

I. THE ECONOMIC ENVIRONMENT(1) Overview

1. At the time of the previous Trade Policy Review of Norway in 1991, the economy appeared to be recovering slowly from a severe recession. This has been borne out since, by real growth averaging some 3.5 per cent over the last five years, with a peak of 5.7 per cent being reached in 1994. Per capita income reached US\$32,984 in 1995 (Table I.1). The recent expansion was a response to macroeconomic policies as well as increased oil and gas production and a firming up of oil prices; however, growth was not confined to the hydrocarbons (offshore) sector. Consumer price inflation remained moderate, dropping to 1.4 per cent in 1994, although it increased again to 2.4 per cent in 1995, partly reflecting increases in indirect taxation (Table I.2). Unemployment stood at 4.9 per cent in 1995; a further 1.9 per cent of the work-force participated in job-creation programmes. The current account surplus has grown in the last three years, driven by the growth of oil and gas exports.

Table I.1
Major features of the economy, 1992-95
(Per cent)

	1992	1993	1994	1995 ^a
Population (million) ^b	4.29	4.31	4.34	4.36
Growth of population (annual percentage change)	0.6	0.6	0.6	0.6
GNP per capita (US\$)	28,811	26,811	27,784	32,984
Share of GDP (per cent)				
Agriculture, forestry and fishing	2.6	2.7	2.6	2.3
Oil	11.9	12.4	13.1	13.3
Mining	0.2	0.2	0.2	0.2
Manufacturing	11.3	11.3	11.3	11.7
Services	61.9	61.1	60.5	60.4
Taxes	12.1	12.1	12.2	12.0
Statistical discrepancy	0.0	0.2	0.1	0.1

a First six months.

b On 1 January.

Source: Statistics Norway, Economic Survey (various editions).

2. There was a serious banking crisis in the early 1990s, following a period with strong domestic demand and credit growth. Consequently, the Norwegian Banking, Insurance and Securities Commission has been considerably strengthened during the past four years. The crisis came to an end in 1993. As a consequence of the crisis the Government became the major shareholder in the commercial banks. The Government intends to keep a majority of the shares in the two largest commercial banks under State control for the time being. The banking crisis is discussed in more detail in Chapter IV.

Table I.2

Recent economic performance, 1990-95

(Percentage change and per cent)

	1990	1991	1992	1993	1994	1995
	Percentage change					
Real GDP	1.6	2.9	3.3	2.1	5.7	3.7
Private consumption	0.7	1.5	2.2	2.1	4.6	2.7
Government consumption	4.1	3.9	5.5	1.0	1.1	0.6
Gross capital formation	-7.9	-4.4	-3.9	6.1	9.2	9.6
Exports of goods and non-factor services	8.6	6.1	5.2	2.0	8.5	3.7
Imports of goods and non-factor services	2.5	0.2	0.7	4.0	6.6	4.1
Consumer prices (CPI)	4.1	3.4	2.3	2.3	1.4	2.4
Real earnings	1.2	1.8	1.3	0.6	1.4	0.6
Labour productivity ^a	3.1	3.7	2.0	2.6	3.8	1.6
Unit labour costs ^b	-2.8	1.7	-3.6	-0.9	2.1	4.8
	Per cent					
Unemployment ^c	5.2	5.5	5.9	6.0	5.4	4.9
Participation in job-creation programmes	1.9	2.1	2.2	2.5	2.4	1.9
Money supply (M2) ^d	6.0	10.6	7.3	0.5	6.6	4.8
Interest rate (per cent) ^e	11.54	10.56	11.83	7.25	5.85	
	Share of GDP (per cent)					
Central Government budget						
Revenue	9.6	3.3	-0.5	3.1	7.2	...
Expenditure	8.8	7.1	6.4	3.6	2.5	...
Balance (per cent of GDP)	2.1	0.5	-2.6	-2.8	-0.8	1.8

... Not available.

a Mainland Norway.

b Per cent of labour force.

c Three months NIBOR (Norwegian Interbank Offered Rate).

d The growth rate of M2 is the 12-month growth rate from December to December.

e Unemployment is defined according to international standards. This is not consistent with the number of persons on job-creation schemes. Registered unemployment for 1990-95 was, respectively, 4.3, 4.7, 5.4, 5.5, 5.2 and 4.7 per cent.

