March 2004
IMF Country Report No. 04/94

Norway: 2003 Article IV Consultation—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Norway.

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2003 Article IV consultation with Norway, the following documents have been released and are included in this package:

- the staff report for the 2003 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **December 9, 2003**, with the officials of Norway on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on February 27, 2004**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff supplement of **March 19, 2004** updating information on recent developments.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its March 22, 2004 discussion** of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for Norway.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

NORWAY

Staff Report for the 2003 Article IV Consultation

Prepared by Staff Representatives for the 2003 Consultation with Norway

Approved by Ajai Chopra and Martin Fetherston

February 27, 2004

- Discussions were held in Oslo during December 1-9, 2003. The mission, comprising Mr. Ford (head), Ms. Cerra, Mr. Bonato, and Mr. Jafarov (all EUR), met with the Minister of Finance, the Governor of the central bank, other senior officials, representatives of labor and business organizations, private-sector analysts, and academics. Advisor to the Executive Director Mr. Gulbranson participated in the meetings.

- Norway has accepted the obligations of Article VIII, Sections 2, 3, and 4, of the Articles of Agreement. Its payment system is free of restrictions on current transactions. Norway subscribes to the Special Data Dissemination Standard, and its economic statistics are satisfactory for surveillance purposes. Norway is a member of the European Economic Area, which provides for free movement of goods, services, labor, and capital with the European Union.

- A minority coalition was formed in September 2001. National elections are scheduled for 2005.

- The authorities intend to publish this report.

Contents

I. Background

1. At the time of the last consultation, concluded on March 7, 2003 (on a lapse of time basis), Directors supported the authorities' commitment to low inflation and the policy of investing the bulk of oil revenues abroad (PIN 03/34). They welcomed the easing of monetary policy in light of weakening economic activity, while urging wage restraint. They noted the importance of preserving the credibility of the fiscal rule and cautioned against slippages. In view of population aging, they recommended pension reforms. Directors welcomed initiatives to enhance labor supply, while arguing for further reforms.

2. **The Norwegian economy performed strongly through the 1990s**. Following a financial crisis at the beginning of the decade, several years of strong output growth resulted in rising employment and falling unemployment rates (Figure 1). However, the tightening of the labor market eventually began to put pressure on wages, gradually increasing inflation and eroding international competitiveness (Figure 2).

3. **Petroleum revenues ensure medium-term fiscal and external sustainability.** Petroleum (oil and gas) exports have bolstered the trade balance (Figure 3), and will ensure a healthy current account surplus for several years to come. Fiscal surpluses also rose during the decade, driven largely by petroleum revenue (Figure 4). At the same time, the policy of saving the bulk of this revenue has fed the rapidly growing Government Petroleum Fund (GPF). The structure and management of the GPF, which is invested in bonds and equities overseas, are considered among the best in the world. [1]

4. **In 2001, the authorities reformed the monetary and fiscal policy frameworks**. Monetary policy had been based on nominal exchange-rate stabilization, but this became more difficult to execute as the 1990s wore on. In 2001, inflation targeting was adopted instead. Under this framework, the independent central bank (Norges Bank) has an operational target of core inflation (the consumer price index excluding the effects of direct taxes, excises, and extraordinary temporary disturbances) of 2.5 percent, normally within two years.[2] Regarding fiscal policy, political pressures to spend more petroleum revenue intensified (indeed, they remain strong). The fiscal rule, also adopted in 2001, was meant to allow some use of this revenue, while preserving the capital of the GPF. Accordingly, it provides that structural non-oil central government budget deficits should not exceed the long-term real return on the GPF, assumed to be 4 percent. Guidelines allow transitory deviations from this rule over the business cycle, and in the event of extraordinary changes in the value of the GPF.

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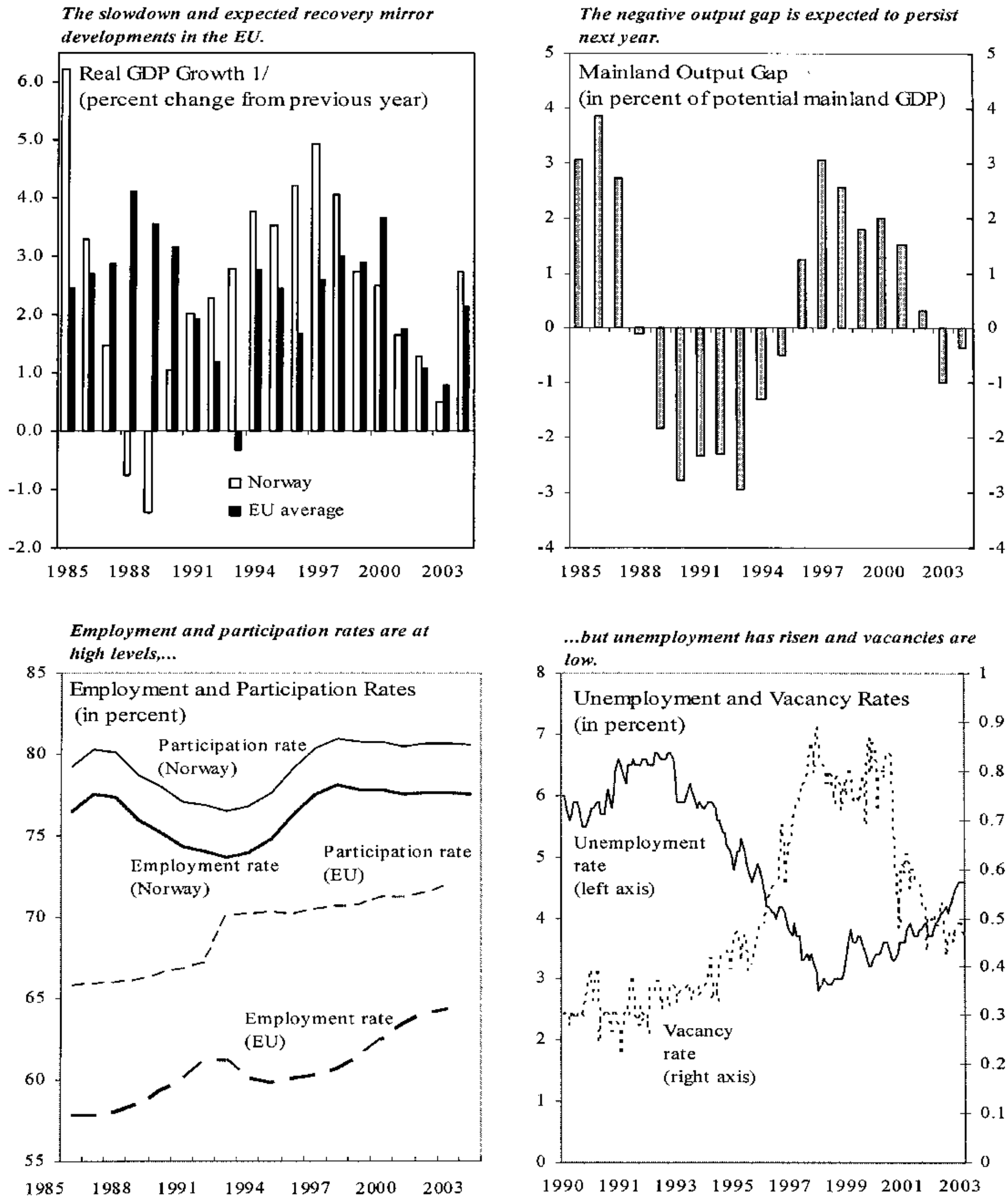
[1] For a discussion of the operation of the GPF, see Martin Skancke, "Fiscal policy and petroleum fund management in Norway", in Fiscal Policy Formulation and Implementation in Oil-Producing Countries (IMF, 2003).

[2] See Jarkko Soikkeli, "The inflation targeting framework in Norway", IMF working paper 02/184.

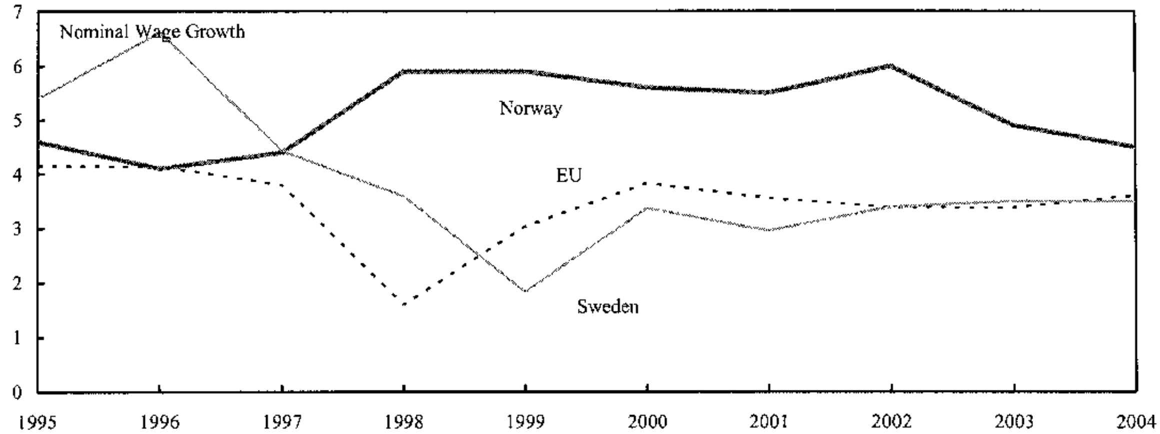
Figure 1. Norway: Cyclical Indicators



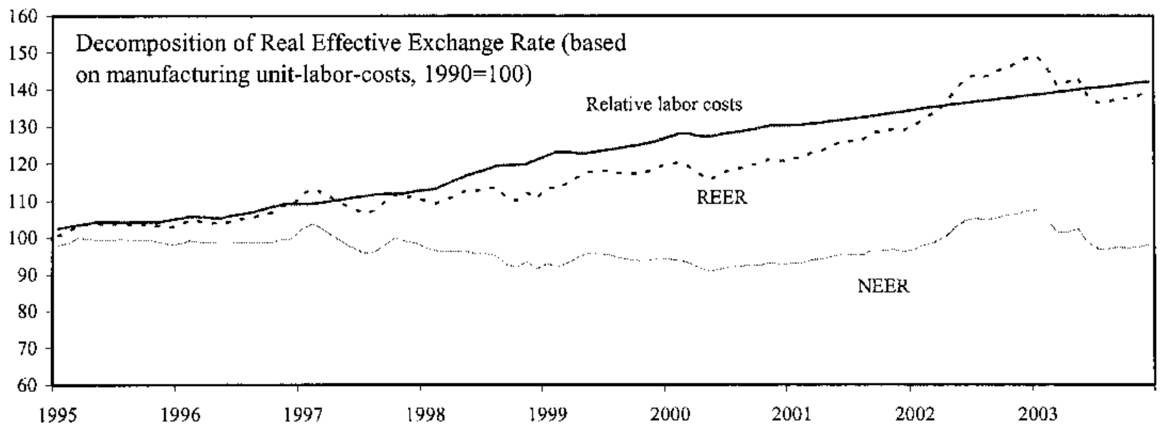
Source: Statistics Norway; and staff estimates.
1/ Mainland GDP for Norway.

Figure 2. Norway: Wage and Price Developments

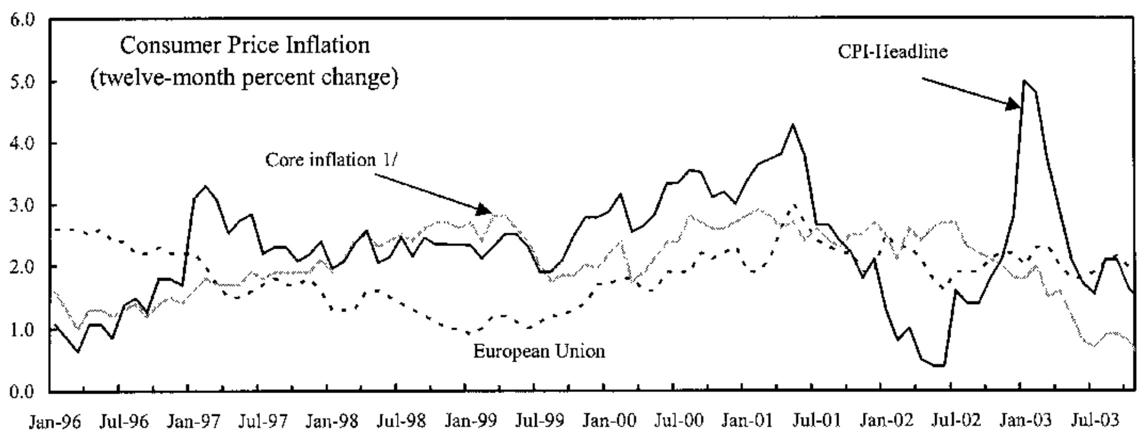
Wage growth in Norway has outpaced that of the EU for several years in a row...



...contributing to a real appreciation since the mid 1990s.

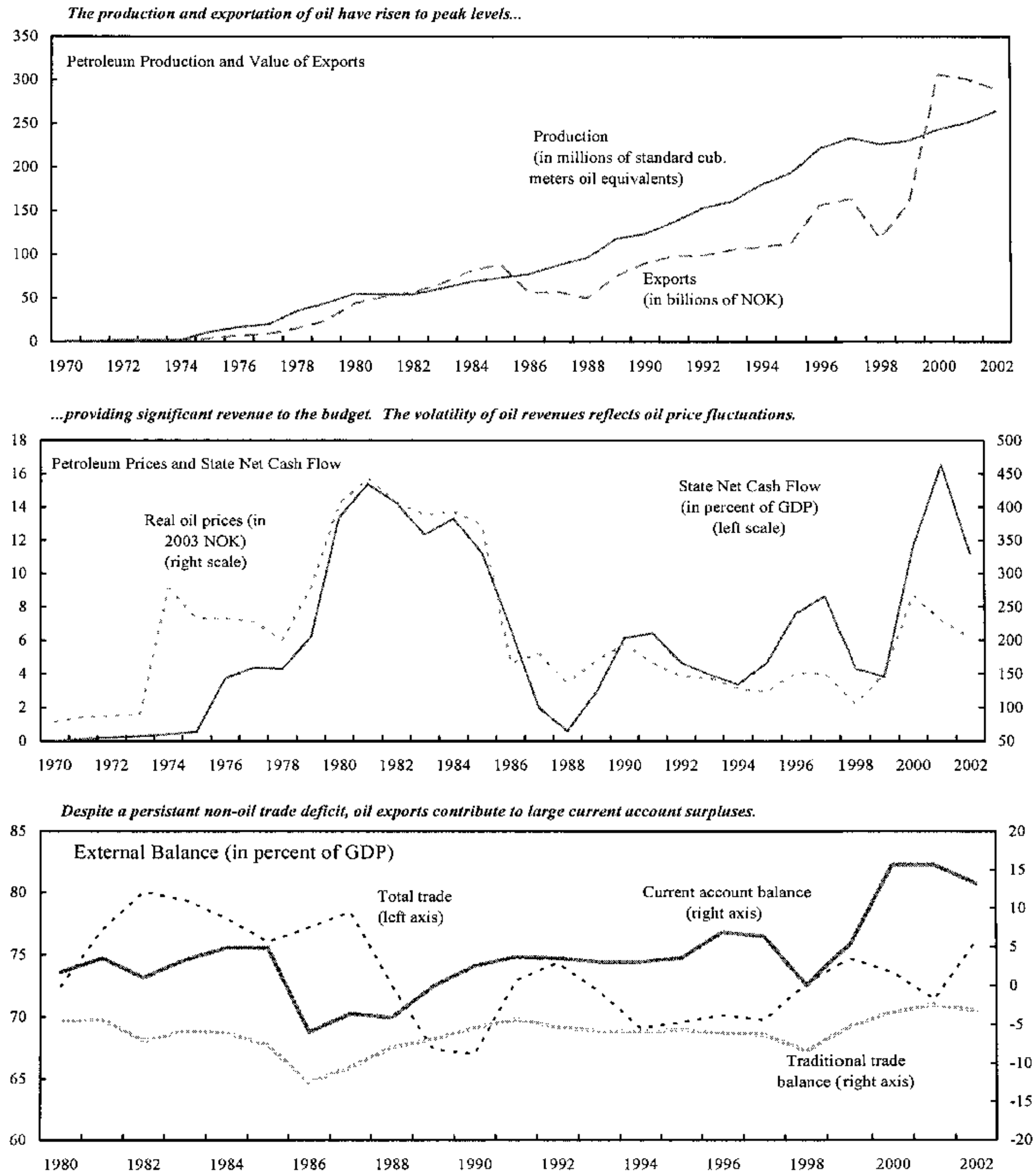


Yet, with declining import prices, core inflation has fallen to well below the inflation target.



