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Statement by Mr. Vidvei on Norway
Executive Board Meeting
April 5, 1982

The staff has presented a comprehensive and balanced report for this consultation and I would like to take this opportunity to express my appreciation for their work. On behalf of the Norwegian authorities I would also like to thank the staff for the useful discussions held in Oslo in January.

At the outset of 1982 I would characterize the Norwegian economy as fairly well balanced. It is operating at practically full employment. The current external account shows a moderate surplus. The two main areas of concern are at present, first, the high rate of price increases generated by rising costs and high level of demand and, second, the lack of growth in the economy. These negative features seem to persist into 1982, and might result in a weakening of the labor market. In spite of this the unemployment rate in Norway will remain low by international standards.

The Norwegian economy--as other small open economies--is strongly influenced by the present world recession and the restrictive demand policies pursued by its major trading partners. But, as correctly pointed out by the staff, Norway faces a domestic cost and price problem that has to be solved. After having reduced the inflation rate--as measured by the consumer price index--to 4.8 per cent in 1979 and closed a large part of the "cost gap" in the non-oil export industries that had opened vis-à-vis competitor countries in the years 1974-77, an acceleration in the rate of inflation was registered in the first part of 1980, reflecting higher import costs, pent up price pressure from the price-freeze period and adjustments in administered prices. Subsequently, the high rate of inflation was reinforced by wage and salary increases, rises in administered agricultural prices, and changes from direct to indirect taxes. Thus, the rise in prices has to an increasing extent--as pointed out by the staff--been the result of domestic rather than external factors. From 1980 to 1981 prices on imported consumer goods--as measured in the consumer price index--rose by only 7.4 per cent.

Maintenance of full employment is a priority goal of Norwegian economic policy. This policy has in recent years been based on strong growth in domestic demand and high investments in the development of oil and gas resources. In the first stages, growth of domestic demand was financed from foreign borrowing and subsequently by increased oil revenues. The development of the petroleum resources had certain demand effects upon important sectors of the economy and facilitated restructuring in the direction of growth industries. The result was, all in all, that government future and present revenues from oil taxes were channeled into the domestic economy. An important issue for the Norwegian authorities is now how best to control or limit the effects of the oil sector on the domestic economy to avoid too rapid structural adjustments. The price and cost problem is clearly related to this issue and the Norwegian authorities attach great importance to the maintenance of the commpetitive position of Norwegian industries, regarding this as a precondition for maintaining full employment in the future. The need to improve competitiveness of traditional industries has been further emphasized by the recent downward revisions of output from existing oil fields and by the decline in oil prices. Thus, the latest projections indicate that increases in real incomes in the 1980s will have to be based mainly on the expansion of the non-oil sector.

Let me at this point comment briefly on the latest developments in oil prices. The most recent official forecasts on the Norwegian economy were based on a price of $37.50 per barrel in 1982. That was the contract price up to February when Statoil (The State Oil Corporation) reduced its price to $36. In early March the price was further reduced to $31-32 per barrel. Based on this dollar price and an exchange rate of 5.75 kroner per dollar, there will be no dramatic consequences for the official 1982 estimates. Government revenues for 1982 might be reduced by approximately NKr 3 billion, and the current external account might turn into a small deficit, instead of the small surplus as projected in the most recent official forecasts.

Obviously the medium-term consequences might prove to be more significant. Instead of a moderately increasing trend in oil revenues, one might now see a relatively large drop in government revenues from oil and gas production in 1983, and a leveling off at the 1983 level, or below, for the remaining two years of the long-term program period 1982-85. Needless to say, such a development would have important implications for the Government's financial position and the balance of payments in the years to come. Rough calculations indicate that deficits on the current account of the balance of payments--under certain assumptions--might reach as high as NKr 10 billion in 1983 and 1984. However, too great importance should not be attached to such figures. Nevertheless, they demonstrate the uncertainties and the vulnerability of the economy if it is based too heavily on the petroleum sector.

It is difficult to estimate price and cost developments for 1982, as they will be greatly affected by the result of the income negotiations this spring. The average increase in consumer prices from 1980 to 1981 was 13.6 per cent, the highest rate since 1951. A part of the increase was, however, due to tax adjustments and corrected for these the consumer price rise was 11 1/2 per cent. The carry-over of price increases from 1981 into 1982 was approximately 3 1/2 per cent, markedly less than last year's. The exceptionally high rise of 3 per cent in consumer prices in January was to a large extent due to increases in indirect taxes. For 1982 one might expect a consumer price rise of around 10 per cent, well above the average rise in consumer prices (forecast at 8 per cent) in the countries that are Norway's most important trading partners.