Source: Statistics Norway; IMF.

3. Fiscal policy was expansionary in 1992-93, to give a stimulus to the economy. However, since 1994, under the Long-Term Programme for 1994-97, it has been tightened, including by an increase in indirect taxation in 1995. This has produced a surplus in the central Government budget, estimated at 1.8 per cent of GDP in 1995. Overall, monetary policy has been essentially geared to maintain relative stability of the Norwegian krone against other European currencies, and this has also helped promote price stability. The real effective exchange rate declined through 1993, increasing the competitiveness of non-petroleum exports and helping to stimulate an export-led recovery, but it has been allowed to appreciate slightly since then (Table I.3).

Table I.3
Balance of payments 1990-95
(US\$ million)

	1990	1991	1992	1993	1994	1995 ^a
Merchandise trade balance	7,761	8,696	9,303	7,995	8,321	8,270
Exports	34,313	34,212	35,162	31,989	34,922	41,952
Imports	26,552	25,516	25,860	23,995	26,601	33,682
Services credits	12,765	13,330	13,642	12,744	13,105	13,680
Services debits	12,358	12,701	14,789	13,848	14,392	13,149
Income credits	3,896	3,540	3,040	2,448	2,810	...
Income debits	6,596	6,293	6,457	5,785	4,579	...
Balance on goods, services and income	5,468	6,573	4,739	3,553	5,265	...
Other current net transfers	1,470	1,541	1,757	1,401	1,620	...
Current account	3,992	5,032	2,982	2,152	3,645	...
Direct investment abroad	-1,470	-1,782	-411	-877	-1,628	...
Direct investment in Norway	1,003	-398	716	2,003	623	...
Portfolio Inv. assets	-987	-2,523	-192	853	750	...
Portfolio Inv. liabilities	1,548	-585	1,054	-1,188	-599	...
Other Inv. assets	-1,502	-326	-1,068	2,146	1,501	...
Other Inv. liabilities	648	1,968	-474	344	1,968	...
Other	31	17	-21	14	-19	...
Capital Account	730	-7,564	-396	3,294	-1,340	...
Net Errors and Omissions	-2,848	-219	-3,442	-1,309	-854	...
Overall balance	414	-2,751	-855	4,138	1,451	...
Memorandum items						
Nominal exchange rate, krone per U.S. Dollar ^b	6.25	6.49	6.21	7.11	7.03	6.3
Real effective exchange rate (1990 = 100)	100.0	97.0	96.6	98.5	93.3	97.8
Terms of trade (1987 = 100)	106.5	103.7	97.2	96.9		...

... Not available.

a Data for 1995 supplied by Norwegian authorities. Norwegian national data for merchandise trade and services are slightly different from IMF IFS which are adjusted to international definitions.

b Average exchange rate.

Source: IMF (1996), *International Financial Statistics*, January.

4. There have been no significant changes in the overall structure of the Norwegian economy since the previous review, except that the share of oil production increased slightly from 11.9 per cent in 1992 to 13.3 per cent in 1995. Services accounts for over 60 per cent of GDP, while manufacturing

contributes some 11 per cent. The share of agriculture, fishing and forestry was 2.3 per cent in 1995, having fallen slightly from previous years.

5. The offshore oil and gas sector remains the backbone of the economy, with important linkages through to the mainland. Estimates of proven reserves have been continually revised upwards.¹ The Norwegian economy is considered to be more resilient to possible oil and gas price falls than ten years ago, largely because of a reduction in production costs through improvements in technology. The recent acceleration of production may be seen as an attempt to reduce the impact of future price uncertainties. Should this be possible without substantial negative effects on prices, then there would be further benefits for the current account and increased surpluses in the Government budget.

6. It is understood that the budgeted fiscal surplus of 1.3 per cent of GDP in 1996 is to be used to activate the State Petroleum Fund, described in the previous Trade Policy Review of Norway. The purpose of the Fund is to dampen the volatility of revenues (which can have a strong macroeconomic impact) and to reduce their impact on the competitiveness of other sectors, for example, through upward pressure on the real exchange rate. Although the Fund was established in 1990, in practice no reserves have been accumulated as the Government used current revenues to boost economic recovery. From 1996, the surpluses placed in the Fund will be invested in a portfolio of foreign financial assets managed by the Norges Bank (the Norwegian Central Bank). This planned build-up of financial assets would be expected to help reduce the vulnerability of the Norwegian economy to volatility in oil and gas revenues.

