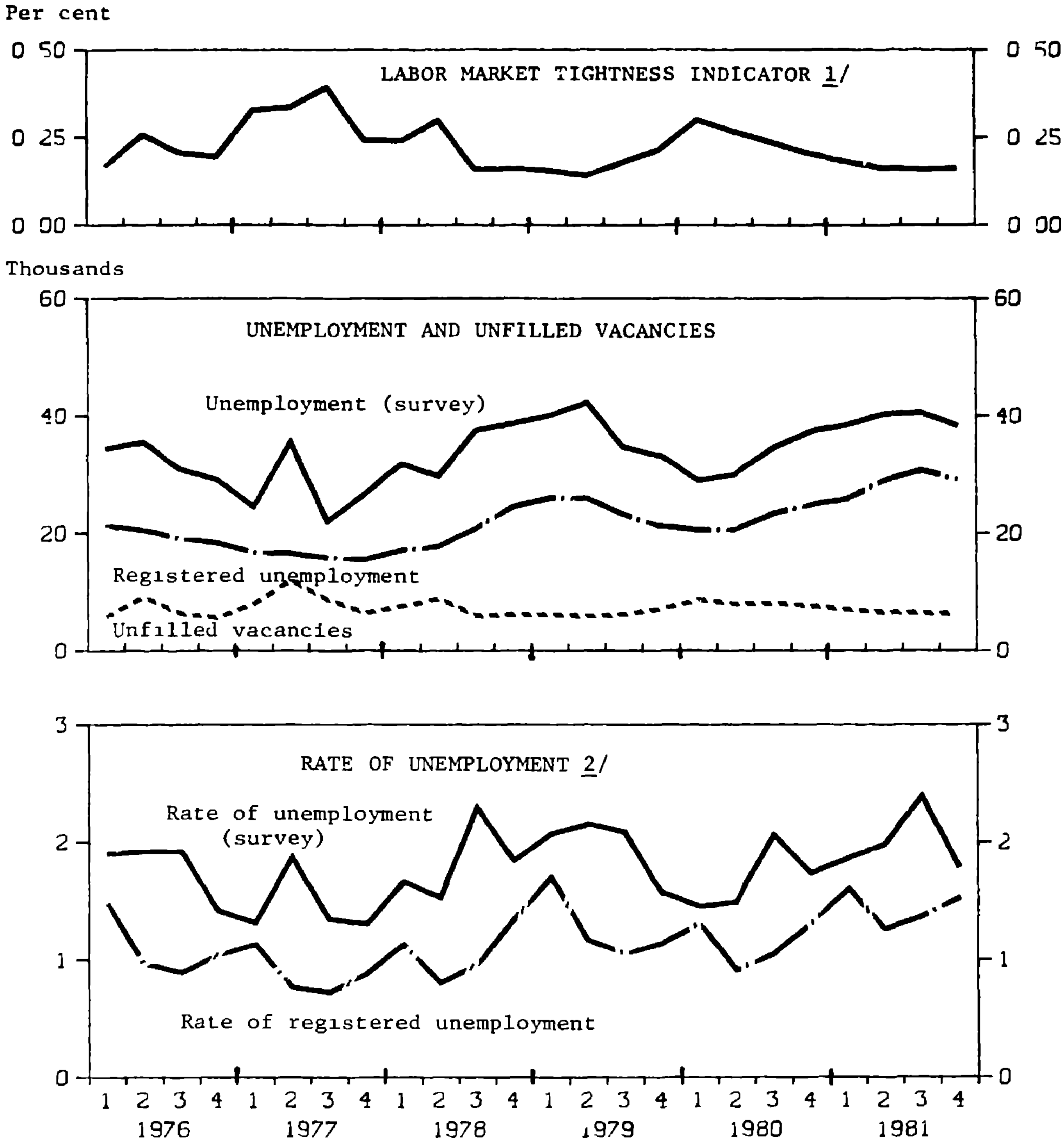
Sources: Central Bureau of Statistics, Konjunkturtendensene, and Statistisk Månedshefte; IMF, Data Fund; and staff estimates.

1/ Including oil.