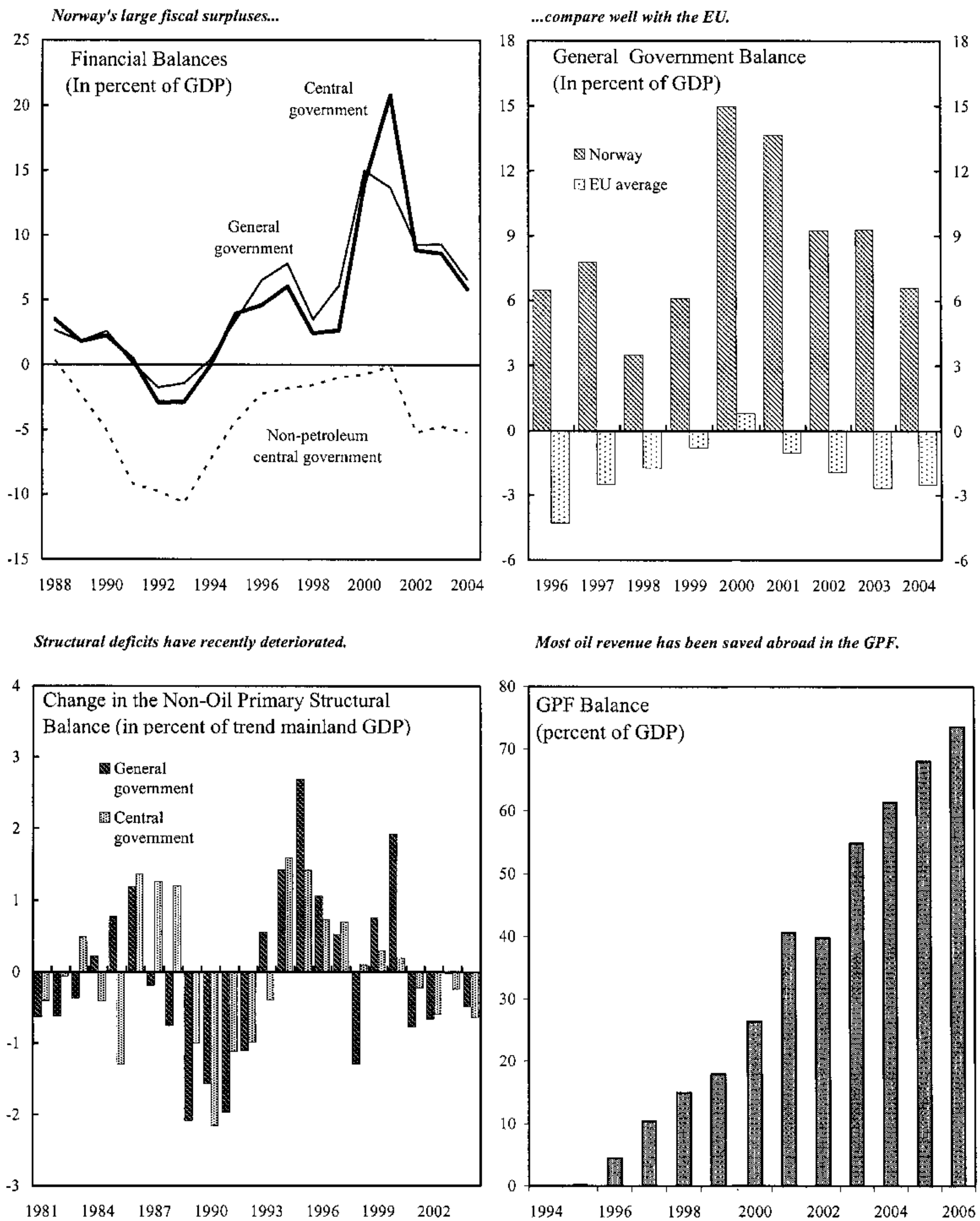
Source: Statistics Norway; and staff estimates.

Figure 3. Norway: The Petroleum Sector and External Balance



Source: Ministry of Finance, Statistics Norway; and staff estimates

Figure 4. Norway: Public Finances



Source: Ministry of Finance; and staff estimates

5. **In 2003, domestic and external factors slowed real GDP growth to an estimated 0.5 percent.** Norges Bank held its policy rate near 7 percent until very late in 2002, maintaining a tight stance longer than other central banks did (Figure 5). The decision to keep rates high, which was criticized in Norway but supported by the staff in last year's report, was motivated by surprisingly strong wage growth in mid-2002 and the fiscal stimulus in place. This monetary stance widened interest differentials with respect to other countries. This premium, along with the prospect of fiscal crowding out, resulted in a significant appreciation of the krone in 2002, which squeezed exporting and import-competing industries (the exposed sector). The macroeconomic effects of these factors were reinforced by continuing weakness in global economic activity. As a result, while household consumption held up, in part because past rises in house prices had boosted wealth, business investment and, to a lesser degree, non-oil exports fell (Tables 1 and 2).

6. **With inflationary pressures waning, Norges Bank cut interest rates aggressively.** As activity weakened, the unemployment rate rose and wage growth began to fall. Core inflation also eased, due in large part to falling import prices, and stood at only 0.1 percent in January (year-on-year). Beginning in late 2002, NB cut its intervention rate in several steps, to 2 percent by end-January 2004, well below levels considered cyclically neutral. As a result, the interest rate differential with the euro area narrowed sharply, contributing to a reversal of the exchange-rate appreciation; following the cut in late January, the krone fell to a five-year low against the euro.

7. **The non-oil fiscal position has deteriorated somewhat over the past two years, only partly reflecting the cycle** (Tables 3 and 4). The central government non-oil balance deteriorated sharply in 2002, partly due to cyclical factors but also to a one-time transaction with local governments. The central government non-oil deficit narrowed somewhat to an estimated 4.7 percent of mainland GDP in 2003, but it substantially exceeded the budget estimate (text table). The fiscal stance has recently been somewhat expansionary, with a cumulative rise in the central and general government non-oil structural deficits of just over 1 percent of mainland GDP during 2002-03.[3]

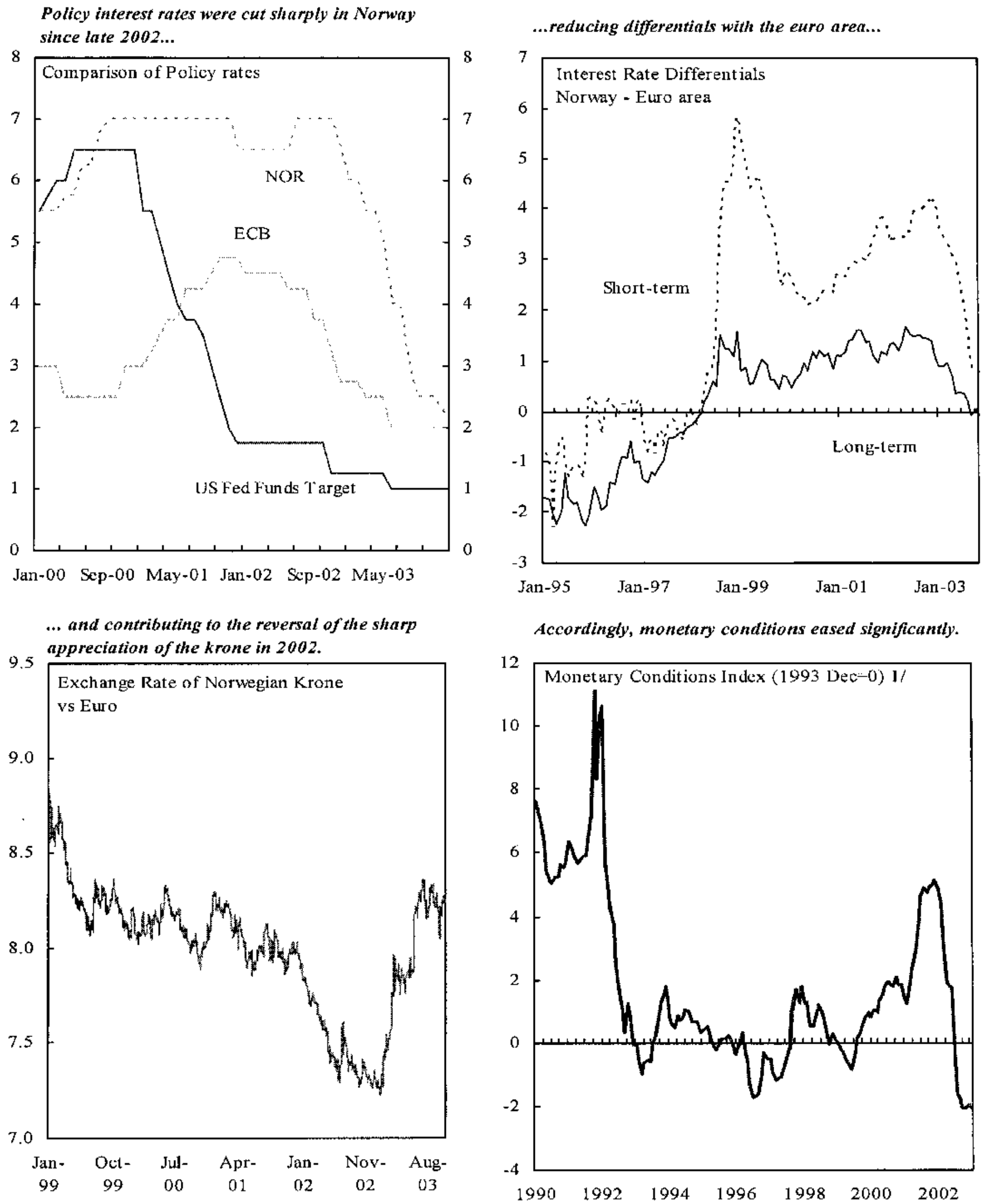
Norway: Implementation of 2003 Budget
(Percent of mainland GDP)

	Initial budget	Proj. outturn
Total revenue	57.6	55.8
Oil	15.2	14.9
Non-oil	42.4	40.9
Total expenditure	46.5	47.2
Oil	1.3	1.6
Non-oil	45.2	45.6
Balance	11.1	8.6
Non-oil balance	-2.8	-4.7

Source: Ministry of Finance, and IMF staff.

[3] The central government structural balance is used for the purposes of the fiscal rule. It is produced by the authorities and excludes both cyclical factors and extraordinary items. The general government cyclically adjusted balances account for only cyclical factors, and the authorities and staff use different adjustment methods.

Figure 5. Norway: Monetary Conditions



Source: Norges Bank; Federal Reserve; ECB; and Bloomberg

1/ A weighted average of 3 month (NIBOR) interest rates and the nominal effective exchange rate for the krone. Weighted by a factor of 1/3: a 1 percent change in the interest rate is considered to have the same impact on CPI as a 3 percent change in the exchange rate.

II. Policy Discussions

8. **Discussions covered the short-term outlook and policy options, the monetary and fiscal policy frameworks, aging and long-term fiscal sustainability, and structural reform.** Norwegian monetary and fiscal policy have been broadly consistent with Fund recommendations (Box 1), though the mission suggested measures to strengthen both. While oil and gas revenues ensure a very strong medium-term fiscal position, the authorities and staff agreed that fiscal prudence and pension reform would be required to meet the cost of population aging. The Norwegian labor market performs well by international comparison, but social programs have been enlarged over the years, and recent increases in some of them may threaten labor supply.

Box 1. Policy Recommendations and Implementation

Consistent with Fund recommendations, and in light of falling core inflation and easing wage pressures, Norges Bank cut interest rates aggressively through 2003. Three suggestions by staff—regular appearances by the central bank governor before parliament, an improved mechanism for selecting Norges Bank board members, and periodic outside policy reviews—were implemented. However, Directors' recommendation to remove the reference to the international value of the krone in the regulation on monetary policy has not been implemented.

The authorities have continued their efforts to adhere to the fiscal rule which limits the structural non-oil central government budget deficit to 4 percent of the GPF, but have not yet succeeded. The 2004 budget projected the rule would not be met until 2009. The policy of further tax cuts remains, but the multi-year spending ceilings recommended by Directors are not under consideration. The report of the Pension Commission in January, 2004 begins a process which, if carried through, would be consistent with Directors' recommendations for significant pension reform.

The authorities are pursuing a gradualist and consensual approach to labor market reform, and have not yet taken decisive action to contain the rapidly growing sick leave and disability programs.

A. Short-term Outlook and Policies

9. **The mission agreed with the authorities that prospects for a recovery in 2004 were good**. The substantial easing of monetary conditions in 2003 was beginning to stimulate household consumption, and a recent survey indicated relatively strong investment intentions. On the external side, it seemed increasingly likely that the world economy would turn the corner. Accordingly, the staff projects real mainland GDP growth of 2¾ percent in 2004, somewhat above its estimate of potential growth of 2¼ percent and the 2004 budget assumption of 2.6 percent.[4] Moreover, with inflation expected to rise only gradually—staff projects headline inflation of 1¼ percent in 2004—the preconditions seemed in place for a sustained expansion.

10. **The projection was viewed as balanced, but carried risks**. Both world growth and the exchange rate could prove different from current expectations, with important effects on the exposed sector. The authorities expressed concern that past rises in house prices and associated high growth in household borrowing had created a risk of a correction. If it occurred, consumption would be cut and firms' balance sheets weakened, with adverse repercussions on investment and the financial system. The staff raised the risk that a tighter labor market produced by the upswing might lead to rising wage increases, forcing Norges Bank to tighten its stance. This risk was mitigated, however, by the apparent willingness of the social partners to reach a moderate settlement in the upcoming negotiations for 2004-05.

11. **The financial system has weathered the downturn, though with some weakening of profitability**. Banking profits had fallen somewhat, reflecting higher loan-loss provisions, but capital ratios and return-on-equity remained satisfactory (Figure 6). Some debtors, notably the fish farming industry, had come under stress, but the authorities saw no systemic concerns. The financial system is highly exposed to residential mortgages but these carry a low default risk. Indeed, studies conducted by the financial supervisor to assess the effects of Basel II concluded that the concentration in mortgage lending would imply an improved position for Norwegian banks, relative to current rules. The merger of two large banks had been approved by the relevant authorities, which considered, among other things, that financial stability considerations were not a major obstacle to the merger. An FSAP is scheduled to conclude at the time of the next Article IV consultation.