7. Population growth is very low, at 0.6 per cent. In common with many industrialized countries, there is a growing percentage of older people in the population. This is likely to have long-term negative effects on public finances through the drawing down of social security payments, which are quite important in Norway. The reform of the National Insurance Scheme is under consideration in a welfare White Paper, which recommends, *inter alia*, raising the effective retirement age. Overall, the proposals represent a refinement of the present system, rather than radical reform.

8. There is no indication that rejection by referendum in December 1994 of membership of the European Union (EU) has had any serious, negative effects on Norway's overall economic performance. Moreover, participation in the European Economic Area (EEA) ensures the free flow of industrial goods and services between Norway and its European partners (see Chapter II).

(2) Recent Economic Performance

9. In 1991, the Norwegian economy had begun to recover from a severe recession, during which unemployment had risen from about 2 per cent of the labour force in the mid-1980s to more than 7 per cent, including those enrolled in job-creation programmes. The modest expansion continued in 1992, driven by higher output of off-shore petroleum. Boosting tax receipts, the increase in petroleum production also allowed the Government to increase its spending to stimulate the economy. Price increases were brought under control, dropping from nearly 9 per cent in 1987 to 3.4 per cent in 1991 and 2.3 per cent in 1992. However, the deepening banking crisis, rooted in falling asset values and a high level of bankruptcies, underlined the fragile state of the mainland economy.

10. Although real GDP grew by 2.1 per cent in 1993, unemployment continued to increase, reaching 6 per cent, plus a further 2.5 per cent in job-creation programmes. In addition, some industries faced

¹Statistics Norway (1996).

a more challenging environment as the currencies of some of Norway's major trading partners (Sweden, the United Kingdom and the United States) depreciated markedly. However, the performance of the financial sector improved significantly during 1993, aided by major reductions in interest rates, which prepared the ground for a broad-based economic recovery. Inflation was maintained at 2.3 per cent.

11. The strong economic performance in 1994, when real GDP rose by 5.7 per cent, was due not only to buoyant domestic demand, but also solid growth in exports of both petroleum and "traditional" Norwegian goods, and services such as tourism. The expansion in employment, the highest annual growth rate since the mid-1980s, has also helped to cut unemployment, which stood at about 5.4 per cent of the labour force in 1994 (plus 2.4 per cent on job creation programmes). Despite the higher growth, price inflation was further reduced to only 1.4 per cent.

12. In 1995, growth moderated to 3.7 per cent, despite an increase of some 9.6 per cent in gross capital formation (Table I.2). Investment in the mainland economy increased by 14 per cent, while investment in petroleum activities declined by 12.2 per cent.² The growth of exports and imports of goods and services slowed to 3.7 and 4.1 per cent, respectively. Reflecting continued fiscal restraint, government consumption rose by only 0.6 per cent. Although inflation increased to 2.4 per cent, the rise can be mainly attributed to an increase in VAT. Excluding such increases, the underlying rate of inflation was basically unchanged.³ Employment increased by 2.5 per cent, the largest increase in recent years, while, correspondingly unemployment fell to 4.9 per cent.

(3) Balance of Payments

13. Overall, the current account surplus has expanded strongly in recent years, driven by oil and gas exports, while there has been considerable fluctuation in the capital account. The growth in petroleum revenues is associated with an increase in the volume of exports and somewhat firmer prices, but overall Norway has suffered from declining terms of trade since the mid-1980s. Excluding petroleum, the current account deficit would be the equivalent of some 10 per cent of GDP.

14. In May 1994, a new regulation for the exchange rate régime was adopted by Royal Decree. The operative guideline for Norges Bank is that monetary policy shall be aimed at maintaining a stable exchange rate against European currencies, at about the value prevailing since December 1992. Should significant changes in the krone exchange rate occur, monetary policy instruments will be oriented with a view to returning the exchange rate over time to its initial level. Recent movements in the exchange rate vis-à-vis the U.S. dollar and real exchange rates are shown in Table I.3.