Measured by changes in relative unit labor costs, there was a slight deterioration in the competitive position of Norwegian industries in 1981. In spite of the fact that the carry-over of wage increases at the outset of 1982 (approximately 2 3/4 per cent in manufacturing industry) was only about half as large as the carry-over recorded a year earlier, the scope for wage increases in this year's wage settlement is very limited if a further worsening of the competitive position is to be avoided. The Government has revised the former Government's tax proposal in order to prevent bracket-creep from adding to wage demands. At the present stage of income negotiations, however, it is too early to speculate on the outcome. The important iron and metal workers' union has demanded an 11 1/2 per cent increase in wages in 1982 over 1981, while the management side has stated that the increase in wage costs should be limted to 6 1/2-7 per cent to avoid loss of competitiveness. When account is taken of the carry-over from 1981 and locally negotiated wage increases, the figures imply that there is little room for wage increases through the negotiations at the national level between the different trade unions and their corresponding employers' associations. The staff's judgment that maintenance of competitiveness in 1982 is unlikely to be achieved is thus difficult to challenge. Still, it is the Government's medium-term objective to improve the competitive position of Norwegian industries. This is seen as an important precondition for the maintenance of full employment. Over the comming years the Government will, through its incomes policy, strive to reduce the need for nominal wage increases. This policy will include tax concessions. There is also a need to improve productivity and counteract the tendency toward segmentation in labor markets, i.e., greater labor mobility is needed.

A tighter fiscal policy, as pointed out by the staff, is in line with the intentions of the Government and also the thrust of the 1982 budget. Thus, the budgetary plans for 1982 are aiming at a reduction from 1981 to 1982 in the Government budget deficit, excluding oil revenues, as a percentage of GDP (excluding oil and shipping) and a moderation in the domestic liquidity effect of central government transactions. Due to the latest developments in oil prices and its effects on government revenues, the income tax reductions envisaged in the Government's budgetary plan might have to be spread beyond 1986. This would be in line with the staff's recommendations.

The staff discusses the importance of reducing government support to ailing firms and states its concern that withdrawal of such support might be delayed as a consequence of a possible worsening of the competitive position of traditional industries in 1982. The increase in industrial support in the period 1973-77 was part of an antirecessionary policy adopted in order to bridge a period of weak foreign demand. Since 1977 a real reduction in direct support to the Norwegian industrial sector has taken place, and from 1981 to 1982 the budgetary plans imply even a reduction in nominal terms.

Assessing the degree of government support to industries in various countries is a very complex issue. The economic environment in which the industrial sector is working is shaped by a number of factors. Government support should be seen as a part of the total tax/subsidy system under which firms work. Thus, the net effect of government policy might not be as simple as the support figures themselves imply. If one looks at direct government support to firms in financial difficulties, the figures in Norway are fairly small.

It is the intention of the Government to reduce selective support to enterprises, but there are clearly partly conflicting considerations involved, especially in the short term. As some reduction in corporate taxes is contemplated, this could be implemented simultaneously with reductions in selective support. In the shipbuilding sector the scope for reduction of the support is limited in the short run, as long as other countries seem to be maintaining their government support to this sector at a relatively high level. In the longer run, however, increased demand in connection with developments of new oil fields in the North Sea and maintenance work at oil fields should leave room for reducing support to the shipbuilding sector. Government support policy in Norway also has very important regional aspects and is often related to the problems created by one-factory towns in remote areas.

A number of new steps have been taken in the monetary policy field during the last few months. The index-linked bond offer in January was very well received by the household sector and was greatly oversubscribed. The amount, NKr 1 billion, corresponds to a reduction of the money stock, broadly defined, by one half of one percentage point. A new offer with the same terms will be made in April, but this time the amount might not be limited. The bond investment obligation for banks, insurance companies, and pension funds has been reduced, and interest rates on government bonds have been increased in order to limit the supply of credit to the private sector. On five-year government bonds the interest rate is currently 12.5 per cent. In order to gain better control of the bond market the guidelines for issuing private bonds have recently been tightened. The rules for conditional loans to banks from the Central Bank have, moreover, been revised so as to supply less liquidity at a given level of credit expansion. The sectoral regulation of loans from the banks was abolished from the end of March. But total loans from the savings banks are now sought contained within strict limits by indirect instruments. Furthermore, in order to achieve even more flexibility in the control of savings bank lending through indirect instruments, the Government has proposed that the maximum ratio for their reserve requirement, should be raised. The Minister of Finance has asked the credit institutions for their cooperation in restricting the supply of credit through the unregulated market and has said that if this does not prove sufficient, the bank guarantees for transactions in this market will be directly controlled.

These steps should make the control of credit expansion more effective than was the case last year. The Government agrees that, in principle, a flexible interest rate policy would be preferable in line with a general reduction of direct regulations in the credit market. In order to achieve this, fiscal policy must be tightened--a process that requires time. Moreover, in the view of the Government, a general increase in the level of interest rates is not appropriate at present. Thus, in its interest rate policy declaration last January, the Government stated that the banks and insurance companies should maintain the present average level of interest rates on loans. Exceptions were made for a few categories of loans where the interest rates are stipulated directly by the authorities and where the rates are particularly low (e.g., house building loans). These rates were raised by 0.5-1 percentage point.

Before concluding, I would like to state my agreement with the staff's appraisal of exchange rate policy. No change in this policy is considered.

Finally, Mr. Chairman, I think the Government's short- and medium-term economic strategy can be summarized as follows:

- tightening of overall fiscal policy;
- reducing personal and corporate taxes;
- limiting the growth of public expenditure, in particular of transfer payments;
- easing the burden which the monetary policy has to carry with the aim to stimulate private investments and productivity growth;
- supplementing fiscal and monetary policies by incomes policy measures; for example, in the form of tax reductions with the aim of influencing income negotiations;
- strengthening policies aiming at improving the functioning of the production sector and at easing structural problems.