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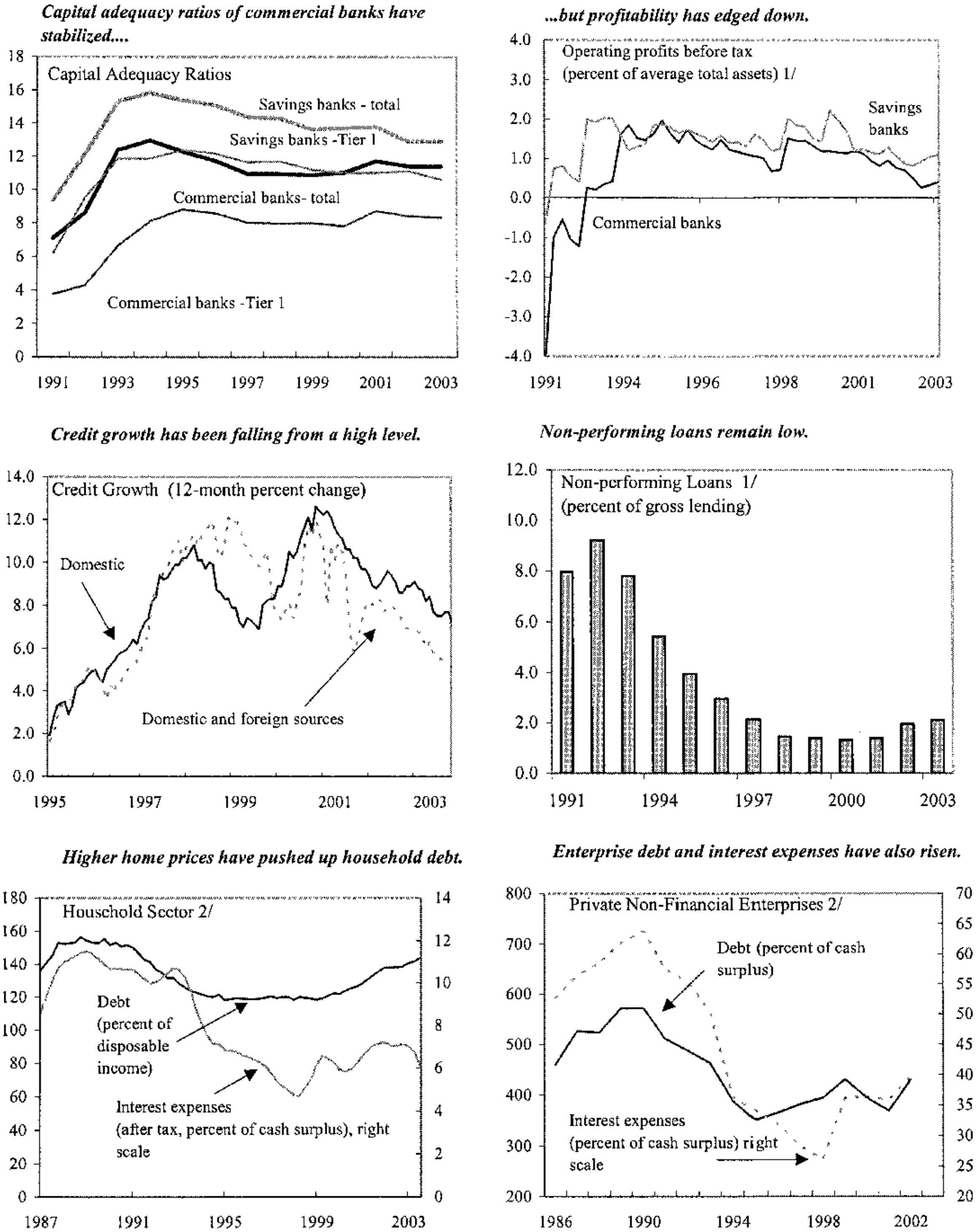
[4] The February Consensus Forecast is 3.0 percent growth of real mainland GDP.

Figure 6. Norway: Indicators of Financial Sector Health



Source: Norges Bank

1/ Data for 2003 refer to the third quarter.

2/ Data for 2003 are an estimate.

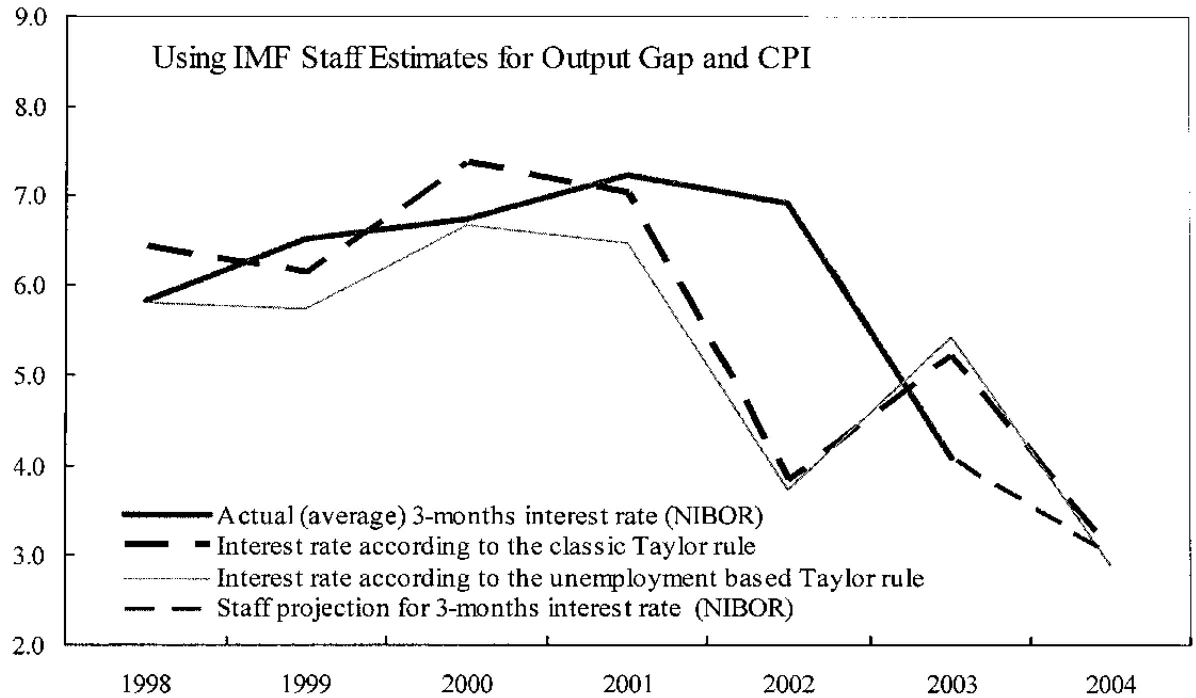
12. **Regarding monetary policy, it was agreed that the tight conditions in 2002 had wrung inflationary pressures out of the system, although late in 2003 it appeared the inflation target was being undershot.** At least partly in response to NB's policy, the social partners had adopted a realistic stance on the upcoming wage negotiations for 2004-05, and the traditional bargaining pattern (with the exposed sector, which is most concerned about competitiveness issues, taking the lead in negotiations) appeared to have been reasserted. Taylor rules prepared by the staff suggest the monetary stance in 2002 was appropriate given the inflation projections of the time, but too tight ex post, in view of the surprisingly weak inflation outturn (Figure 7). The sharp fall in core inflation was concentrated in imported goods, and the authorities pointed out that world prices for many goods had been depressed. There was also agreement that the inflation decline reflected the lagged pass-through effect of the earlier appreciation of the krone. To this extent, the decline should be transitory, and inflation might be temporarily pushed up in 2004 due to the subsequent depreciation; however, this has yet to appear in the data through January 2004.

13. **The mission endorsed the authorities' policy of maintaining accommodative monetary conditions for the time being.** The absence of indications of a rise in underlying inflation and the tentative nature of the recovery argued for such a policy. There was agreement, however, that current very low rates would have to be increased as the expansion took hold. The authorities acknowledged the possibility that these rates, if maintained too long, might feed a house-price bubble. At the same time, they noted that interest rate developments in the United States and the euro area could have a considerable impact on the krone. The mission argued that an appreciation of the krone, if it occurred, would be part of the transmission mechanism and should be taken into account to the extent it affected progress in achieving the inflation target.

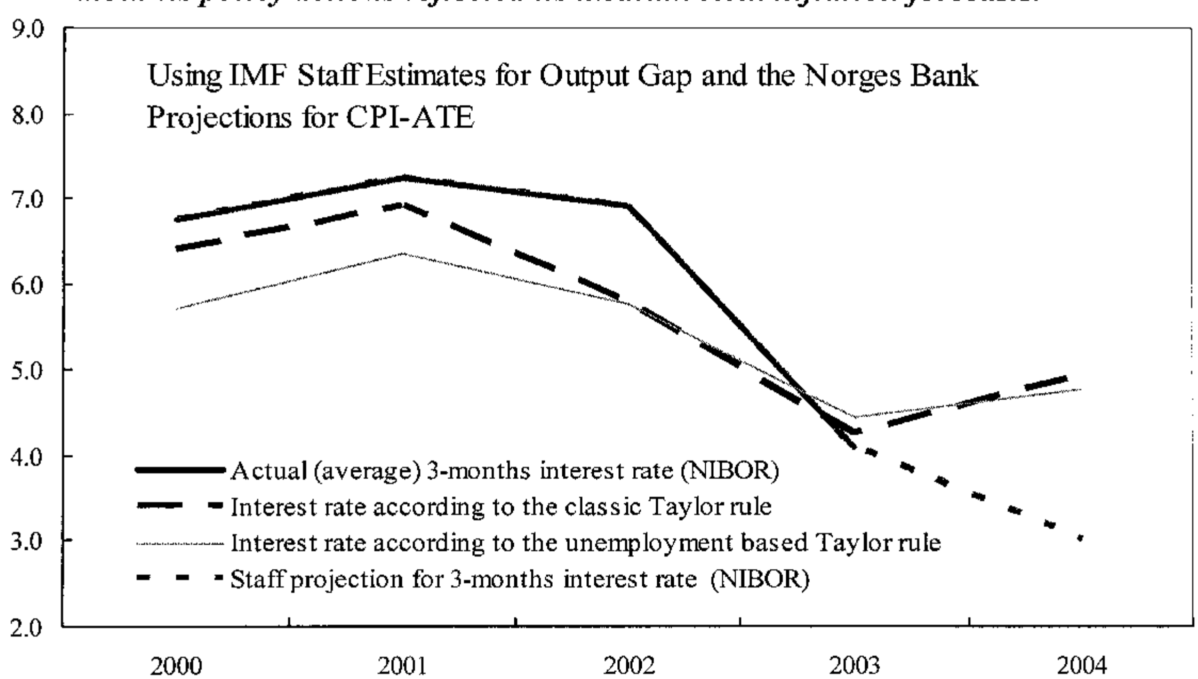
14. **Turning to fiscal policy, the 2004 budget is again expected to result in an increase in the central government non-oil deficit of about ½ percent of GDP, further undermining fiscal credibility** (Box 2). The general government non-oil deficit would rise by about 0.7 percent of GDP and, since growth is projected at somewhat above potential rates, the corresponding cyclically adjusted non-oil deficit would rise by more. Regarding the central government budget, the authorities argued that the composition of spending and revenue changes, and the different multipliers attached to each, implied no net fiscal stimulus. The mission felt that a structural deterioration was nonetheless unwarranted during an expected recovery. More importantly, this slippage implied the gap between the deficit and the fiscal rule would not be narrowed, undermining medium-term fiscal credibility, an issue discussed below.

Figure 7. Norway: Actual and Taylor Rule Based Interest Rates
(In percent)

Ex post, Norges Bank was slow to reduce interest rates in 2002 ...



...but its policy actions reflected its medium-term inflation forecasts.



Source: Norwegian authorities; and Fund staff estimates.

B. The Monetary Policy Framework

15. **The authorities reported that the flexible inflation targeting framework was operating successfully**. The two-year horizon anchored medium-term expectations, while allowing policymakers to reduce unnecessary short-term volatility in output and the exchange rate. They noted that this horizon could be shortened or extended if warranted by extraordinary circumstances. They also pointed out that exchange-rate volatility had been lower in Norway than in other inflation-targeting countries, although the mission argued that this might reflect different shocks, rather than intrinsic stability. For example, since inflation had been well contained even under the old policy framework, Norway's monetary policy had yet to be severely tested.

Box 2. The 2004 Budget

The non-oil deficit is expected to rise by 0.5 percent of mainland GDP in 2004, reflecting additional spending. The expenditure ratio is projected to increase by 1.5 percent of mainland GDP, boosted by transfers to firms, capital expenditure, rising wage costs, and transfers to households due to higher unemployment. A number of relatively small tax cuts (reduction of the tax on the imputed income of owner-occupied housing, lower day-care fees, and a temporary exemption of firms from the electricity tax) are also in the budget. However, the revenue effect of these measures will be more than offset by stronger GDP growth and by increases in alcohol and tobacco excises. The overall surplus is expected to fall by 2.8 percentage points of mainland GDP, mostly reflecting declines in petroleum revenues due to lower projected krone prices.

The budget implies a moderately expansionary stance. While growth is projected to be somewhat above potential in 2004, the structural non-oil deficit (which is used for assessing the fiscal rule) is projected to rise from 3.3 percent to 3.9 percent of trend mainland GDP.

Norway: Central Government Fiscal Accounts

(In percent of mainland GDP)

	2000	2001	2002	Est. 2003	Proj. 2004
Revenue 1/	58.4	65.2	57.2	55.8	53.5
Expenditure 1/	44.5	44.5	48.4	47.2	47.7
Balance	13.9	20.8	8.9	8.6	5.8
of which: non-oil balance	-0.7	-0.1	-5.2	-4.7	-5.2
Structural non-oil balance 2/	-2.2	-2.4	-3.0	-3.3	-3.9
Net assets 3/	60.6	71.9	72.6	76.5	82.0

Source: Ministry of Finance

1/ Budget definition. Ministry of Finance estimates and projections.

2/ Percent of trend mainland GDP. Adjusted for cyclical effects and extraordinary items.

3/ Percent of GDP.

16. **Three recent institutional reforms to strengthen monetary policy oversight and formulation were welcomed by the mission**. First, the governor of the NB is to periodically appear before parliament; his first appearance, judged very successful, was during the mission team's visit to Oslo. Second, a new procedure to choose central bank board members was instituted as of January, 2004 to ensure a more independent and less political board. And third, monetary policy is now subject to regular review by outside experts.

17. **As was the case last year, the mission was concerned that the reference to the external stability of the krone in the regulation on monetary policy risked confusing markets** (Box 3). The authorities interpret this reference to mean that inflation targeting fosters medium-term exchange-rate stability. Nevertheless, some outside observers (including business and labor economists, and academics), appeared to perceive a greater sensitivity to the exchange rate on the part of Norges Bank in the wake of the 2002 appreciation. The mission, arguing that this situation could result in misinterpretation of central bank actions or in undue difficulty in communicating policy to markets, reiterated its advice to remove the exchange rate reference. The authorities, however, did not favor opening up the regulation, since doing so might itself cause confusion, especially as they believed that markets understood the framework.