CHART 5

NORWAY

LABOR MARKET INDICATORS
(Seasonally adjusted)



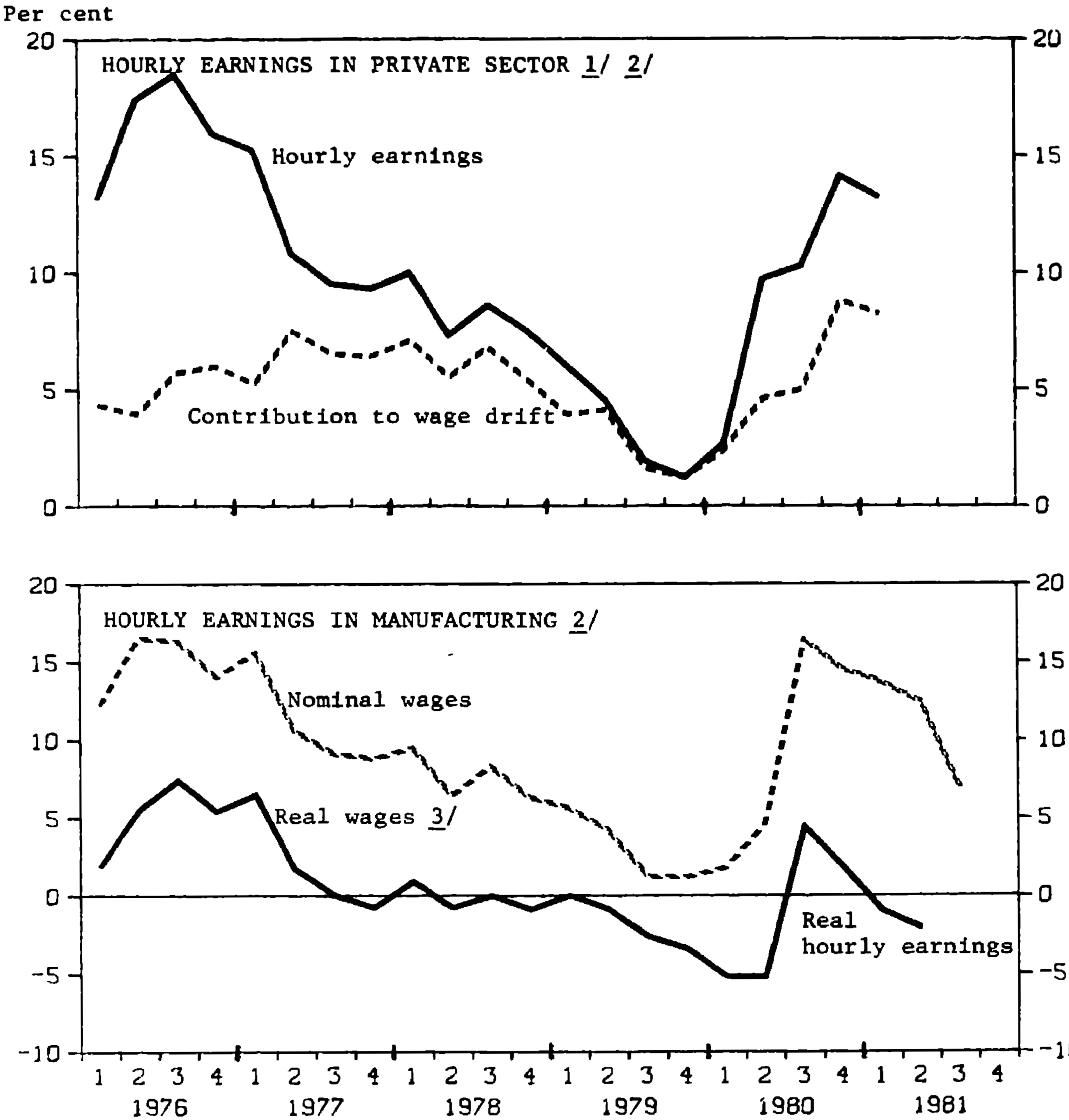
Sources Central Bureau of Statistics, Statistisk Ukehefte; IMF, Data Fund, and Norges Bank, Economic Bulletin.

1/ Ratio of vacancies to registered unemployed.
2/ Unadjusted data.

CHART 6

NORWAY

WAGE DEVELOPMENTS
(Percentage change from corresponding period of previous year)