(i) Trade

(a) Commodity composition of trade

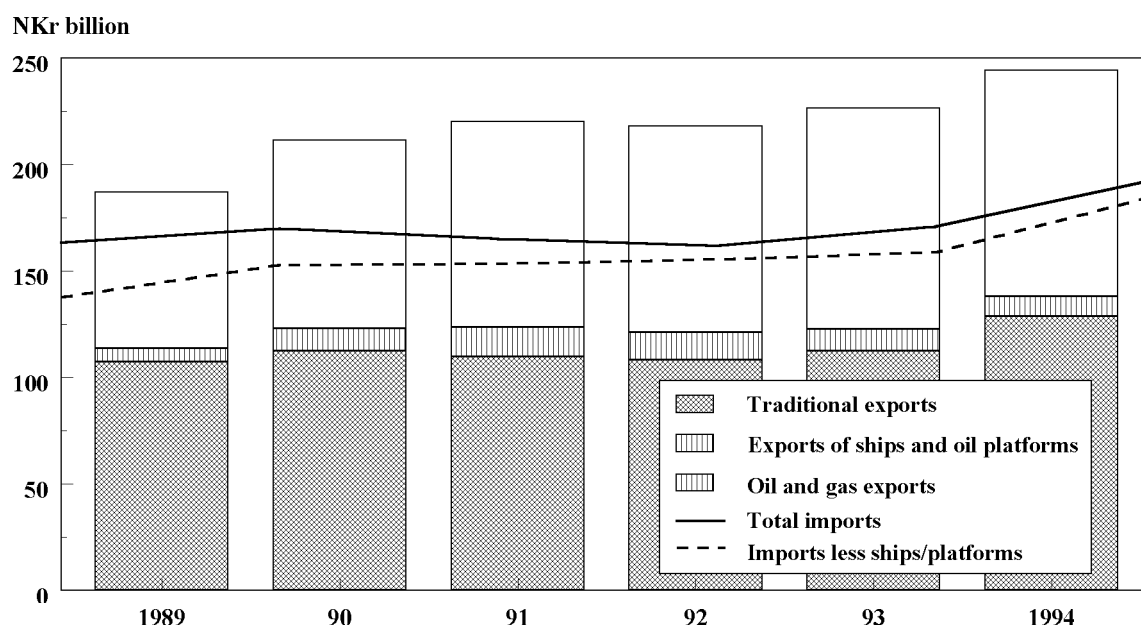
15. With oil production expanding by more than 50 per cent since 1991, Norway is at present among the world's leading producers and exporters of crude oil. Fuels, including natural gas and petroleum products account for about 50 per cent of Norway's export earnings (Chart I.1). The chemical industry also exports plastic products, derived from petroleum, in various forms in addition to the main

²Statistics Norway (1996).

³Statistics Norway (1996).

"traditional" chemical export: manufactured fertilizer. Other major exporting industries of long standing are based on transformation of natural resources such as forests, hydro-electric power and fish.

Chart I.1
Merchandise exports and imports in current prices, 1989-94



Source: Central Bureau of Statistics, Oslo.

16. Exported products of the wood processing industry include newsprint, kraft paper and board, and chemical wood pulp, while energy is largely transformed into non-ferrous metals such as aluminium, ferro-alloys, nickel and zinc, mostly exported as staple goods. Fish exports have grown rapidly with the expansion of fish farming, notably of salmon, and currently account for about one sixth of Norway's non-fuel exports.

17. Although products with a low degree of processing dominate Norway's exports, the country also has important production and export of sophisticated machinery and equipment, particularly linked to maritime services and communication technology.

18. Norway has substantial services exports, particularly in the areas of shipping and tourism (see Chapter IV). Overall there has been a small net deficit on services trade in recent years, according to the IMF (Table I.3). However, Norwegian national data show a small surplus, amounting to some US\$500 million in 1995.

19. The structure of Norway's imports of goods to some extent reflects the relatively small size of the domestic market and the corresponding tendency to import goods in whose production significant economies of scale exist (examples include motor vehicles, specialized machinery and a wide range

of consumer goods). Norway's climate also limits or precludes production of many food items; imports of wheat, sugar, vegetable oils, tropical products and seasonal imports of vegetables and fruit can thus be substantial.