Box 3. The Regulation on Monetary Policy

The following is the text of Section 1 of the regulation adopted by parliament in 2001 governing the inflation targeting framework:

"Monetary policy shall be aimed at stability in the Norwegian krone's national and international value, contributing to stable expectations concerning exchange rate developments. At the same time, monetary policy shall underpin fiscal policy by contributing to stable developments in output and employment.

Norges Bank is responsible for the implementation of monetary policy.

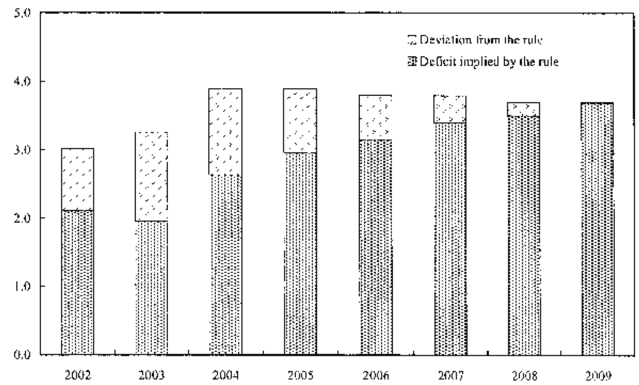
Norges Bank's implementation of monetary policy shall, in accordance with the first paragraph, be oriented towards low and stable inflation. The operational target of monetary policy shall be annual consumer price inflation of approximately 2½ percent over time.

In general, the direct effects on consumer prices resulting from change in interest rates, taxes, excise duties and extraordinary temporary disturbances shall not be taken into account."

C. Medium and Long-term Fiscal Policy

18. **The short and medium-term budgetary outlook is to be governed in part by the 2001 fiscal guidelines, but the key rule limiting deficits has not been adhered to.** Central government non-oil structural deficits exceeded 4 percent of the GPF in both 2002 and 2003 (see text chart). Moreover, the budget does not anticipate the fiscal rule being met until 2009. The authorities noted that deviation from the rule was permitted by the significant slowdown in economic growth and the collapse in stock markets. The mission argued that the inauspicious beginning and the very gradual plan to return to the rule threatened credibility and, thereby, the loss of an anchor for expectations about the medium-term course of policy. If markets came to anticipate a fiscal expansion, upward pressure on the real exchange rate (the "Dutch disease") could be exacerbated, a risk that would be reduced by a more ambitious timetable for adherence to the 4 percent rule.

Norway: Central Government Deficit, 2002-09
(as a percentage of trend mainland GDP; 2004 Budget)



Source: Ministry of Finance and IMF staff.

19. **The planned tax reform in 2005 may add further to fiscal pressures, heightening the need for expenditure control.** Specific measures have not been announced, but the authorities will be guided by the recommendations of a high-level commission, which are designed to improve economic efficiency.[5] The authorities noted, however, that one recommendation, to raise property taxes, would be politically difficult. The mission felt that property taxation should be raised to finance cuts elsewhere. It is likely that the reform, regardless of the exact measures, would result in a net revenue loss of perhaps 0.6 percent of GDP (although no decision had been taken). This would be broadly in line with past government commitments to reduce the tax burden, an objective supported by the mission. However, the mission also stressed that strict spending discipline would be needed to square further tax cuts with a return to the fiscal rule.

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[5] Two key recommendations are: reduce opportunities for tax arbitrage by lowering marginal labor tax rates and imposing the normal tax rate on dividends and capital gains on shares to the extent it exceeds a risk-free rate of return; and focus on less mobile tax bases by eliminating the wealth tax and raising real property taxes (which are relatively low in Norway in comparison with other capital taxes and by international comparison).

20. **In view of these developments, the mission underscored the advantages of buttressing the fiscal framework with explicit multiyear spending ceilings and foregoing discretionary fiscal policy**. Similar rules have been adopted by the Netherlands, Sweden, and the United Kingdom. Multi-year spending ceilings would complement the current rule, which focuses on deficits. Eschewing discretionary countercyclical policy, while continuing to use the automatic stabilizers, would avoid possible conflicts with the inflation targeting framework. Otherwise, the central bank might have to offset discretionary fiscal action in order to achieve the inflation target. In the case of a fiscal expansion, the result could be an undesirable policy mix of loose fiscal and tight monetary conditions. The authorities noted that the government had already announced a policy of holding spending growth to that of mainland GDP, and argued that because discretionary policy might prove necessary such a fiscal framework could prove unduly restrictive.

21. **The authorities and the mission agreed that the effect of population aging on pension spending was the dominant long-term fiscal issue**. Age-related spending is projected to rise by more than in almost any other advanced economy, which points to the need for both fiscal restraint and pension reform. [6] The projected growth in spending does not reflect relatively adverse demographics, but rather a system that is both quite generous and still maturing. As a consequence, in the absence of tax increases or program reform, the long-term fiscal situation is unsustainable, even though Norway has the advantage of the large petroleum fund (Appendix I). Indeed, the authorities noted that the existence of the GPF had led to excessive public complacency regarding the pension problem.

22. **A high-level Pension Commission recently recommended important reforms to the old-age pension program.** [7] The report, transmitted to the government on January 13, projects spending on old-age pensions alone to rise from the current 5.9 percent of GDP to 15.2 percent of GDP in 2050, under current rules. The package of reforms is designed to improve work incentives, notably by having benefits accrue with age, even after 67, the minimum age of eligibility. Crucially, a number of recommendations would reduce expenditure growth: to index pensions to a simple average of wages and prices, rather than wages; relate benefits to average lifetime earnings, rather than the best 20 years; and reduce payments as life expectancy at 67 rises. And two recommendations would strengthen long-term fiscal discipline: to incorporate the GPF into a formal pension fund; and institute a new fiscal rule forbidding increases in the remaining unfunded pension liability.

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[6] Chapter IV of the OECD Economic Outlook No. 69 (2001) compares aging costs across countries. Although Norway is classified as a "slower aging" country, the increases (in percentage points of GDP between 2000 and 2050) in old-age related and pension spending are the highest of the countries studied.

[7] See http://www.pensjonsreform.no. See http://www.pensjonsreform.no/english.asp for an extensive English summary.

23. **In preliminary discussions (before the commission report had been finalized) the mission supported the thrust of the reforms, but noted that they alone did not ensure fiscal sustainability**. Initiatives to improve incentives to stay in work and to reduce projected costs would surely prove helpful. Staff was especially concerned that political pressures would result in the capital of the GPF being spent, weakening long-term public finances and intensifying medium-term upward pressure on the real exchange rate; policies to protect the GPF were therefore welcomed. Nevertheless, the projected savings from the commission's recommendations would not altogether close the financing gap, a point also noted by the authorities. [8] Thus, further pension reform, compression of other spending, or future tax increases (which would be undesirable given the already high tax burden) will be needed. The mission argued that the second option would require tight control of social spending, a policy which would also prove important to secure continued strong labor market performance.

D. Structural Issues

24. **The Norwegian labor market is characterized by high employment rates and low unemployment rates, though aspects of the welfare system are increasingly seen as impediments to labor supply**. Social transfers are substantial and have grown in the past couple of decades, in part thanks to oil wealth (Figure 8). [9] Recently, rising enrollment in the sickness and disability programs have been of increasing concern, both from a budgetary perspective and because it could begin to cut into labor supply. A tripartite agreement (between employers, unions, and the government) had been put in place to stem this trend. The number of beneficiaries has nevertheless continued to grow, although as labor representatives pointed out the rate of increase slowed. Despite these negative results the agreement has been extended. The disability scheme has been separated into a temporary disability benefit and a permanent pension, which could result in better control of inflows, and efforts have been made to move people from sickness to training programs. The mission

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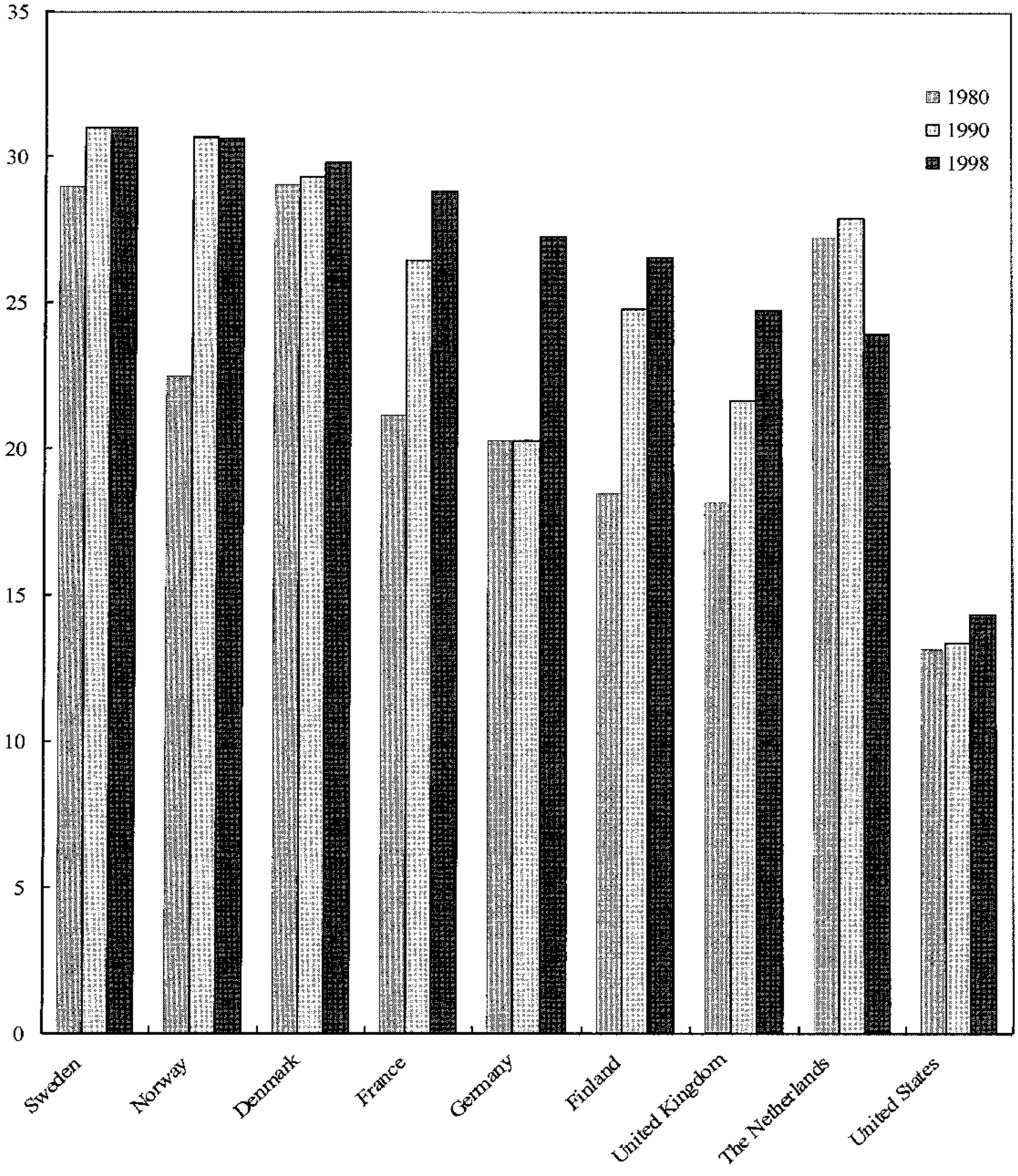
[8] The commission estimates its proposals would reduce the projected nearly 10 percentage point of GDP increase in old-age pension spending between now and 2050, to about 7 percentage points of GDP. The GPF might yield 3 or 4 percentage points of GDP in permanent revenue, above what is being spent today. Such figures depend on estimates of its ultimate size, which are very uncertain, and adherence to the 4 percent fiscal rule. This would leave some 3 or 4 percentage points of GDP to be covered by other means.

[9] According to the OECD summary measure of benefit entitlements, Norway was the fourth most generous country in the OECD in 1999 (OECD, Benefits and Wages, 2002). However, because benefits are more highly taxed in Norway than in some other countries (such as the United Kingdom or the United States), differences in net benefits may be less than those in gross benefits. See Willem Adema, "Net Social Expenditure, Second Edition", OECD Labor Market and Social Policy Occasional Paper 52 (2001).

Figure 8. Public Social Expenditure 1980-1998 1/
(as a percentage of GDP 2/)

Social spending is among the highest in the OECD, having risen sharply since 1980.



Source: OECD

1/ 1999 for the United States.
2/ Mainland GDP for Norway.

argued, however, that stricter administrative procedures and, especially, a reduction in the generosity of these programs would probably be needed to roll back the take-up of these programs.[10]

25. **A number of reforms have recently been introduced to improve labor markets.** Active labor market programs have become somewhat more widely used. In 2003, the maximum unemployment benefit duration and replacement rate were reduced, the waiting period before receiving benefits has been increased (though only to 5 days), and rules for temporary workers and others with weak labor-force attachment have been tightened. The vocational rehabilitation scheme, another program experiencing rapid growth, has been tightened in several respects. Caps on overtime have been eased. And proposals to liberalize fixed-term contracts, rejected by parliament in 2003, are being assessed by a tripartite commission.

26. **Regarding product markets, reform is also underway, particularly regarding regulation.** Public ownership is still substantial in Norway—about 40 percent of the value of the Oslo stock exchange is in public hands. Parliament authorized a reduction in state ownership of Statoil, currently 81.8 percent, to 67 percent, and there were a few privatizations of smaller enterprises last year. Also, the so-called statutory companies lost the benefit of state guarantees for debt incurred after 2002. Based on proposals in a 2003 white paper, regulators and supervisors ("tilsyn") will have increased autonomy, although parliament delayed consideration of a proposal for independent appeal bodies (currently, appeals are to the ministry concerned) until 2005. Finally, competition law is to be strengthened in several respects, to remain consistent with practice in the EU, which is about to devolve considerable competence in this area to the national level.

27. **Regarding trade policy, the authorities reported that policies remain largely unchanged from previous years.** A priority is to restart WTO negotiations, and they support the inclusion of investment and competition rules. While the authorities accept the importance of agricultural trade to many developing countries, Norwegian tariffs are likely to remain high, in order to meet the social goal of support to sparsely populated regions of the country. However, some "nuisance" tariffs on agricultural products were dropped; also certain textile and clothing tariffs were lowered. Norway is also pursuing increased market access through EFTA. Norway had intended to extend free movement of workers to the new countries joining the EU, but the government announced in early February that it was considering some restrictions for an interim period in light of decisions in other countries. Norway has deposed all relevant documents with regard to the OECD's anti-bribery agreement, and in 2003 passed legislation toughening the treatment of bribery of foreign

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[10] Sickness benefits, for example, are the most generous among developed countries, with a gross replacement rate of 100 percent for up to 52 weeks.

public officials. Finally, overseas development aid was 0.94 percent of GNP in 2003, well above the United Nations target of 0.7 percent of GNP. The goal is to raise this figure to 1 percent of GNP.

III. Staff Appraisal

28. **A strong macroeconomic policy framework has underpinned enviable prosperity and a high degree of social equity in Norway**. Real incomes are among the highest in the world; employment is high and unemployment low; and petroleum revenues ensure large current account and fiscal surpluses for several years to come. The key challenges facing policymakers are to continue to pursue strong monetary and fiscal policies, and to implement initiatives as soon as possible to ensure long-run fiscal solvency and continued good labor-market performance.