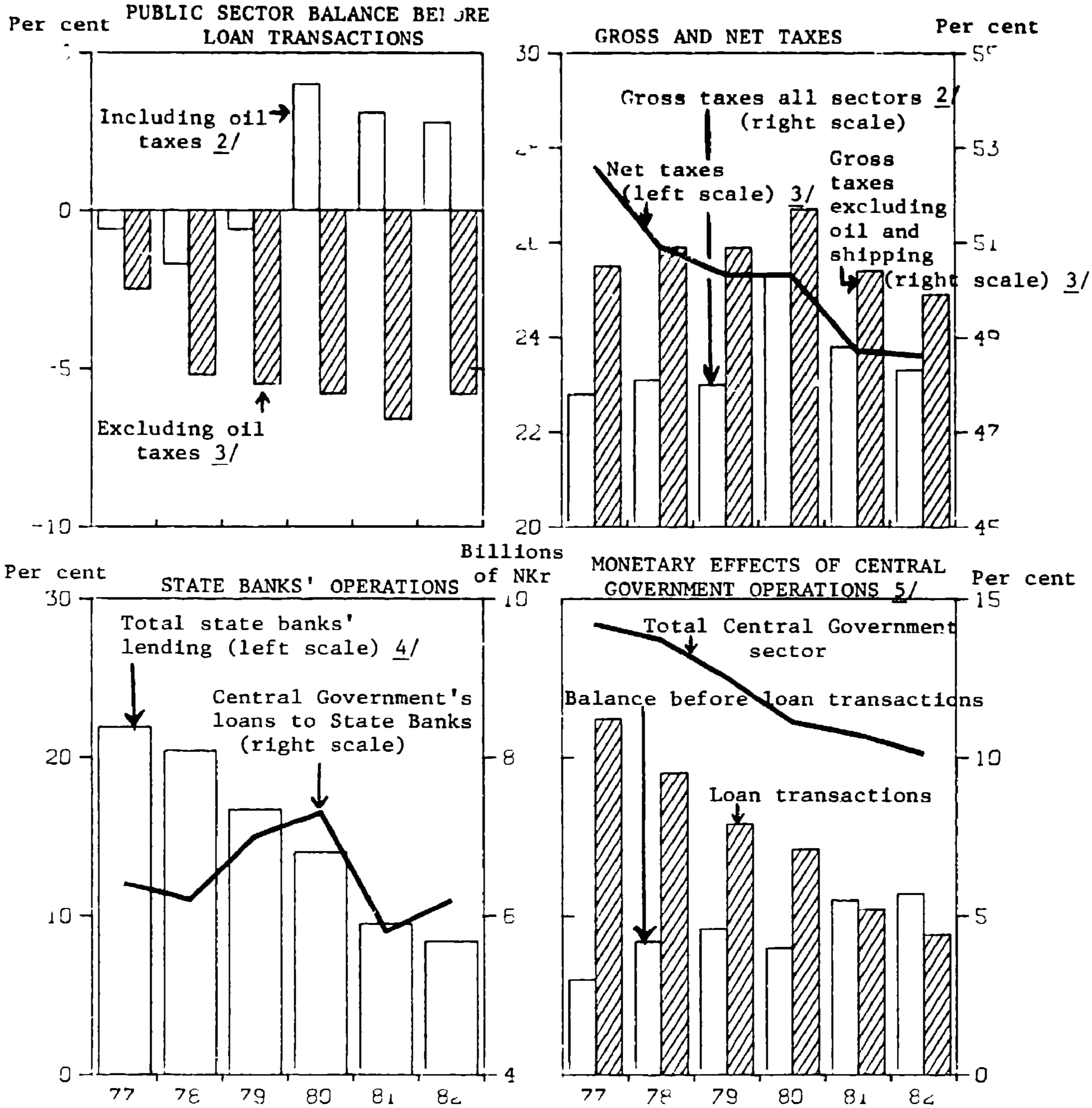
Sources: Ministry of Finance, National Budget; and Central Bureau of Statistics, Statistisk Månedshefte.

1/ Wages in private sector firms belonging to the Norwegian Employers' Confederation.
2/ Adult men.
3/ Deflated by the consumer price index.

