NORWAY

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SUMMARY
The economy of Norway is strong and thriving. Most economic indicators would lead to the belief that Norway is, as one report labeled it, “a prosperous bastion of welfare capitalism.” Its economy has prospered due in part, to the large amount of oil reserves and natural resources that it trades. Although it is heavily reliant on trade, Norway is one of the few countries in the world that is an external creditor, maintaining no external debt from year to year. Although it has a floating exchange rate, it maintains a very stable rate of inflation from year to year due to tight monetary policy enacted by the central bank. Yet, despite the current economic indications, it would seem that Norway has two significant problems on the horizon. These problems, a high interest rate and a large amount of government expenditure, may be rectified by enacting policies that would lower the high interest rate that Norway has continually maintained.

KEY ECONOMIC INDICATORS

Interest Rates/Exchange Rates/Inflation
Norway’s interest rates average around 6%, the highest rate in Europe except for Iceland. This high interest rate has contributed to the Norwegian krone’s appreciation against the Euro over the past year. In the first few months of 2002, it looks like the Norwegian krone may also be appreciating against the United States dollar. The exchange rate in January was 8.9 Norwegian krone/1 USD, and this rate has climbed to 8.66 Norwegian krone/1 USD in April.

Norway has lifted nearly all foreign exchange restrictions. Residents must convert foreign currency into the Norwegian krone within thirty days, however one-year extensions can be made. Residents may also have foreign bank accounts provided they give the central bank the account number and allow them to obtain account information when necessary. This freedom of exchange restrictions would imply that the central bank’s policy options are not constrained by the need to maintain interest rates. However, the central bank of Norway fights to maintain a low inflation rate. Inflation in Norway has averaged 2.7% between 1997-2001.

Tax Rates/Government Expenditure
Norway, like other Scandinavian countries, has a high tax rate, especially when compared to the United States. Corporate taxes run at 28%, with an additional 50% tax on oil extraction, transport and processing. The value-added tax (VAT) was raised in 2001 to 24% for most items, except food, which is taxed at only 12%. Norwegian capital gains taxes are set at 28%. Norway also has a differentiated system of payroll tax to encourage investment in rural areas.

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The Norwegian government uses the large tax base to provide Norwegians with generous welfare benefits, with government expenditures equaling more than 50% of GDP. However, the government expenditure system does not run efficiently, and there is redundancy. Early retirement incentives allow individuals who retire before the legal age of sixty-seven to earn two sets of pension benefits. This program, in particular, poses a challenge in future years with Norway’s aging population and the possibility of a decline in oil revenues.

Norway’s government also controls large segments of the economy, including the petroleum industry. There has been movement in the past few years toward partial privatization, starting in the telecommunications industry. Privatization is expected to continue, especially in the energy sector, to encourage competition and foreign investment.

**Gross Domestic Product**

One of the primary economic indicators of any economy is gross domestic product (GDP). GDP in Norway has three main components: agriculture, which accounts for 2.2% of GDP, industry, which accounts for 26.3%, and services, which account for 71.5%, according to 1998 estimates. Output in Norway is heavily dependent upon trade. Norway does most of its trading in raw materials, particularly oil, petroleum and other materials such as fish, lumber and minerals.

Over the past decade, Norway’s GDP growth rate has had two noticeable drops. The first occurred in the early 1990s. This drop in the growth rate dissipated when interest rates in the economy fell. The fall in interest rates stimulated investment and exports. The second drop in the GDP growth rate has been a recent occurrence. For the past several years, the GDP long-term growth rate has been below projected estimates by approximately 1 1/2 to 2 %. This has been attributed to several factors, such as a reduction in the demand for oil and a slowdown in the global economy. However, recent reports of GDP indicate that the Norwegian economy is recovering from its period of slow growth. In the year 2000, the real GDP growth rate was 2.7% a large increase from the 1999 level of .8%.

**Monetary Policy**

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8 http://www.ssb.no/kt_en/
Both monetary policy and foreign exchange policy in Norway are determined by the Central Bank, the Norges Bank. The Norges Bank has exclusive authority over coinage. It also provides loans for and receives deposits from domestic banks in Norway. Like the Fed in the United States, the Norges Bank also influences interest and exchange rates in the Norwegian economy through intervention actions, purchasing and selling foreign currency and government bonds. In addition, the Norges Bank advises the government on matters of economic policy. The guiding principle of the Norges in determining monetary policy is to maintain a low and stable rate of inflation.

This monetary policy has been in effect since 1986. According to the Governor of the Central Bank, Svein Gjedrem, this policy enables expectations of future inflation and interest rates to remain stable. The inflation target is set at 2½ percent. If inflation is higher than the target rate, the bank will act to increase interest rates. Similarly, if the inflation rate is lower than the target rate, the bank will act to lower interest rates.

**Net Exports and Trade**

Despite its small economy, Norway is an important actor in international trade. It is a major economic partner of Europe, the United States and Asia. The EU, however, is by far Norway’s biggest consumer taking 64% of all exports, or just under 300 billion Norwegian Krone (NOK) worth of goods. Specifically, the majority of these goods go to its fellow Scandinavian states Germany, Sweden and Denmark. Overall, Norway exported $59.2 billion worth of goods in 2000, while only importing about $35.2 billion. Thus Norway enjoys a significant trade balance. In fact, the nation’s trade surplus is one of the largest in the world in relation to its population.