29. **After a sharp slowdown in 2003, the prospects for an economic recovery are promising**. Activity slowed last year due to weak external demand and—against a backdrop of strong wage growth and possibility of further fiscal expansion—tight monetary conditions in 2002. As inflation pressures eased significantly, the central bank cut interest rates aggressively, and appropriately, through 2003. These interest rate cuts also helped to reverse the krone appreciation which, together with the improving world economic outlook, should boost exports.

30. **The accommodative monetary stance is appropriate for the time being**. Core inflation is well below the 2.5 percent target, and the upcoming round of wage negotiations is likely to produce a moderate settlement. As the recovery takes hold, however, interest rates will have to move toward a more neutral stance. A sustained expansion will depend on the social partners contributing to a benign inflation outlook, with continued wage moderation being key. In addition, a prudent fiscal policy that preserves the credibility of the fiscal guidelines will help to forestall pressures for a real exchange rate appreciation that would damage the exposed sector. Finally, recent movements in the nominal exchange rate are likely to continue to pass through into inflation, and careful judgment will be required to ensure a monetary stance consistent with achieving the two-year-ahead inflation target.

31. **Against the backdrop of strengthening economic activity, policy makers face a number of medium-term challenges**. Control of both spending and the non-oil deficit is the key to a strong fiscal position, and measures need to be taken soon to reform pensions. The monetary policy framework has been strengthened by recent institutional changes, although the mandate should be clarified. On the structural side, strong labor market performance would be bolstered by ensuring adequate work incentives, and productivity enhanced by promoting dynamic product markets able to exploit new opportunities.

32. **Despite the adoption of fiscal guidelines and efforts to control non-oil deficits, the structural budget position is expected to deteriorate again in 2004**. The expected widening of the non-oil central government structural balance implies a further deviation from the fiscal rule. This development, and the fact that the rule has never been met, risks weakening fiscal credibility. It would therefore be important to take advantage of the coming

economic expansion to achieve the rule significantly sooner than now envisaged. In addition, tax reforms to be proposed next year seem likely to reduce revenues and thus need to be coupled with spending restraint to avoid further fiscal deterioration.

33. **There is scope to buttress the fiscal guidelines**. Consideration should be given to introducing a binding expenditure rule, as have a number of other countries, with a view to ensuring room for desirable tax cuts consistent with the current rule governing the non-oil central government deficit. The automatic stabilizers should continue to operate, but discretionary countercyclical policy should be foregone. This would reduce the temptation for asymmetric policies that would, over time, enlarge the deficit. In any case, with inflation targeting, discretionary fiscal expansion would tend to be offset by monetary policy.

34. **The rise in pension costs as the population ages is the most important long-term fiscal policy issue facing Norway**. The recent report of the Pension Commission contains many welcome recommendations which, after discussion and refinement, should be implemented quickly. As a first step, the fact that future pension payments depend in part on the petroleum fund should be made explicit by formally linking the two, as the Commission has suggested.

35. **The petroleum fund will not be enough to meet these costs**. Thus, spending containment will also be necessary. Price, rather than wage, indexation of benefits, linking eligibility or benefits to increases in life expectancy; broadening the base of the benefit calculation to lifetime earnings; and enhancing incentives to stay in work will all contribute to bolstering the public finances in the long-term. Even these measures, however, are unlikely ensure long-run sustainability, and further pension reform or measures to compress other spending should be considered as soon as possible.

36. **In sum, both recent and prospective long-run developments point to the need for a stronger framework to achieve the necessary fiscal consolidation.**

37. **The flexible inflation targeting framework is well suited to the small, open Norwegian economy**. Recent reforms will further strengthen policy formulation and implementation. Regular hearings before parliament with the governor of Norges Bank will increase monetary policy transparency, and are particularly appropriate in an inflation targeting framework, since the central bank is given considerable autonomy and responsibility to pursue the target. The new procedure for choosing bank board members will enhance independence and expertise at the highest policy making levels. And regular outside policy reviews will promote best practices. However, to clarify markets' perceptions of policy objectives, the reference to exchange rate stability should be removed from the regulation.

38. **The financial sector appears to have dealt well with the economic downturn**. Higher loan losses have reduced profits, but the overall health of the banking sector remains strong. An abrupt decline in house prices, should it occur, would hurt aggregate demand and thus raise losses on business loans, but would not threaten the banking system directly given low default rates on mortgages. Looking forward, the Basel II capital requirements will improve the financial position of Norwegian banks but, since capital requirements will

generally be leaner, both financial institutions and supervisors will have to exercise close oversight of risks.

39. **Norwegian labor markets perform very well by international comparison, and the challenge will be to maintain, and even improve, this situation in the years ahead**. Of immediate concern is the rapid uptake of sickness and disability benefits, which erodes labor supply and is costly to the budget. Recent reforms of the disability and rehabilitation schemes are welcome, but these measures will probably have to be bolstered by tighter administrative controls and, to reduce incentives to enter the programs, lower replacement rates. Norway has one of the lowest average working hours among advanced economies. While to some extent this reflects individual choice, high labor tax rates pose a significant disincentive to work longer hours. Substantial cuts in tax rates thus hold some promise of further raising labor supply, but need to be accompanied by appropriate spending control.

40. **Dynamic product markets will be the key to strong long-term productivity growth**. The government can contribute by ensuring an efficient and neutral tax system, and the recommendations of the tax commission provide a map for the way forward. Reducing tax arbitrage possibilities and raising the currently low tax rates on property would improve the tax structure. Streamlining the regulatory framework is an important priority, and recent progress in this area is welcome. Supervisory agencies are gaining greater operational independence and their roles are being clarified. Further reduction in the government's large ownership position in the economy would be desirable.

41. **Norway's economic statistics are adequate for surveillance purposes**. Coverage, quality, and timeliness are satisfactory. As well as the usual economic and fiscal statistics, the authorities publish comprehensive information on the GPF, including asset composition and investment performance. A Report on the Observance of Standards and Codes (ROSC) regarding data was published in July, 2003 (Country Report No. 03/207).

42. **Policies regarding international trade are generally commendable, apart from the agricultural sector**. Norway's strong support of multilateral trade negotiations is welcome. Again, however, high protection of agriculture is a weak point that should be addressed, preferably by meeting the social goals of the policy in a way that does not distort trade. Norway's high level of development assistance is commendable, as is the intention to raise it to 1 percent of GNP.

43. It is proposed that the next Article IV consultation be held on the standard 12-month cycle.

Table 1. Norway: Selected Economic Indicators

	2000	2001	2002	2003 1/	2004 1/
	Annual percent change				
Private consumption	3.9	2.6	3.6	2.3	3.8
Public consumption	1.3	2.7	3.2	1.5	2.0
Gross fixed investment	-3.6	-4.2	-3.6	0.8	1.8
Export of goods and services	4.0	4.1	-0.5	1.1	2.7
Of which: Oil and gas	5.0	5.2	0.2	1.0	0.6
Import of goods and services	2.7	0.9	1.7	4.5	4.0
GDP	2.8	1.9	1.0	0.6	2.5
Mainland GDP 2/	2.5	1.7	1.3	0.5	2.8
Unemployment	3.4	3.6	3.9	4.6	4.6
Consumer prices	3.1	3.0	1.3	2.5	1.3
Wages	5.6	5.5	6.0	4.9	4.5
Nominal effective exchange rate	-2.8	2.9	8.8	-2.2	...
Broad money, M2	9.2	8.6	8.2	1.9	...
Domestic credit	12.4	9.8	8.9	7.4	...
Three-month interbank rate 3/	6.7	7.2	6.9	4.1	...
Ten-year government bond yield 3/	6.2	6.2	6.4	5.0	...
	(In percent of mainland GDP)				
Central government					
Revenues	58.4	65.2	57.2	55.8	53.5
Expenditures	44.5	44.5	48.4	47.2	47.7
Overall balance	13.9	20.8	8.9	8.6	5.8
General government financial balance	20.0	18.0	11.6	11.7	8.2
Current account balance	15.6	15.6	13.2	12.6	12.7

Sources: Ministry of Finance; Norges Bank; Statistics Norway; International Financial Statistics; and IMF staff estimates.

1/ Staff estimates and projections as of February 2004.
2/ Excludes items related to petroleum exploitation and ocean shipping.
3/ Period average, in percent.

Table 2. Norway: External Indicators
(In billions of U.S. dollars, unless otherwise indicated)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
						Projections			
Balance of payments									
Goods and services									
Exports	77.9	77.6	79.0	90.3	99.7	96.9	94.4	94.4	94.3
Goods	60.3	59.3	59.4	68.3	74.4	70.9	68.9	68.4	68.0
o/w: oil and natural gas	34.8	33.5	33.2	38.9	40.6	36.3	34.8	33.9	33.0
Non-factor services	17.6	18.2	19.6	22.0	25.3	26.0	25.6	26.0	26.4
Imports	49.0	48.4	52.0	61.8	69.7	70.9	71.5	73.7	75.9
Goods	34.4	33.3	35.5	39.9	45.0	45.8	46.1	47.5	49.0
Non-factor services	14.6	15.1	16.5	21.9	24.7	25.1	25.3	26.1	26.9
Trade balance	25.9	26.0	23.9	28.4	29.4	25.2	22.8	20.9	19.0
Services balance	3.0	3.1	3.1	0.0	0.6	0.8	0.2	-0.2	-0.6
Balance of goods and services	28.9	29.2	27.0	28.4	30.0	26.0	23.0	20.7	18.4
Balance of factor payments	-2.9	-2.6	-1.9	-0.7	0.3	1.1	2.0	2.8	3.6
Current account balance	26.0	26.5	25.1	27.8	30.3	27.1	24.9	23.5	22.0
(In percent of GDP)	15.6	15.6	13.2	12.6	12.7	11.3	10.3	9.6	8.9
Net capital flows	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Net financial flows	-13.9	-25.2	-8.2	-27.7	-30.2	-27.0	-24.8	-23.4	-21.9
Reserve changes	-3.4	2.8	-4.2	-0.8	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Net foreign assets									
(In percent of GDP)	29.6	41.6	51.1	65.5	78.2	89.6	99.9	109.5	118.3
Government Petroleum Fund									
(In percent of GDP) 1/	26.3	40.6	39.8	54.8	62.8	69.6	75.7	79.0	84.8
Nominal effective exchange rate (1995=100) 3/	92.8	95.5	103.9	101.6	...	...	...	...	...
Real effective exchange rate (1995=100) 2/ 3/	96.1	99.6	107.9	105.4	...	...	...	...	...

Sources: Statistics Norway; Ministry of Finance; and staff estimates.

1/ National Budget 2004 projection for end of years 2003-2008.

2/ Based on CPI.

3/ Numbers for 2003 are for the January-November period.

Table 3. Norway: Fiscal and Monetary Indicators
(In percent of mainland GDP; official projections)

	2000	2001	2002	Est. 2003	Proj. 2004
Central Government 1/					
Revenue	58.4	65.2	57.2	55.8	53.5
of which : oil revenue	16.8	23.1	15.4	14.9	12.6
Expenditure	44.5	44.5	48.4	47.2	47.7
of which : oil expenditure	2.1	2.2	1.3	1.6	1.6
Balance	13.9	20.8	8.9	8.6	5.8
of which : non-oil balance	-0.7	-0.1	-5.2	-4.7	-5.2
less adjustments:					
Extraordinary items 2/	-0.6	0.2	-1.8	-0.4	-0.1
Cyclical correction 3/	2.0	2.0	-0.4	-1.1	-1.3
Structural non-oil balance	-2.1	-2.3	-2.9	-3.2	-3.9
In percent of trend mainland GDP	-2.2	-2.4	-3.0	-3.3	-3.9
General Government 4/					
Revenue	73.6	72.3	67.5	68.3	65.0
of which : oil revenue	19.6	18.3	15.1	15.9	13.1
Expenditure	53.6	54.4	55.9	56.6	56.8
of which : oil expenditure	0.0	0.0	0.0	0.0	0.0
Balance	20.0	18.0	11.6	11.7	8.2
of which : non-oil balance	0.4	-0.4	-3.5	-4.2	-4.9
Cyclically-adjusted non-oil balance 5/	-1.7	-2.4	-3.1	-3.1	-3.6
Net assets 6/	60.6	71.9	72.6	76.5	82.0
Monetary Indicators:					
M2 7/	9.2	8.6	8.2	1.9	...
Domestic credit 7/	12.4	9.8	8.9	7.4	...
Three-month interbank rate 8/	6.7	7.2	6.9	4.1	...
Ten-year government bond yield 8/	6.2	6.2	6.4	5.0	...

Sources: Ministry of Finance; Norges Bank.

1/ Budget definition. Ministry of Finance estimates and projections.
2/ Includes exceptional transactions with local government and accounting discrepancies.
3/ Includes cyclical adjustments for transfers from Norges Bank and net interest income.
4/ National accounts definition. Ministry of Finance estimates and projections.
5/ Percent of trend mainland GDP. Adjusted for cyclical effects.
6/ Percent of GDP.
7/ End-period, percent change, national definition.
8/ Period average, in percent.

Table 4. Norway: General Government Financial Accounts, 2000-2004
(Staff projections)

	2000 Act.	2001 Act.	2002 Act.	2003 Est.	2004 Proj.
	(In billions of krone)				
Total revenue	810.5	841.0	815.3	850.5	846.1
Oil revenue 1/	215.5	213.2	182.8	198.4	170.3
Non-oil revenue	595.0	627.8	632.6	652.1	675.8
Financial income	39.8	45.4	47.9	44.0	42.4
Tax revenue	534.6	561.4	570.9	592.4	619.1
Transfers	19.3	19.7	12.6	14.4	13.1
Capital revenue	1.3	1.3	1.2	1.4	1.2
Total expenditure	590.5	632.3	674.8	705.1	739.3
Oil expenditure	0.0	0.0	0.5	0.5	0.1
Non-oil expenditure	590.5	632.3	674.2	704.6	739.2
Financial expenditure	31.7	29.2	28.5	28.1	26.9
Consumption	281.1	309.8	332.5	346.9	364.6
Transfers	254.4	275.9	297.0	314.0	331.1
Capital expenditure	23.3	17.4	16.3	15.6	16.6
Overall balance	220.0	208.7	140.6	145.4	106.9
Non-oil balance	4.5	-4.5	-41.7	-52.5	-63.4
	(In percent of mainland GDP)				
Total revenue	73.6	72.3	67.5	68.8	65.4
Oil revenue 1/	19.6	18.3	15.1	16.0	13.2
Non-oil revenue	54.0	54.0	52.4	52.7	52.3
Financial income	3.6	3.9	4.0	3.6	3.3
Tax revenue	48.5	48.3	47.3	47.9	47.9
Transfers	1.8	1.7	1.0	1.2	1.0
Capital revenue	0.1	0.1	0.1	0.1	0.1
Total expenditure	53.6	54.4	55.9	57.0	57.2
Oil expenditure	0.0	0.0	0.0	0.0	0.0
Non-oil expenditure	53.6	54.4	55.9	57.0	57.2
Financial expenditure	2.9	2.5	2.4	2.3	2.1
Consumption	25.5	26.6	27.5	28.0	28.2
Transfers	23.1	23.7	24.6	25.4	25.6
Capital expenditure	2.1	1.5	1.3	1.3	1.3
Overall balance	20.0	18.0	11.6	11.8	8.3
Non-oil balance	0.4	-0.4	-3.5	-4.2	-4.9
Cyclically-adjusted non-oil balance 2/	-0.7	-1.2	-3.6	-3.6	-4.6
Memorandum items:					
Net public assets					
in billions of krone	890.4	1,097.6	1,103.5	1,208.2	1,312.9
in percent of GDP	60.6	71.9	72.6	77.3	80.9
Nominal GDP /3	1,469.1	1,526.6	1,520.7	1,562.7	1,622.7
Nominal mainland GDP /3	1,101.5	1,162.5	1,207.1	1,237.0	1,292.9
Trend nominal mainland GDP /3	1,075.4	1,144.9	1,202.0	1,252.1	1,301.1
Output gap /3	2.4	1.5	0.4	-1.2	-0.6

Source: Ministry of Finance, and IMF staff calculations.