CHART 7

NORWAY

FISCAL INDICATORS 1/



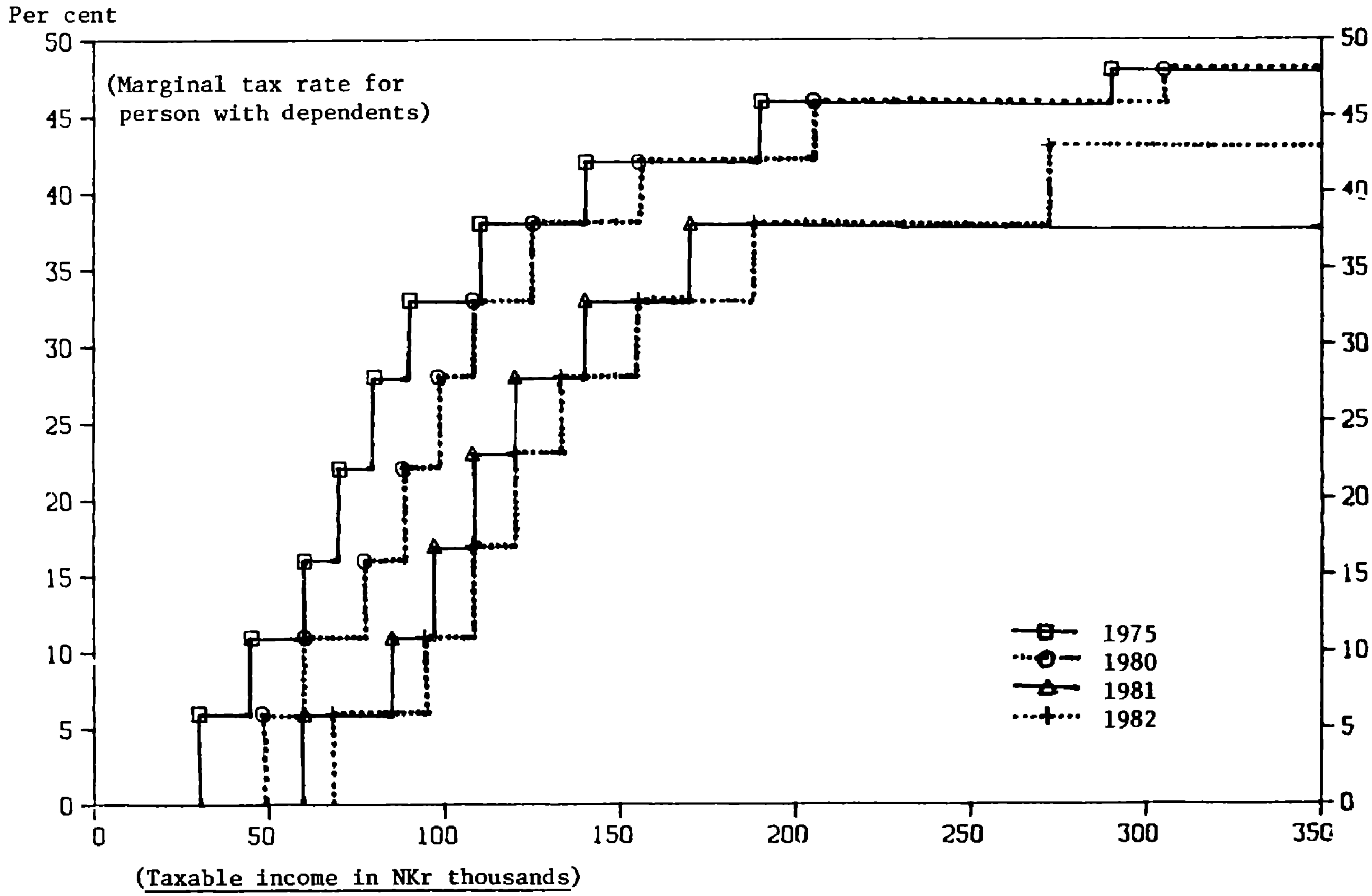
Source: Ministry of Finance, National Budget.

1/ Data for 1981 and 1982 are official Norwegian estimates and forecasts of October 1981.
2/ In per cent of GDP.
3/ In per cent of GDP, excluding oil and shipping.
4/ Yearly percentage change.
5/ Percentage contribution to the growth of broad money.