About 50% of Norway’s export revenues come from the sale of petroleum goods. Norway’s North Sea oil fields produced NOK 312 billion worth of exports in 2000 alone. The United States, the world’s largest consumer of oil, is a primary importer of this oil and gas. In fact, Norway is second only to Saudi Arabia in overall petroleum exports. So large are Norwegian oil revenues that for some years now, the government has been investing a large part of these revenues abroad. With so much reliance on the oil industry, many are worried about the effects of a drastic downturn in the oil market, or a major disruption in the North Sea supplies. The idea of the Government Petroleum Fund is to provide extra stability to the economy by insulating it from fluctuations in the oil market. Moreover, the Fund allows the profits from the industry to benefit future Norwegians as well. The Fund is currently valued at over $43 billion.

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10 Svein Gjedrem, Central Bank governor, address at SR Bank, April 5, 2002.

11 http://odin.dep.no/nhd/engelsk/publ/brochures/024001-120035/indexdok000-b-n-a.html

12 CIA Factbook: www.cia.gov

13 http://odin.dep.no/nhd/engelsk/publ/brochures/024001-120035/index-dok000-b-n-a.html
In addition to hydro-carbons, Norway also has a robust manufacturing sector. 30% of its exports consist of machinery or transportation items. This industry produces large power and office machinery, as well as telecommunications and computer equipment. One quarter of the manufacturing exports are ships. Norway’s history is deeply connected to the sea, and it is still home to some of the finest ship producers in the world. All in all, this sector brought in NOK 49 billion to Norway’s coffers in 2000.  

Perhaps one of Norway’s best-known exports is fish. Although it only accounts for 5% of gross exports, it is still a primary symbol of Norwegian trade. Cod, haddock, herring and mackerel fished off the coast of Norway appear in restaurants and grocery stores around the world. Norway is also home to a large aluminum, ferro-alloy, and other metal mining industry.

These strong industries allow Norway to be in a trade surplus and enjoy low unemployment and a high standard of living. Norway also happens to be a net creditor, with substantial investment abroad. Direct foreign investment in Norway is another major contributor to its stellar economic performance. Large increases in investment in Norwegian industry in the 1990’s allowed for a significant amount of expansion of the economy. In 1999, these investments totaled roughly NOK 250 billion. Moreover, the industrial production growth rate in 2000 was 3% while the real growth rate overall was 2.7%. A large reason for these highly respectable numbers is the strong export market, as well as high foreign investor confidence.

**Policy Problem**

One of Norway’s most significant problems is that it has a high interest rate. This has several implications. First, because of high interest rates, Norway has a very strong currency relative to many of its trading partners. This has made Norway’s exports less competitive. Because Norway’s economy depends very heavily on trade, this can pose significant problems. Second, the high interest rate may discourage investment in the Norwegian economy. This is, in part due, to the crowding out effect of the high amount of government spending. The results of high interest rates have been exacerbated in times of economic crises. In the past, when the economy has experienced lags due to decreases in oil prices, interest rates have been raised. This has the effect of exacerbating economic downturns when they occur.

A second problem in the Norwegian economy is the high amount of government spending. This spending is attributable to the numerous welfare benefits that the country offers its citizens. This spending has, since Norway’s pronouncement as a welfare state,

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14 Ibid.
15 CIA Factbook.
16 One example of this is the economic crisis of the late 1990s. An article describing this can be found at [http://news.bbc.co.uk/hi/english/business/the_economy/newsid_157000/157440.stm](http://news.bbc.co.uk/hi/english/business/the_economy/newsid_157000/157440.stm)
been supported by its oil trade. However, a recent concern among government officials and citizens alike is the effects that a cut back in this spending will have on the economy when the oil reserves run dry. In addition, as discussed previously, Norway has an aging population. Many citizens are receiving a windfall of government benefits due to early retirement, and inefficiencies in the welfare system. This problem can only be expected to exacerbate as the population continues to age.

RECOMMENDATION

The recommendation that will be set forth will address both of the problems discussed above. This recommendation is two fold: it entails loosening monetary policy and reducing interest rates through a cutback in government spending and privatization. Norwegian monetary policy, as described above, is aimed at keeping the inflation rate at 2 ½ %. If the Norges bank began to move away from a narrow target rate, monetary policy could be used to lower the interest rate and to stabilize the economy and provide a cushion for exogenous shocks that the economy is very vulnerable to given its reliance on trade.

Secondly, the Norwegian government should reduce its government spending. Ideally, it would begin to privatize many of its current operations. A key industry it could privatize would be the oil industry, over which it currently has exclusive control. By reducing government spending, interest rates...
would also be reduced, investment would be stimulated and privatization would be more likely to occur. In addition, by reducing government expenditure, the government would have an incentive to reform and tighten its welfare programs, thereby reducing the meting out of double benefits to some citizens, as mentioned earlier. Finally, reducing government spending and encouraging privatization does not necessarily reduce significantly the amount of revenue for the welfare programs. Because of the excessive taxes levied by the government, especially on petroleum and oil related industries, encouraging investment and privatization would provide additional revenues to the government for welfare related programs.

LIMITATIONS

Limitations of this policy recommendation are that the Norges bank prides itself on stable inflation rates and claims that this inflation rate is the anchor of the economy. Moving away from an inflation stabilization economy would, they might argue, cause dramatic upsets in the economy. Further privatization of the oil industries may cause the oil reserves to run dry sooner, rather than later. However, the benefits of greater trade and investment can easily offset the temporary shocks that may occur to the economy should the Norges bank relaxes its monetary policy, as well as the acceleration of the depletion of the oil reserves.