1/ Includes Government Petroleum Fund dividends .

2/ Percent of trend mainland GDP. Adjusted for cyclical effects. IMF staff estimates and projections.

3/ IMF staff estimates and projections.

Table 5. Norway: Indicators of External and Financial Vulnerability
(In percent of GDP, unless otherwise indicated)

	1996	1997	1998	1999	2000	2001	2002	2003	
External Indicators									
Exports of goods and services (annual percentage change, in U.S. dollars)	15.8	0.3	-13.3	10.1	25.2	-0.3	2.4	14.9	
Imports of goods and services (annual percentage change, in U.S. dollars)	-7.3	-2.7	-3.1	6.5	2.9	1.3	-7.6	33.1	
Terms of Trade (annual percentage change)	-1.6	1.6	-9.2	12.0	27.2	-2.3	-3.1	-1.2	
Current account balance	6.9	6.3	0.0	5.4	15.6	15.6	13.2	12.6	
Capital and financial account balance	-5.0	-3.5	4.3	-3.7	-10.5	-13.3	-6.5	-9.2	
Direct investment, net	-1.7	-0.7	0.8	1.3	-1.6	1.6	-2.1	-2.1	
Portfolio investment, net	-6.1	-6.3	-1.4	-1.8	-9.7	-16.4	-12.0	-11.1	
Central Bank international reserves (end of period, in billions of U.S. dollars)	26.6	23.4	18.6	20.7	20.4	15.7	21.1	37.5	
Exchange rate against US dollar (NOK, period average)	6.4	7.1	7.5	7.8	8.8	9.0	8.0	7.1	
Exchange rate against Euro (NOK, period average)	8.2	8.0	8.5	8.3	8.1	8.0	7.5	8.0	
Real effective exchange rate (based on CPI, annual percentage change)	-0.4	1.4	-2.3	-1.2	-1.4	3.1	7.6	-8.6	Nov-03
Financial Markets Indicators									
Gross public debt (end of period)	30.7	27.5	26.2	26.8	30.0	29.2	29.2	29.2	
3-month T-bill yield (nominal, in percent per annum)	4.9	3.7	5.8	6.5	6.7	7.2	7.1	2.9	
3-month T-bill yield (ex post real, in percent per annum)	3.6	1.2	3.1	4.2	3.7	6.2	5.8	2.3	
spread of 3-month T-bill vs. Germany (percentage points, end of period)	1.6	0.4	2.3	3.6	2.4	3.0	3.1	0.9	
spread of 10-year T-bill vs. Germany (percentage points, end of period)	0.5	0.2	0.8	1.0	0.9	1.3	1.3	0.4	
General stock index (percentage change; end of period)	30.8	27.0	-25.8	42.3	9.8	-17.0	-31.8	40.3	
Real estate price index (percentage change; end of period)	10.5	10.8	6.8	18.6	9.8	7.7	2.8	4.1	
Credit from domestic sources (percentage change; end of period)	6.0	10.2	8.3	8.3	12.4	9.8	8.7	7.4	
Financial Sector Risk Indicators									
Loans to assets, commercial and savings banks (in percent)	78.3	81.1	82.2	81.2	80.0	79.8	80.0	76.7	2003Q2
Tier 1 capital ratio, commercial banks	8.6	8.0	8.0	8.0	7.8	8.7	8.4	8.3	2003Q3
Tier 1 capital ratio, savings banks	12.2	11.7	11.7	11.2	11.0	11.0	11.1	10.6	2003Q3
Share of foreign exchange loans 1/	4.9	5.4	7.2	7.1	8.6	8.5	7.8	11.4	2003Q3
Share of foreign exchange deposits 1/	4.1	4.0	3.6	3.4	3.5	3.7	2.9	2.8	2003Q3
Operating profits before tax, commerical banks (in percent of average total assets)	1.1	1.0	0.7	1.2	1.1	1.0	0.9	0.8	2003Q2
Operating profits before tax, savings banks (in percent of average total assets)	1.4	1.2	1.2	1.6	1.8	1.4	1.2	1.4	2003Q2
Household debt (in percent of disposable income)	119.4	120.1	118.9	122.3	127.1	135.1	141.8	...	
Private non-financial enterprise debt (in percent of cash surplus excluding interest expense)	366.0	383.0	392.0	430.0	394.0	369.0	429.0	...	

Sources: Norges Bank, IFS, and Fund staff calculations.

1/ Percent of commercial and savings banks loans to / deposits from the private sector and municipalities.

Long-run Fiscal Projections

Norway faces long-term fiscal challenges as public pension costs rise and petroleum reserves fall. This appendix presents scenarios of long-term fiscal dynamics assuming no change in pension provisions (and a few selected reforms) under alternative fiscal assumptions. [11] These simulations illustrate the need for pension reform to ensure long-term fiscal sustainability. The staff intends to analyze the authorities' pension reforms in the wake of the work of the Pension Commission, which reported on January 13, 2004.

Income from oil wealth, most of which goes to the Government Petroleum Fund (GPF), will generate sizeable fiscal surpluses for the next few years, but will decline sharply after about 2010 (Figures 1 and 2, bottom panels). By contrast, spending related to population aging is projected to rise from 7½ percent of GDP today to around 18 percent of GDP by 2040.

In the absence of pension reform or other spending or tax changes (and on current projections of petroleum revenues), the fiscal rule that the non-oil central government structural deficit equal 4 percent of the GPF cannot be achieved. Rather, the GPF would top out in another decade as a percent of GDP and then shrink rapidly (Figure 1).

Figure 2 illustrates a simulation in which the fiscal guideline is adhered to, but non-pension spending falls by almost 10 percentage points of GDP by 2040 to compensate for rising pensions.

Figure 3 illustrates the sensitivity of the analysis to alternative assumptions. An increase in the real return on GPF assets or higher oil revenue (due to higher prices or more extraction) would raise the GPF relative to the baseline and reduce the required adjustment to non-pension expenditure. Pension reform that reduces the maximum pension cost ratio by about 5 percentage points of GDP, taking effect in the 2020s would dramatically reduce the required adjustment to non-pension expenditure. Such reform could include indexing pension benefits to prices rather than wages, reducing replacement rates, or raising the retirement age.

Figure 4 shows the use of debt, rather than non-pension spending compression, to finance pension costs. The budget components are the same as in the bottom panel of Figure 1, but the GPF profile is that in Figure 2. Debt explodes to make up the difference. This policy may give the appearance of preserving the GPF, but in fact violates the 4 percent fiscal rule and thereby allows the government's financial position to deteriorate.

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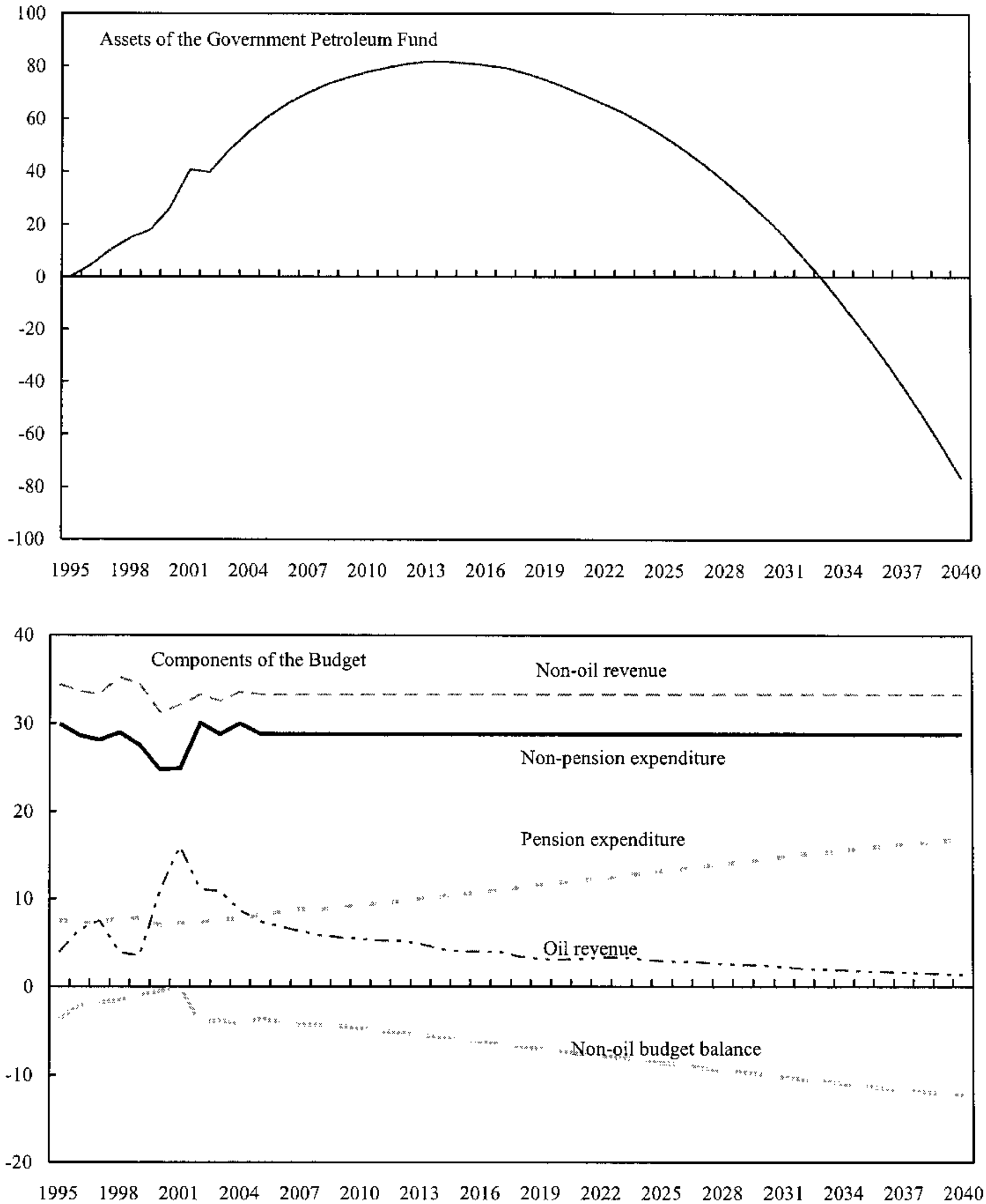
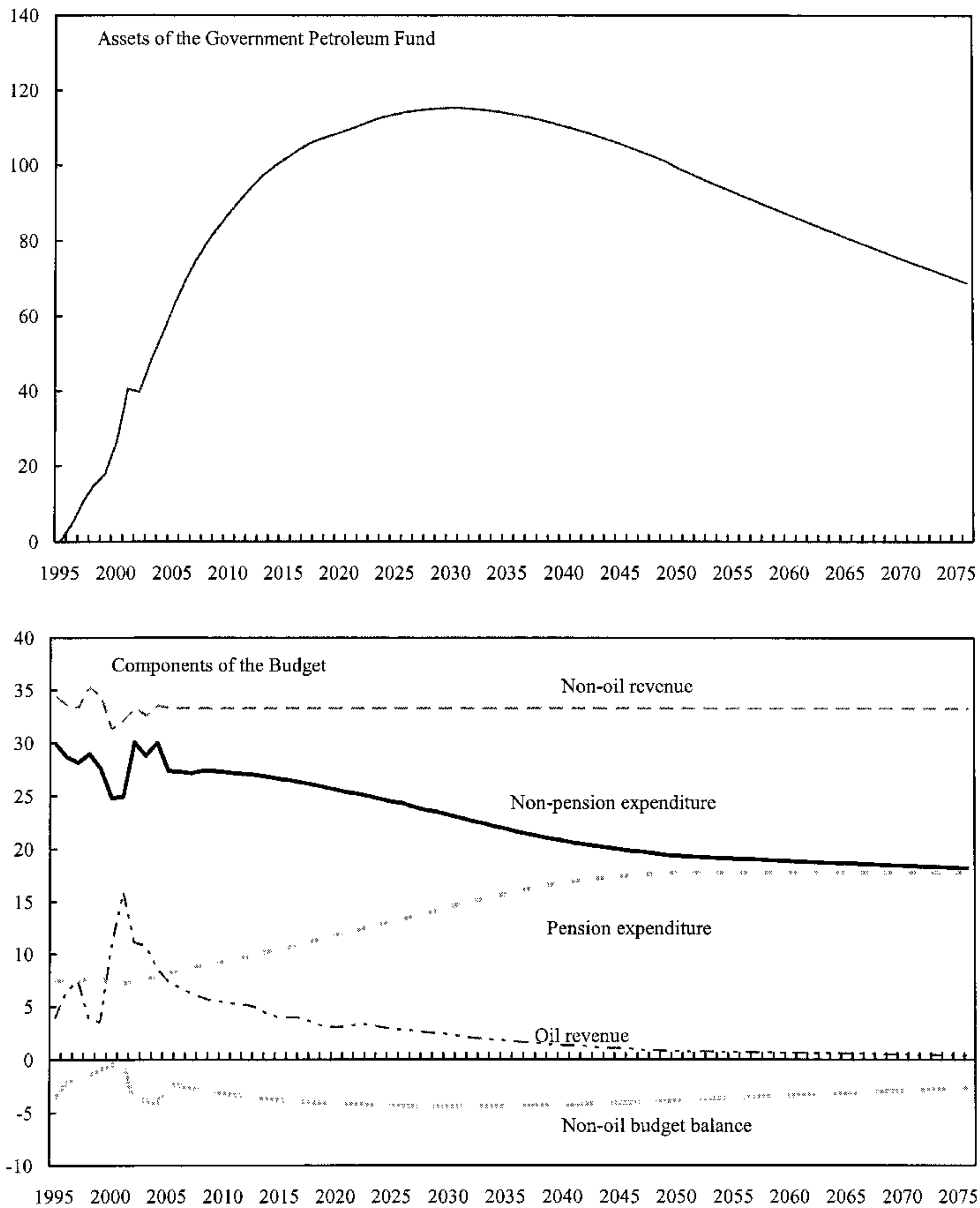
[11] Budget projections are used through 2004, after which the fiscal assumptions vary by simulation. The authorities' projections are used for future oil revenue and pension expenditures. WEO projections are used for GDP, trend non-oil GDP, and consumer prices through 2008, after which potential growth is assumed to be 2.25 percent and inflation 2.5 percent. The baseline assumes a future real return on the GPF of 4 percent.