(b) Direction of trade

20. The direction of Norwegian trade has, by and large, remained stable since 1991 (Chart I.2). Trade with the European Union has, however, intensified, including as a result of the recent enlargement; with the accession of Austria, Finland and Sweden - all former partners in the European Free Trade Association (EFTA) - the EU is now the origin of nearly 70 per cent of Norway's imports and the destination of more than three quarters of its exports.

21. Participation in the EEA is expected to have considerable quantitative significance for Norwegian trade, leading to even greater intensification of two-way trade. In the longer term, higher growth is linked to the possibility of deepening trade relations with the faster growing markets of Asia.⁴

22. The share of imports from developing countries has fallen, but this is essentially linked to the intensification of trade with the EU, and to a lesser extent with the central and eastern European countries, rather than an absolute decline in imports from the developing countries.

(ii) Investment

23. Net foreign direct investment (FDI) in Norway was substantial in the 1970s, when heavy investments were being made in the emerging offshore oil and gas sectors. However, investment tapered off in the 1980s, with net outflows in 1984 and 1985. Since the mid-1980s, annual net inflows have varied, due to the impact of large individual operations (Table I.3).⁵

24. Chart I.3 gives an indication of the geographical breakdown of investment flows into Norway in the period 1987-94. FDI is mainly concentrated in oil and gas, finance and wholesale and retail trade.⁶ The United States is the major source, accounting for 42.8 per cent of investment flows in 1987-94.⁷ Sweden was the second largest, with 34.3 per cent, and Denmark was the source of 7.3 per cent of investment in this period. Important investments have also been made by Germany and by Switzerland (included in Other Europe in the chart).

⁴Statistics Norway (1996).

⁵OECD (1995).

⁶OECD (1995).

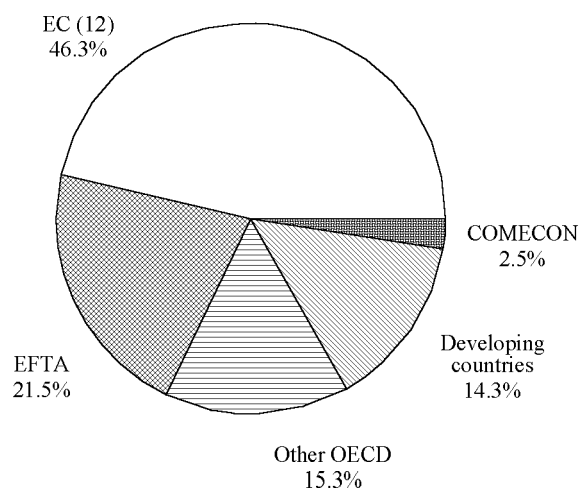
⁷OECD (1995).