CHART 8

NORWAY

CENTRAL GOVERNMENT INCOME TAXATION

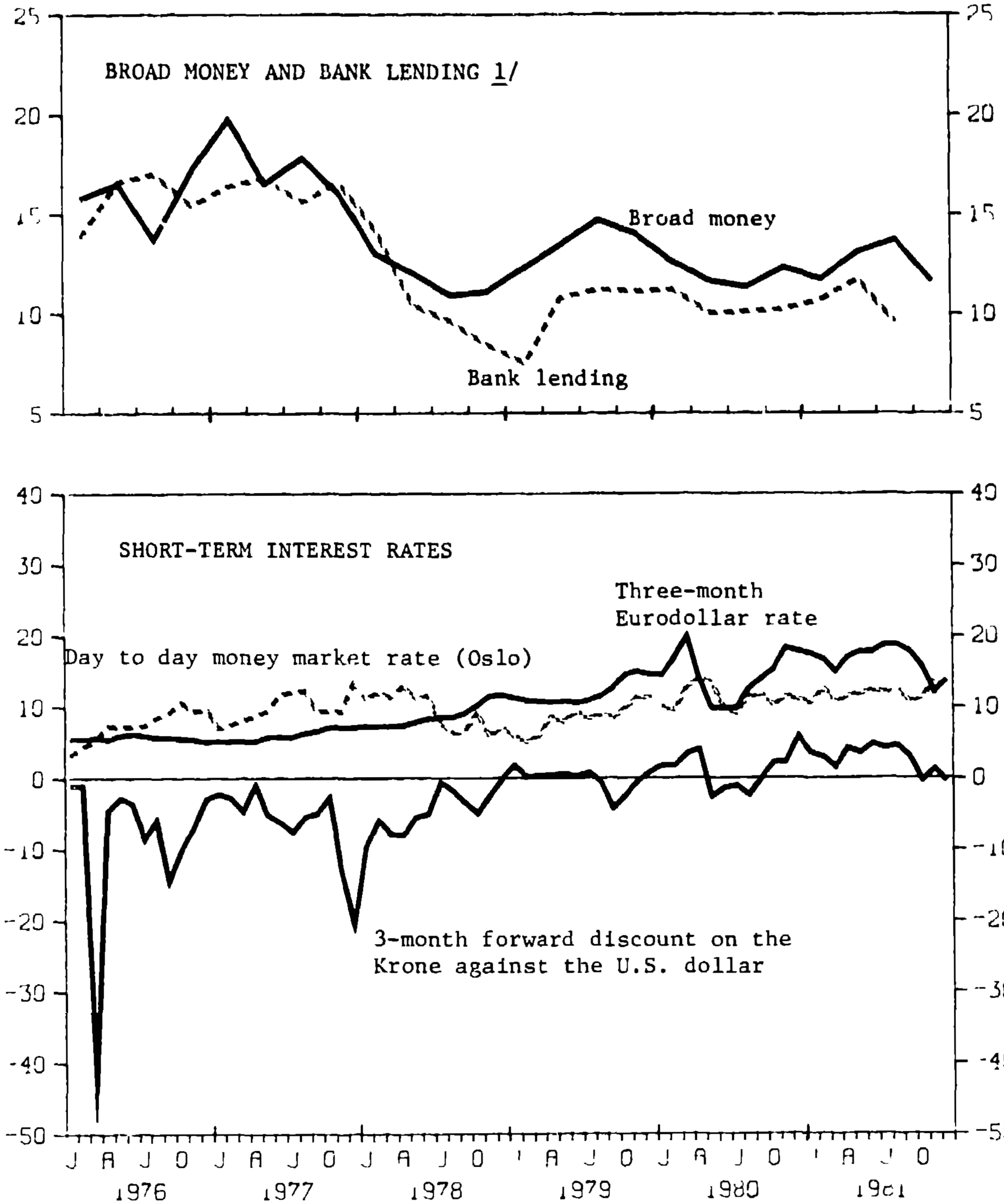


Sources: Ministry of Finance, National Budget, various years, and Revised Budget Proposal 1982.

CHART 9

NORWAY

BANK LENDING AND INTEREST RATES
(In per cent)