Figure 1A. Norway: No Policy Change, 1995-2040
(Percent of GDP)



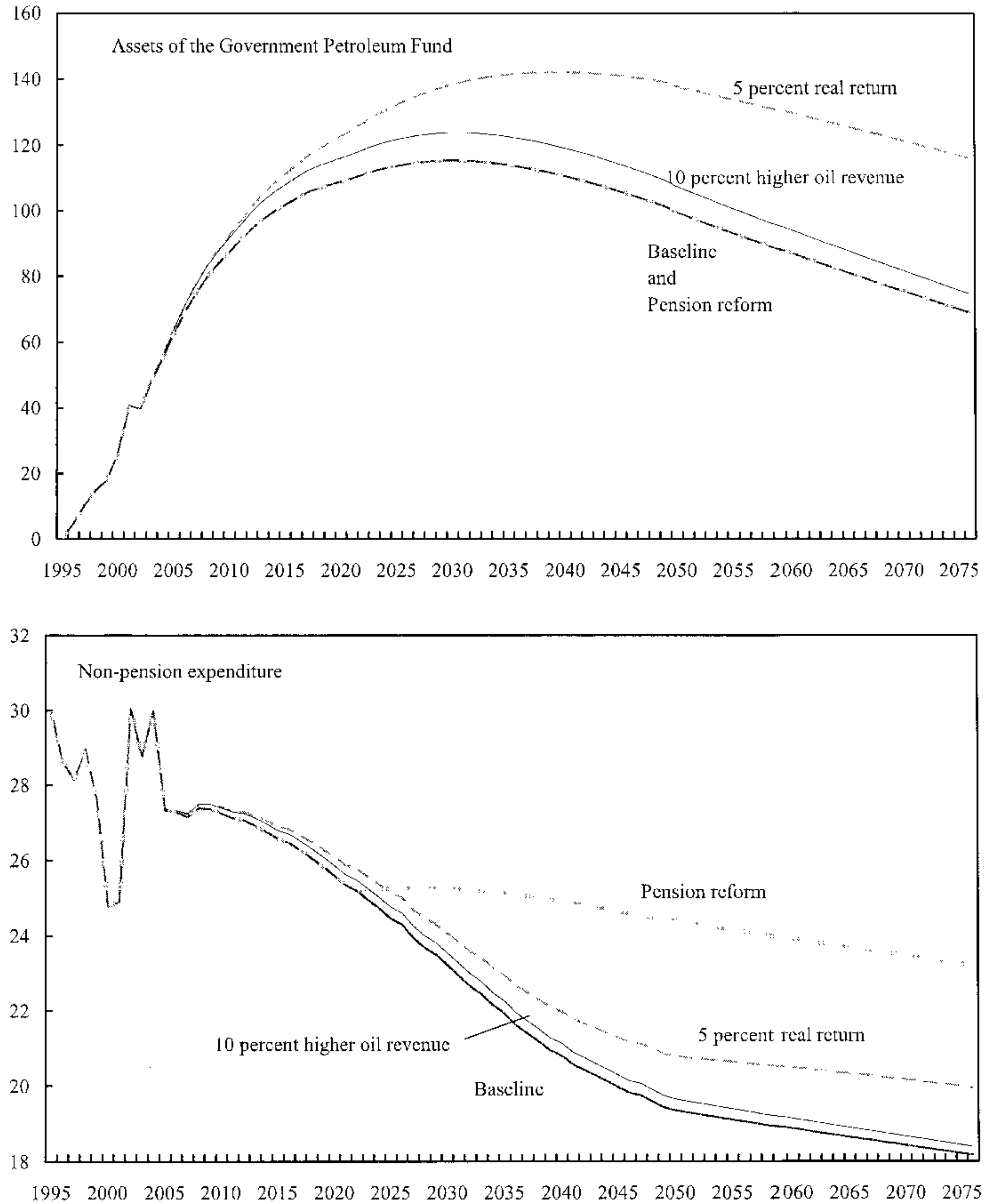
Source: Ministry of Finance and staff calculations

Figure 2A. Norway: Adhering to Fiscal Rule, 1995-2075
(Percent of GDP)



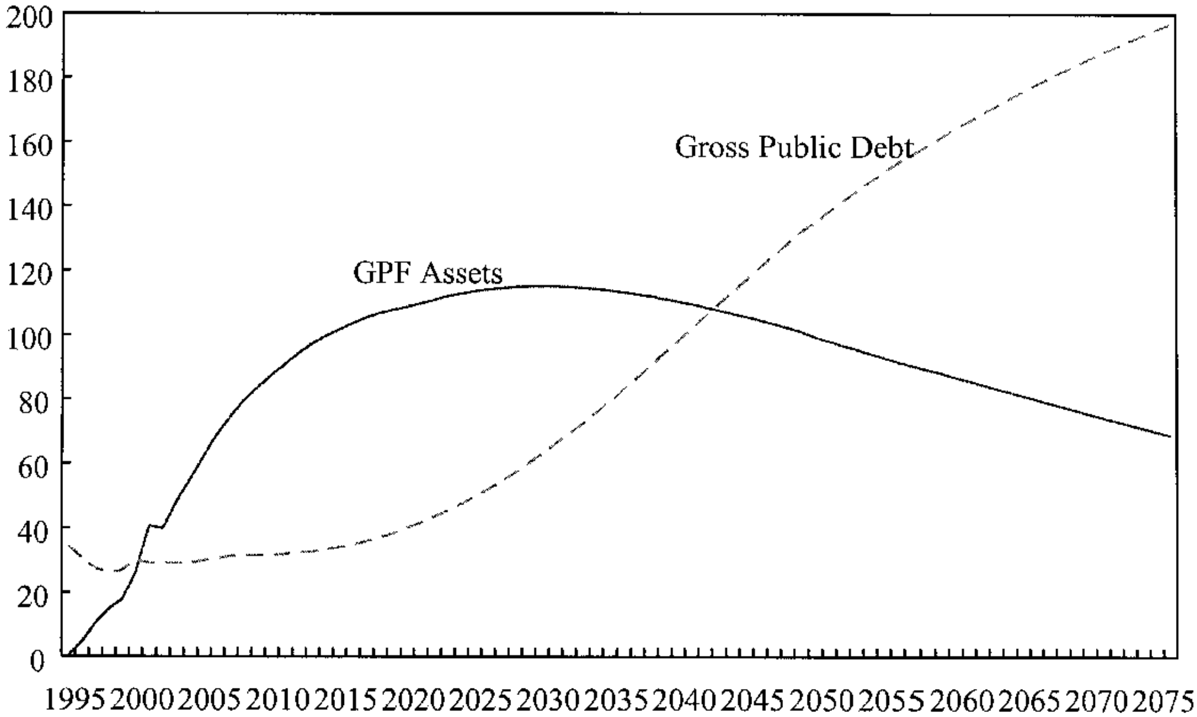
Source: Ministry of Finance and staff calculations

Figure 3A. Norway: Sensitivity Analysis, 1995-2075
(Percent of GDP)



Source: Ministry of Finance and staff calculations

Figure 4A. Norway: Debt Financing Scenario, 1995-2075
(Percent of GDP)



Source: Ministry of Finance and staff calculations.

NORWAY: FUND RELATIONS

(As of December 31, 2003)

I. **Membership Status**: Joined 12/27/45; Article VIII

II.	**General Resources Account**:	**SDR Million**	**% Quota**
	Quota	1,671.70	100.00
	Fund holdings of currency	1,002.21	59.95
	Reserve position in Fund	669.50	40.05
III.	**SDR Department**:	**SDR Million**	**% Allocation**
	Net cumulative allocation	167.77	100.00
	Holdings	225.42	134.36

IV. **Outstanding Purchases and Loans**: None

V. **Financial Arrangements**: None

VI. **Projected Obligations to Fund**: None

VII. **Exchange Rate Arrangement**: The present exchange rate arrangement for the krone is classified as an independent float, following the adoption of an inflation targeting regime on March 29, 2001.

As of February 5, 2002, exchange restrictions against the Federal Republic of Yugoslavia (Serbia/Montenegro) were limited to former President Slobodan Milosevic and people closely affiliated with him. As of May 25, 2003, sanctions against Iraq were limited to financial assets belonging to Saddam Hussein and his family, and members and representatives of the former Iraqi government.

VIII. **Article IV Consultation**: Discussions for the 2002 Article IV Consultation were held in Oslo, December 4-11, 2002. The Staff Report was considered by the Executive Board on March 7, 2003.

IX. **Technical Assistance**: Technical assistance missions organized by the MAE Department were conducted in March 1997 and September 1998.

X. **Resident Representative**: None

Norway: Core Statistical Indicators

(As of February 26, 2004)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Govern-ment Balance 1/	GDP/ GNP	External Debt/Debt Service
Date of Latest Observation	Feb. 26, 2004	Jan. 2004	Jan. 2004	Jan. 2004	Jan. 2004	Feb. 26, 2004	Jan. 2004	Dec. 2003	Nov. 03	2002	2003 Q3	2003 Q3
Date Received	Jan. 31, 2004	Feb. 2004	Feb. 2004	Feb. 2004	Feb. 2004	Feb. 26, 2004	Feb. 2004	Jan. 2004	Jan. 2004	Nov. 2003	Dec. 2003	Jan. 2004
Frequency of Data	Daily	Monthly	Monthly	Monthly	Monthly	Daily	Monthly	Monthly	Monthly	Annual	Quarterly	Variable
Frequency of Reporting	Daily	Monthly	Monthly	Monthly	Monthly	Daily	Monthly	Monthly	Monthly	Three times a year	Quarterly	Quarterly
Source of Update	Norges Bank	Norges Bank	Norges Bank	Norges Bank	Norges Bank	Norges Bank	Statistics Norway	Statistics Norway	Statistics Norway	Ministry of Finance	Statistics Norway	Norges Bank
Mode of Reporting	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic
Confidentiality	None	None	None	None	None	None	None	None	None	None	None	None
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Daily	Monthly	Monthly	Monthly	Three times a year	Quarterly	Quarterly

1/ Government finance figures are updated three times a year in connection with the presentation of next year's budget proposal (early October), the final budget proposals (late November), and the revised budget (early May).

INTERNATIONAL MONETARY FUND

NORWAY

Staff Report for the 2003 Article IV Consultation

Supplementary Information

Prepared by the European Department

Approved by Michael Deppler and Martin Fetherston

March 19, 2004

1. This note provides information relevant for the Board discussion that became available after the staff report was finalized. It does not change the staff appraisal.

2. Norges Bank announced a further cut in its policy rate by 25 basis points, bringing it to 1.75 percent, effective on March 12. In coming to this decision, the Executive Board stated that it had weighed the objective of raising inflation to its target of 2.5 percent in two year's time and stabilizing inflation expectations, against the risk that output growth would prove too high. It maintained an easing bias for the immediate future, stating that the probability of core inflation being below 2.5 percent in two year's time was greater than the probability of it being higher. It also noted that as inflation rises from its current very low rate the basis will be laid for gradually moving toward a more neutral short-term interest rate level.

3. Preliminary 2003 fourth-quarter national accounts estimates have been released, along with revisions to previously published 2001-03 estimates. The effects of this release are incorporated into the attached Table 1, which also appears in the PIN. For 2003, real mainland GDP growth was revised up from the estimate of 0.5 percent to 0.7 percent; notably, third-quarter growth was revised from 0.8 to 1.3 percent (at quarterly rates), and the preliminary fourth-quarter growth estimate is 0.8 percent, just below what the staff had assumed. For 2004, the staff does not intend to raise its projection of 2.8 percent growth for the time being, although the fiscal ratios to GDP are lower because the revisions raised the level of GDP. However, upside potential has increased and the growth rates of 3 percent or even more that have figured in recent official statements are within reach.

4. Finally, the tripartite committee examining working time and employment protection, mentioned in the last sentence of paragraph 25 of the staff report, has submitted its report. It recommends, among other things, allowing employers somewhat greater freedom to make use of temporary employment and to ease to some extent regulations on working hours.

Norway: Selected Economic Indicators

	2000	2001	2002	2003 Prel.	2004 1/
(Annual percent change)					
Private consumption	3.9	1.8	3.6	3.7	3.8
Public consumption	1.3	5.8	3.1	1.3	2.0
Gross fixed investment	-3.6	-0.7	-3.4	-2.5	1.8
Export of goods and services	4.0	5.0	0.1	0.1	2.7
of which : Oil and gas	5.0	5.2	2.2	-0.5	0.6
Import of goods and services	2.7	0.9	2.3	1.8	4.0
GDP	2.8	2.7	1.4	0.3	2.5
Mainland GDP 2/	2.5	2.1	1.7	0.7	2.8
Unemployment	3.4	3.6	3.9	4.6	4.6
Consumer prices	3.1	3.0	1.3	2.5	1.3
Wages	5.7	6.4	6.3	4.3	4.5
Nominal effective exchange rate	-2.8	2.9	8.8	-1.9	...
Broad money, M2	8.8	9.3	8.3	1.9	...
Domestic credit	12.4	9.7	8.9	7.1	...
Three-month interbank rate 3/	6.7	7.2	6.9	4.1	...
Ten-year government bond yield 3/	6.2	6.2	6.4	5.0	...
(In percent of mainland GDP)					
Central government					
Revenues	58.4	65.0	56.9	55.7	53.4
Expenditures	44.5	44.3	48.1	47.1	47.6
Overall balance	13.9	20.7	8.8	8.6	5.8
General government financial balance	20.0	17.9	11.6	11.7	8.2
Current account balance	15.6	15.4	12.9	12.9	13.0

Sources: Ministry of Finance; Norges Bank; Statistics Norway; International Financial Statistics; and IMF staff estimates.

1/ Staff projections as of February 2004.
2/ Excludes items related to petroleum exploitation and ocean shipping.
3/ Period average, in percent.

Statement by Jon A. Solheim, Executive Director for Norway
March 22, 2004

On behalf of the Norwegian authorities, we would like to thank the staff for a thorough and well written report on the Norwegian economy.

Economic outlook – recent projections

Norway, like other countries, experienced a period of strong expansion in the 1990s. The expansion in Norway lasted longer than in other countries. Wage increases culminated in the spring of 2002 and the expansion was reversed in the second half of the year. Growth came to a halt and employment fell. A number of factors triggered this development. Higher wage costs had weakened competitiveness. Global stagnation also had a dampening impact on Norwegian exports. In Norway, the interest rate was kept high to counteract high wage increases. A persistent low level of interest rates abroad resulted in a strong krone. The sharp rise in electricity prices during the winter of 2003 also affected the domestic economy.

Consumer price inflation in Norway declined sharply through 2003 and into 2004. In February, the annual rise in the consumer prices adjusted for tax changes and excluding energy products (CPI-ATE) was -0.1 percent. A number of factors appear to have contributed to the decline. The appreciation of the krone through 2002 pushed down import price inflation. A change in trade patterns and external economic conditions have resulted in an unexpectedly sharp fall in import prices, even when measured in terms of what Norwegian importers pay in foreign currency. A major increase in imports from Asia and the change in trade patterns have made a considerable contribution to the sharp decline in prices for clothing and shoes, partly reflecting the reduction or removal of tariffs and import quotas. Rapid technological advances have also pushed down prices for audiovisual equipment. In Norway, competition has probably increased in the retail industry and other service sectors in recent years, putting downward pressures on prices.

The cyclical downturn last winter, low wage increases last year, fiscal discipline, an unexpected decline in inflation and prospects of low inflation have resulted in a considerable easing of monetary policy. The interest rate has been reduced by 5¼ percentage points since December 2002 and is now approximately at the same level as among Norway's trading partners. The krone (trade weighted) depreciated by about (12) percent over the past year.