Chart I.2 Direction of trade, 1990 and 1994

NKr billion and per cent

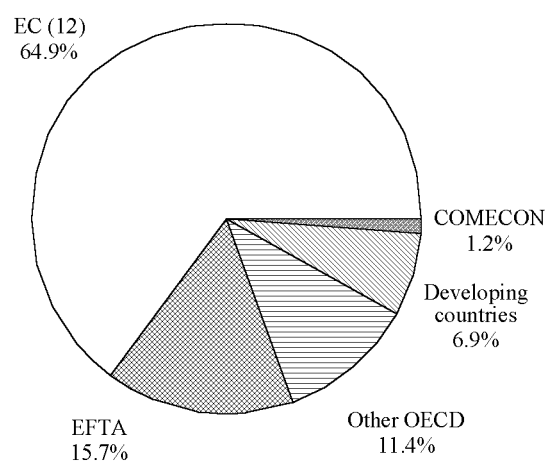
1990

Imports



Total: NKr 168 billion

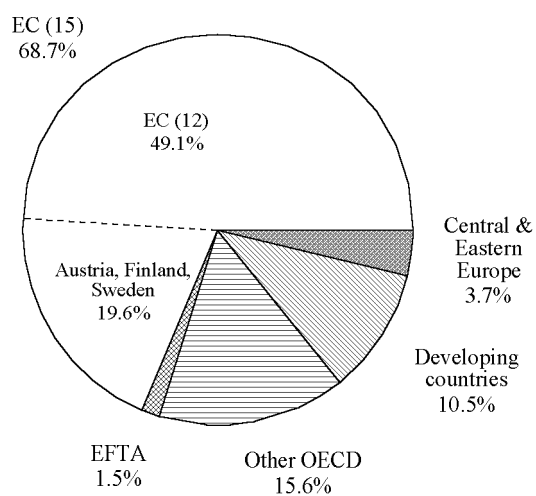
Exports



Total: NKr 212 billion

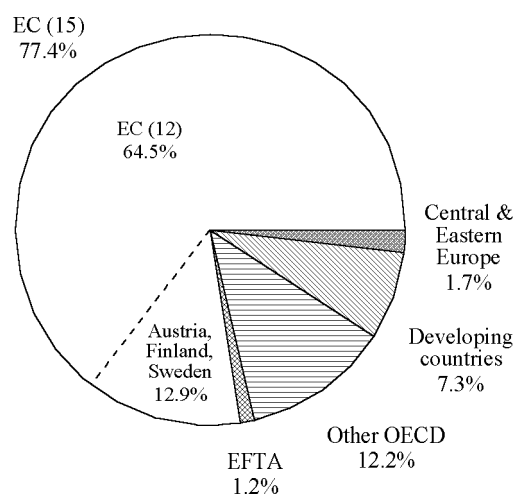
1994

Imports



Total: NKr 193 billion

Exports

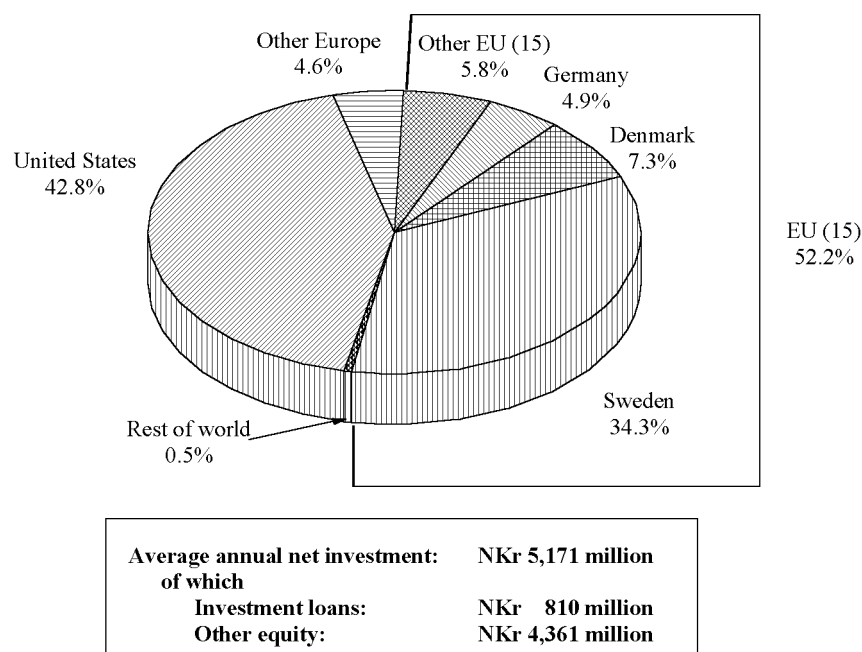


Total: NKr 244 billion

Source: Central Bureau of Statistics, Oslo; and WTO Secretariat estimates.

Chart I.3 Net foreign investment in Norway, 1987-94

NKr million and per cent



Source: Central Bank of Norway.

25. Since the previous Trade Policy Review of Norway, there has been an opening up of the foreign investment régime. For example, to meet the terms of the EEA agreement, in December 1994, the Norwegian Parliament enacted a new general law replacing the previous application procedures by a uniform notification and screening system for intended investments by foreigners and Norwegian nationals.⁸ The Act establishes a reporting requirement for individual investors or a group of investors purchasing shares or assets resulting in ownership of more than one third, one half or two thirds of a business undertaking or a company's share capital.⁹ However, the Act does not specify any equity participation limits and applies equally to Norwegian and foreign investors. The new system is also considered to reduce the discretionary powers of the authorities.¹⁰

26. Under the new legislation, some areas have been excluded from liberalization under the EEA Treaty, notably agriculture and fleet-based fishing. Moreover, the Act does not cover the acquisition of shares in companies solely engaged in shipping, oil drilling and aviation, or acquisition of shares in financial institutions, which are regulated by special legislation. In the area of petroleum, the State

⁸Act No. 79 of 23 December 1994 relating to the Acquisition of Business Undertakings.