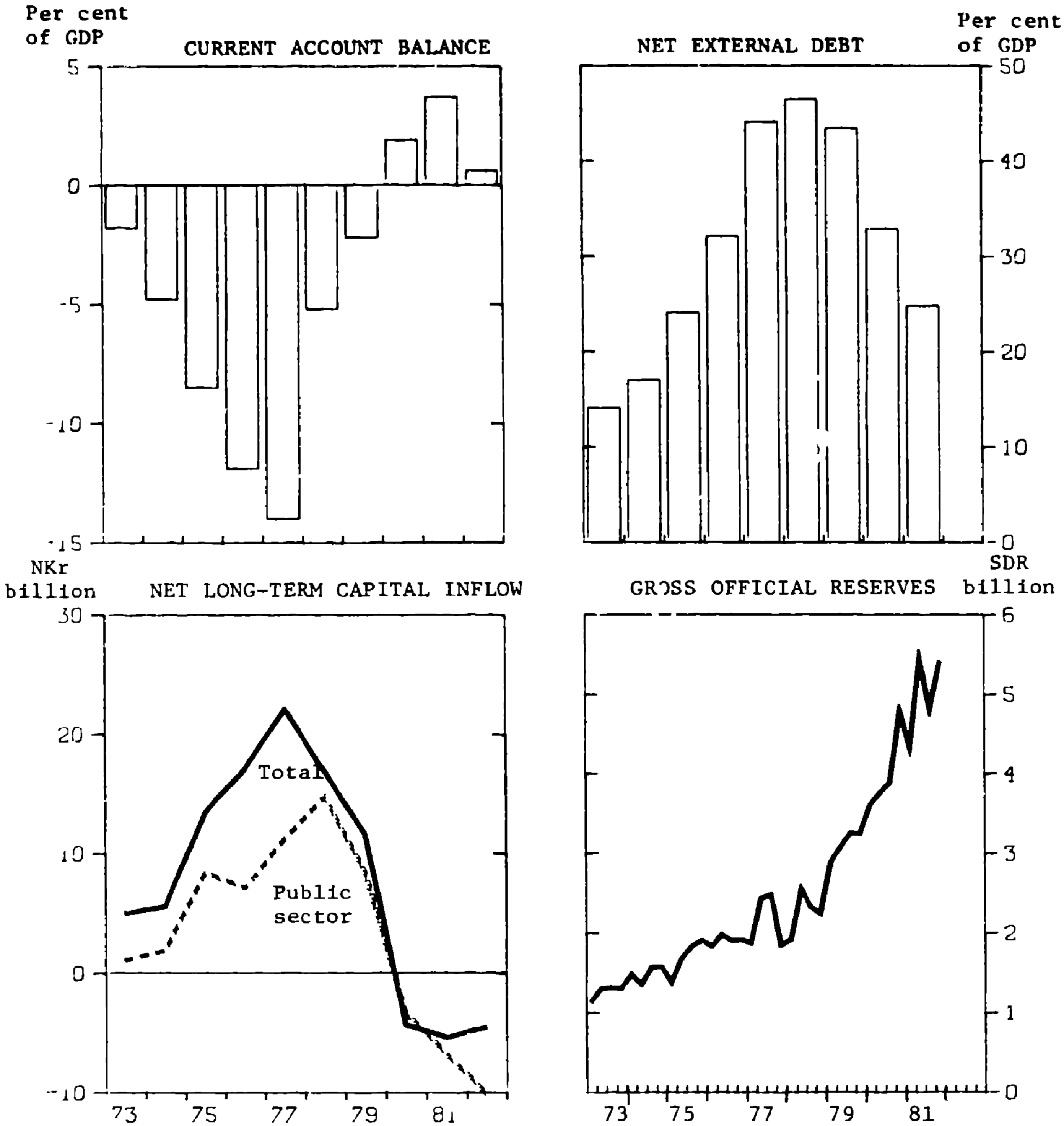
Sources: Norges Bank; and IMF, International Financial Statistics.

1/ Lending of commercial banks and savings banks to private nonbanks and municipalities, percentage changes over the preceding 12 months.