Growth in the Norwegian mainland economy picked up again in late spring of 2003. Mainland GDP in the second half of the year grew by 4.0 percent (annual rates and seasonally adjusted) from the first half. Household consumption is exhibiting high growth. Growth in business investment is still weak, but business sentiment surveys reflect signs of growing optimism. Equity prices have risen sharply. There are signs of a sharp rise in housing prices, while there is excess capacity in the commercial property market. The number of employed has edged up since last summer, but has remained virtually unchanged in recent months. Unemployment, as measured by the Labor Force Survey, has levelled out at around 4½ percent in recent months.

In the period ahead, solid growth in household income, subdued consumer price inflation and low interest rates will provide the conditions for high growth in private consumption. There is optimism in the building and construction sector. High petroleum investment will also be supporting growth in the overall activity. Mainland GDP growth is projected to pick up markedly this year and remain relatively high in 2005 and 2006. We expect inflation to pick up from the summer of 2004. The appreciation of the krone in 2002 is now fully reversed. In isolation, this will contribute to a renewed rise in inflation. The rise in prices for imported consumer goods may, however, be restrained by a continued fall in prices for these goods measured in foreign currency. Domestic inflation, which normally accelerates when output and employment growth pick up, is seen to be curbed by increased competition and high productivity growth in a number of industries.

Monetary policy

The Norwegian authorities note the staff's view that the flexible inflation targeting framework is well suited to the small open Norwegian economy. Moreover, the authorities note that the staff welcomes the further measures undertaken to strengthen policy formulation and implementation including regular hearings before the parliament with the Governor of Norges Bank, the new procedure for choosing bank board members and regular outside policy reviews.

The staff recommends that the reference to exchange rate stability should be removed from the Regulation on Monetary Policy. Both Norges Bank and The Ministry of Finance have several times underlined that the regulation defines a *standard, forward-looking, flexible inflation targeting regime*. The regulation makes it very clear that the operational target for monetary policy is a low and stable inflation and that the target is annual consumer prices of approximately 2½ percent over time. Norges Bank has also made it clear that the bank normally only reacts to the exchange rate insofar as it affects inflation. The opening sentence or preamble of the monetary policy regulation referring to the "stability in the Norwegian krone's national and international value" reflects the close interlinkage between inflation and the exchange rate. Over time, a low and stable inflation is a precondition to stabilize exchange rate expectations.

As noted by the staff, Norges Bank operates a flexible inflation targeting regime where variability in both output and inflation are given weight. Thus, the inflation target is a vehicle for, not an obstacle to, monetary policy's contribution to stabilizing output and employment. This objective is also expressed in the Regulation on Monetary Policy.

The regime does not in any significant manner differ from other inflation targeting regimes. We believe that the regime is well understood in the market.

The Norwegian authorities note that the staff's assessment deems the present accommodative monetary stance appropriately. On March 11, Norges Bank's signal rate was reduced by a further ¼ percent points to 1¾ percent. The board made its decision based on the projections in Inflation Report 1/2004. The projections were based on the assumption that the interest rate moves in line with forward interest rates observed at the beginning of March, i.e., a fall in the key interest rate towards a level of 1½ percent in the period to summer and thereafter a gradual increase. The krone exchange rate is assumed to follow forward exchange rates, which indicate that participants expect a fairly stable exchange rate ahead. The projections provided a reasonable balance between the prospects for reaching the inflation target and stable developments in the real economy.

While sharp increases in asset prices and debt accumulation may pose a risk to economic stability, it is only in the household sector where debt accumulation is high at present. Borrowing activity is low in the enterprise sector. When inflation increases from a very low level, this will provide a basis for gradually moving towards a more normal short-term interest rate level in Norway. This may counter excessive credit growth and excessive pressures on domestic resources in the medium term. Interest rate developments in other countries may also have a considerable impact on the krone and hence on Norwegian interest rates.

Fiscal Policy

As noted by the staff, the 2001 fiscal framework aims at a gradual and sustainable increase in the spending of petroleum revenues. The structural, non-oil budget deficit should, over time, equal expected real return of the GPF, estimated at 4 percent. The guidelines allow transitory deviations from this rule over the business cycle, and in the event of extraordinary large changes in the value of the GPF. For 2002 and 2003, the structural deficit has been larger then 4 percent of the GPF partly as a consequence of weak development in asset prices in 2002 and adverse cyclical conditions. The 2004 budget passed the Storting with a structural deficit still in excess of the expected return of the GPF.

The guidelines allow deviations from the 4 percent rule under circumstances like those present when the 2003 and 2004 budgets were adopted. Fiscal policy in these years has been prudent by market participants and the general public. The deviation from the 4 percent rule should be deemed in line with the guidelines. This perception was broadly shared by market participants and the general public. Fiscal credibility has so far not been seriously affected. Moreover, the 2004 budget did *not* increase the gap between the deficit and the 4 per cent rule, contrary to the impression given by paragraph 14 of the Staff Report.

The Norwegian authorities fully share the view that the pension reform should be implemented quickly to reduce future budgetary strain. A reform along the lines suggested in the recent report of The Pension Commission is an important necessary step to ensure long run fiscal sustainability, although the reform must be supplemented by additional spending restraint or actions to increase revenues.

As a means to such further restraint, the staff argues for the introduction of a binding expenditure rule to ensure room for tax cuts without violating the deficit rule. Such a rule would replace the stated objective of the present government of keeping real growth of spending below the growth of Mainland GDP. Moreover, we would like to inform you that starting with the 2005 budget, the present guidelines will be supplemented by medium term budget projections. The projections will trace out the future spending and revenue consequences of present policies, as a help to advance budgetary discipline. This measure should be evaluated before contemplating a specific move towards a binding expenditure rule.

The staff also urges that discretionary countercyclical fiscal policy should be foregone. The authorities acknowledge that inflation targeting has given monetary policy a far more prominent role in stabilizing the economy. However, contrary to the experiences of some other countries, fiscal policy has been predominantly countercyclical in Norway for the last 20 years. Therefore, it seems unwarranted to write off the option of discretionary countercyclical fiscal policies by changing the fiscal guidelines.

Structural Policy

The main objectives of structural reforms in Norway have been to improve the efficiency of financial and product markets, and to increase user orientation and efficiency in the production of public services. Competition has been enhanced through liberalization and modernisation of the regulatory framework. Privatization has been pursued gradually and on a pragmatic basis. Generally, co-operation and implementation of EU regulation within the context of the EEA Agreement has spurred reviews and reforms of regulations. Recently, additional attention has been focusing more on reform of the public sector – which will require major efforts in the coming years. In 2003, the OECD accomplished a comprehensive review of regulatory reform: "Norway – Preparing for the Future Now". The OECD report recommends that Norway should take further steps to reform the public sector, enhance competition, and strengthen regulatory governance.

In October 2003, the Government presented a bill on a new Competition Act. The bill was adopted by Parliament, and the new regulation will come into force on May 1, 2004. This implies that the text of Norway's competition law will be confirmed with the competition principles of the EU Treaty of Amsterdam. Agreements that restrict or distort competition and abuse of dominance will be prohibited.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 04/30
FOR IMMEDIATE RELEASE
March 31, 2004

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2003 Article IV Consultation with Norway

On March 22, 2004, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Norway.[1]

Background

A decade of sustained economic expansion in the 1990s was underpinned by broadly accepted and prudent monetary and fiscal policies. Notably, substantial and rising petroleum revenues were placed in the Government Petroleum Fund (GPF) and invested abroad, mitigating "Dutch disease" effects and preserving wealth for future generations. In 2001, inflation targeting was adopted as the monetary policy framework and fiscal guidelines were adopted tying the central government non-oil budget deficit to the long-run return on the GPF.

In 2003, real mainland GDP growth slowed sharply to 0.7 percent, reflecting a number of factors. The stance of monetary policy had been quite tight through 2002, in response to higher wage growth than expected and an expansionary fiscal stance. As a result, business investment declined, although household consumption remained relatively strong due to the wealth effects of past house price increases. The tight monetary stance, and the resulting interest differentials against the euro area, helped to raise the value of the krone. This appreciation, along with a weak worldwide economy, hurt exports and the exposed sector more generally.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

The unemployment rate rose and wage pressures receded. The core inflation rate also eased, falling sharply in the latter part of 2003 as import prices declined.

The outlook for 2004 is promising, with the factors restraining growth last year having been reversed. As inflation pressures eased, the central bank cut interest rates aggressively through 2003: the policy rate fell from 7 percent at the end of 2002 to 1.75 percent by March 2004. These cuts resulted in a narrowing of interest differentials with the euro area and a depreciation of the krone, reversing the earlier appreciation. With monetary conditions now quite supportive, domestic demand is expected to pick up. In addition, worldwide growth seems set to rise, which will help to spur exports. Wage negotiations for the 2004-05 period are expected to result in a moderate settlement. Inflation is expected to rise gradually as the economy recovers, although a more rapid increase is possible as the depreciation passes through.

The non-oil fiscal position has deteriorated somewhat in recent years, and the pressures for greater use of petroleum revenues remain strong. The 2003 deficit is expected to have narrowed somewhat, but to have substantially exceeded the budget target. The 2004 budget involves an increase in the non-oil deficit. The central government structural non-oil deficit is also set to rise, thus exceeding the limit laid out in the fiscal rule adopted in 2001 for the third consecutive year. Moreover, the budget does not foresee the rule being met until 2009.

Executive Board Assessment

The directors commended Norway's strong macroeconomic policies, which have delivered one of the highest standards of living in the world and enviably low unemployment. The commitment to low inflation and fiscal restraint, and the strategy of investing the bulk of petroleum revenues abroad have been key to promoting macroeconomic stability and growth. The adoption of inflation targeting and fiscal policy guidelines, in 2001, have further strengthened the policy framework. Against the backdrop of an emerging economic recovery from the 2003 slowdown, Directors saw as priorities for the Norwegian authorities to ensure the skillful implementation of the monetary policy framework, reinforce fiscal discipline, address the medium-term challenges of population aging, and further strengthen labor and product markets.

Directors noted the prospects for a robust economic recovery in 2004. This will be supported by the stimulus provided by the decisive monetary easing since late 2002, at a time of weak economic activity and very low core inflation, along with the depreciation of the krone and the improving global economic climate. Looking forward, Directors considered that monetary policy will have to act in a timely manner in moving toward a neutral stance as the recovery gathers pace and inflation prospects move upward toward the target. They also stressed that wage moderation will continue to be key to ensuring a benign inflation outlook, while prudent fiscal policy should help forestall pressures for a real exchange rate appreciation.

Directors welcomed the recent institutional reforms to the inflation targeting framework. They considered that regular parliamentary hearings with the Governor of Norges Bank, the new procedure for appointing Bank Board members, and regular outside reviews of monetary policy will all contribute to further strengthening policy formulation and enhancing transparency. A few Directors suggested that removing the reference to exchange rate stabilization from the regulation on monetary policy could further clarify market perceptions of the policy objective.

Many other Directors, however, saw no strong reason for such a step, given the authorities' stated commitment to low and stable inflation as the operational target for monetary policy.

Directors recognized the authorities' efforts to contain budget deficits and adhere to the fiscal guidelines introduced in 2001. However, they noted with concern that, on current plans, the key rule limiting non-oil structural deficits to 4 percent of the value of the GPF would not be met until 2009. To safeguard the credibility of the fiscal guidelines, Directors strongly encouraged the authorities to take advantage of the coming recovery to mobilize support for bringing the deficit in line with the 4percent rule at an earlier date. This should be achieved through expenditure restraint, including to create room for the desirable tax cuts planned for the years ahead. While some Directors saw merit in moving toward multiyear expenditure ceilings to buttress the current fiscal guidelines, other Directors considered that the option of discretionary countercyclical fiscal policies should not be foregone in the case of Norway.

Directors underscored the need to address the long-term fiscal challenge arising from population aging, and noted, in this regard, that the assets of the GPF will not be sufficient to cover future pension obligations. They urged the authorities to adopt the recommendations of the Pension Commission with a view to containing spending growth, notably by limiting the degree to which pensions are indexed to wages, aligning benefits to average life-time earnings, and taking into account increases in life expectancy. An explicit linkage of the GPF to the pension system would also be useful in making clear the dependence of future retirement incomes on a careful use of the assets of the fund. Directors also recommended early examination of further measures to ensure long-term sustainability.

Directors commended the strong performance of Norway's labor market, which is characterized by high employment rates and an unemployment level that is very low by international standards. The rapid uptake of sickness and disability benefits—despite a tripartite agreement to reduce the number of beneficiaries—nevertheless risks eroding labor supply and is costly to the budget. While recent reforms to address these concerns are welcome, Directors called for tightening further the restrictions on access to these benefit programs, as well as for cuts to the generous benefit rates.

Directors highlighted the importance of further improvements in product markets to ensure continued strong productivity growth. Improvements in the tax structure—building on the recommendations of the tax commission—and a general lowering of tax rates will be helpful, in this regard, although it will be important to match tax reductions with strict expenditure discipline. Directors also welcomed recent reforms to streamline the regulatory framework, while noting the desirability of further reducing the still high level of government ownership of economic assets, and continued efforts to strengthen competition.

Directors welcomed the overall strength of the Norwegian banking sector. Going forward, they noted that both financial institutions and supervisors will need to continue to exercise close oversight of risks. Directors looked forward to Norway's participation in the Financial Sector Assessment Program next year.

Directors commended the generous level of Norway's development assistance, as well as the goal to raise it even further to 1 percent of GNP. They welcomed the authorities' support for multilateral trade liberalization, while encouraging continued strong efforts to lower the high agricultural trade barriers.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Norway: Selected Economic Indicators

	2000	2001	2002	2003 Prel.	2004 1/
(Annual percent change)					
Private consumption	3.9	1.8	3.6	3.7	3.8
Public consumption	1.3	5.8	3.1	1.3	2.0
Gross fixed investment	-3.6	-0.7	-3.4	-2.5	1.8
Export of goods and services	4.0	5.0	0.1	0.1	2.7
of which: Oil and gas	5.0	5.2	2.2	-0.5	0.6
Import of goods and services	2.7	0.9	2.3	1.8	4.0
GDP	2.8	2.7	1.4	0.3	2.5
Mainland GDP 2/	2.5	2.1	1.7	0.7	2.8
Unemployment	3.4	3.6	3.9	4.6	4.6
Consumer prices	3.1	3.0	1.3	2.5	1.3
Wages	5.7	6.4	6.3	4.3	4.5
Nominal effective exchange rate	-2.8	2.9	8.8	-2.2	...
Broad money, M2	8.8	9.3	8.3	1.9	...
Domestic credit	12.4	9.7	8.9	7.1	...
Three-month interbank rate 3/	6.7	7.2	6.9	4.1	...
Ten-year government bond yield 3/	6.2	6.2	6.4	5.0	...
(In percent of mainland GDP)					
Central government					
Revenues	58.4	65.0	56.9	55.7	53.4
Expenditures	44.5	44.3	48.1	47.1	47.6
Overall balance	13.9	20.7	8.8	8.6	5.8
General government financial balance	20.0	17.9	11.6	11.7	8.2
Current account balance	15.6	15.4	12.9	12.9	13.0

Sources: Ministry of Finance; Norges Bank; Statistics Norway; International Financial Statistics; and IMF staff estimates.

1/ Staff projections as of February 2004.
2/ Excludes items related to petroleum exploitation and ocean shipping.
3/ Period average, in percent.