CHART 10

NORWAY

EXTERNAL DATA

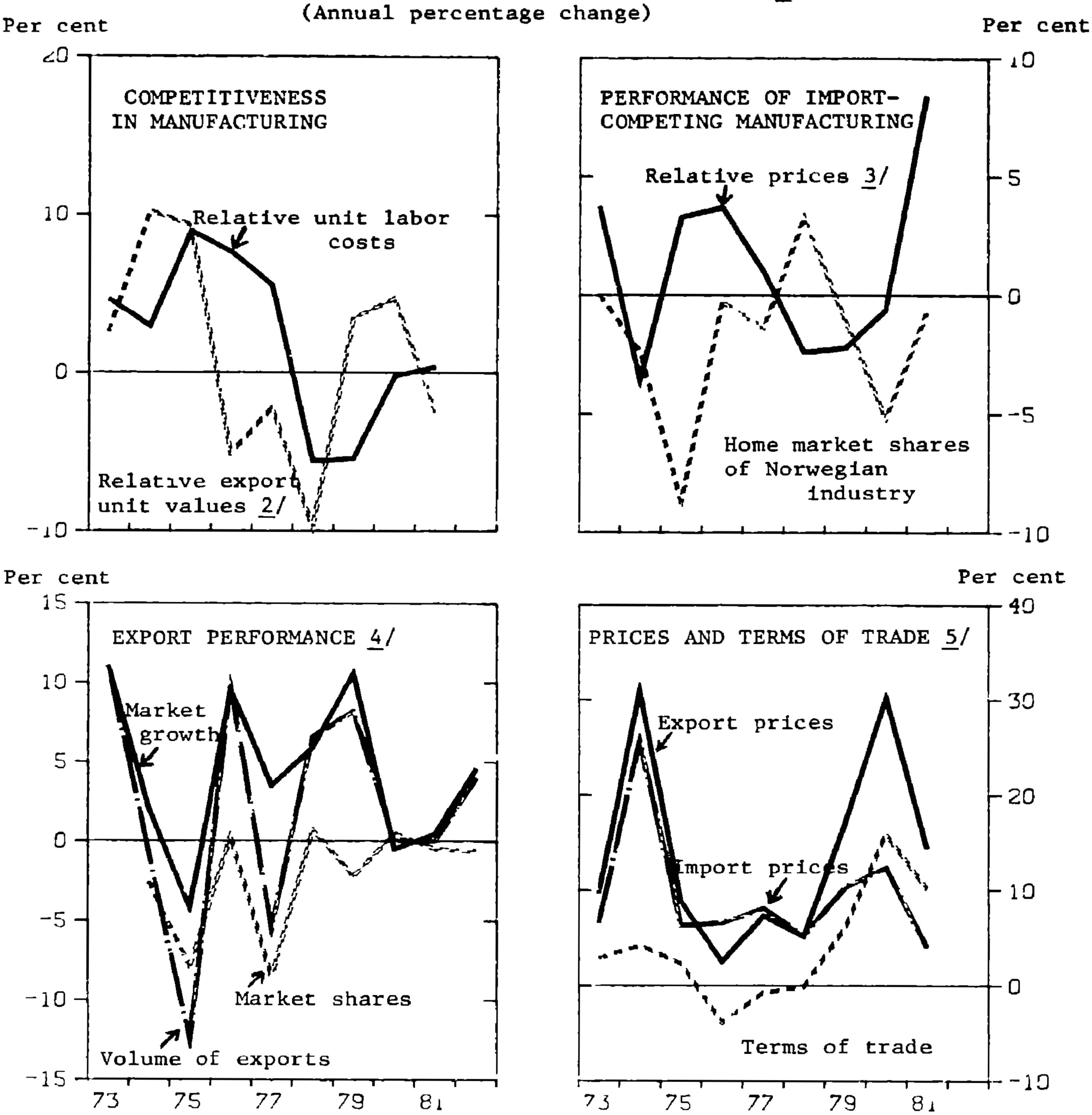


Source. Ministry of Finance, National Budget; Norges Bank, Annual Report, and IMF, International Financial Statistics.

CHART 11

NORWAY

INTERNATIONAL COMPETITIVENESS AND PERFORMANCE 1/
(Annual percentage change)



Source: See Table 31 of the Recent Economic Developments for sources and more complete notes.

1/ Relative unit labor costs and relative prices in Norwegian manufacturing are adjusted for exchange rate changes.

2/ First three quarters 1981.

3/ Relative to import unit values.

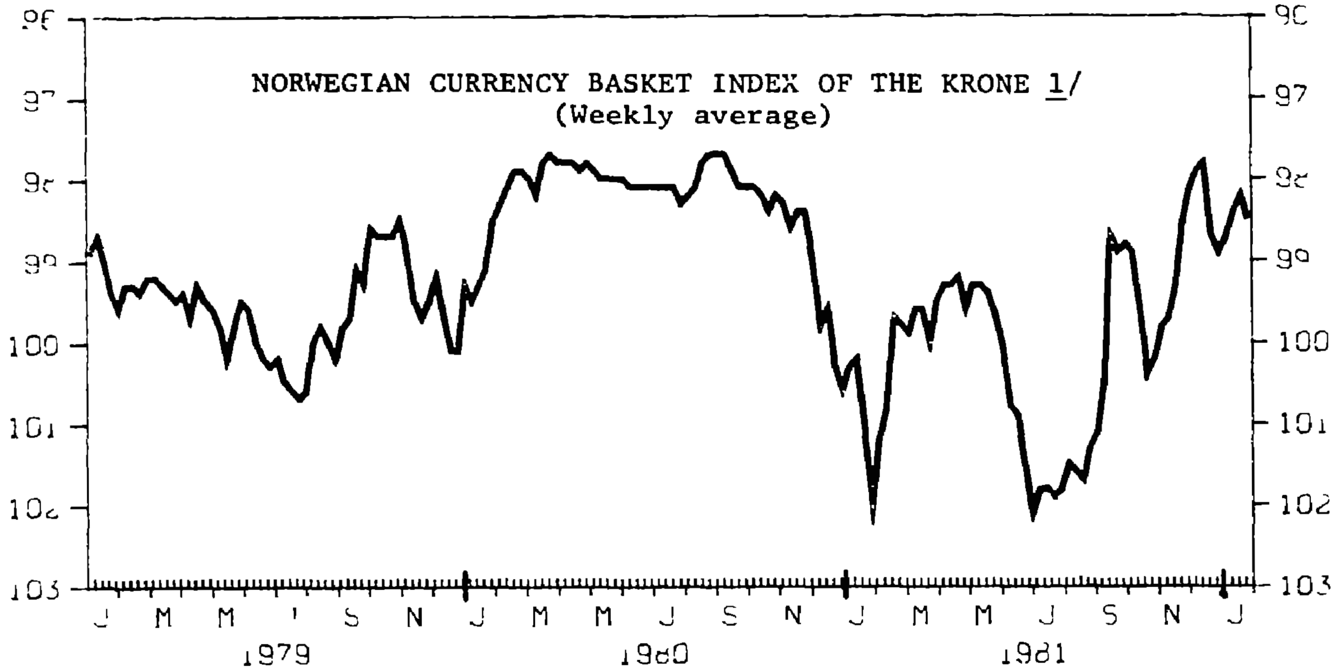
4/ Merchandise exports excluding ships, oil platforms, crude oil, and natural gas.

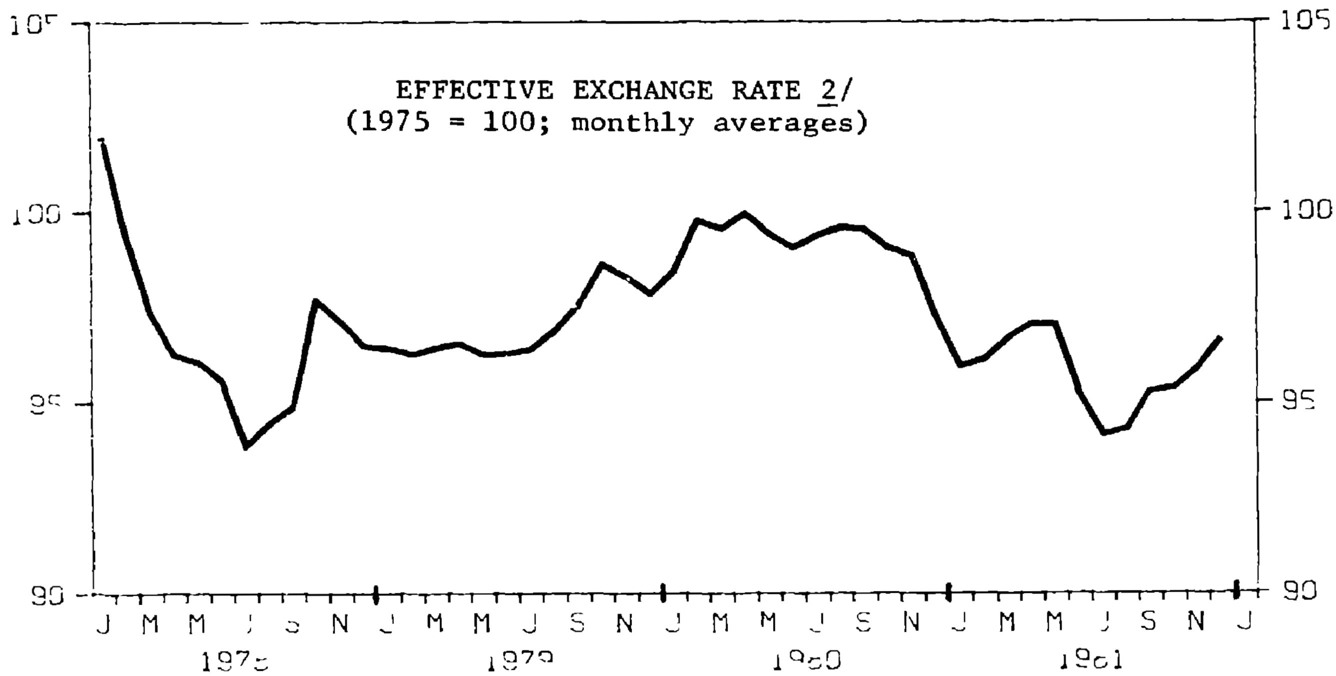
5/ Unit values of merchandise trade excluding ships.

CHART 12

NORWAY

EXCHANGE RATE DEVELOPMENTS





Sources. IMF, International Financial Statistics; and data provided by the Norwegian authorities.

1/ Index of the currency basket of 12 currencies relative to the Norwegian krone; a declining value of the index indicates an appreciating krone (note inverted scale). Basket system in effect since December 12, 1978.

2/ Based on the IMF Multilateral Exchange Rate Model.