⁹Affected by the requirement are companies with an annual turnover of minimum NKr 50 million or a staff of 50 employees or more, or enterprises which have received government support for research and development amounting to NKr 5 million or more over the past eight years.

¹⁰OECD (1995).

oil company, Statoil now participates on a commercial basis. In future licensing rounds, Statoil will have to compete for production licences along with other companies; previously, a certain share of oil and gas licences were allocated to Statoil. After 1985, part of the State participation was allocated to the State Direct Financial Interest (SDFI) in order to channel a greater part of the petroleum rent to the State and reduce Statoil's size. Statoil has gradually been given more scope to act on a purely commercial basis. The State reserves the rights to under-sea (or submarine) petroleum deposits.¹¹

27. The extraction of minerals requires a concession, granted on a non-discriminatory basis, to allow the Government to control any undesirable social or environmental effects. Only Norwegian citizens and nationals of an EEA State who are permanent residents of one of these States are allowed to explore the ground for minerals without a concession. The same applies to corporations established in Norway or in an EEA State. Nationals of a non-EEA State or corporations established outside the EEA require a concession.¹²

28. The acquisition of waterfalls or companies holding rights to exploit waterfalls, considered part of the national patrimony, is subject to a non-discriminatory concession system, regulated in accordance with the provisions of the Industrial Concessions Act and the Act concerning the Regulation of Waterfalls, both dating from 1917. The procedure does not distinguish between EEA and non-EEA nationals or enterprises. An application for a concession is forwarded to the Norwegian Water Resources and Energy Administration (NVE) for publication.¹³ The NVE also requests the opinion of the local authorities (county or municipality). Having taken these comments into consideration, the NVE makes a recommendation to the Ministry of Industry and Energy. The recommendation is once again circulated to the local authorities and to other ministries for comment.¹⁴ Finally, the Ministry's recommendation is forwarded to the Cabinet or, in important cases, to Parliament for approval. A concession, granted by Royal Decree, is in principle valid for a maximum of 60 years. A reversion clause, applied to all private companies, is maintained to ensure "socially beneficial use" of an important source of energy.

29. A concession to acquire fishing vessels or shares in a company which owns such vessels is granted only to Norwegian nationals or joint-stock companies having their registered office in Norway. It is required that all members of the board in such companies must be shareholders and Norwegian citizens residing in Norway. It is also required that at least 60 per cent of the equity capital is owned by Norwegian nationals. It is prohibited for other than Norwegian nationals or companies, as specified above, to process, pack or reload fish, crustaceans and molluscs or parts and products of these, inside the fishing limits or the Norwegian Exclusive Economic Zone. This applies to catches from both Norwegian and foreign vessels. Exceptions are granted under special circumstances.¹⁵

¹¹Act No. 11, of 22 March 1985, relating to Petroleum Deposits.

¹²OECD (1995).

¹³In addition to technical details, the application must also outline possible damage to the environment. A project with serious or uncertain environmental consequences must be supplemented by environmental impact analyses.

¹⁴The recommendation is a public document; anyone, including non-governmental organizations, may thus obtain it and comment on it.

¹⁵Regulation of Participation in Fishing Act, 16 June 1972; Economic Zone Act, 17 December 1976; Fishing Limits Act, 17 June 1966.

30. In maritime transport, Norway has two ship registers, the Norwegian Ship Register (NOR), which is open to ships satisfying Norwegian nationality conditions, and the Norwegian International Ship Register (NIS). The latter was designed to stop an outflow of ships to foreign flags, and apparently such outward investments have dropped, particularly in 1987, when the register was established. The main condition for incorporation in the NOR is 60 per cent ownership by Norwegian natural or legal persons. There is no such limitation for incorporation in the NIS, which mainly applies to ships operating outside Norwegian waters. The main condition is that the ship be operated by a Norwegian shipping company or by a Norwegian management company with its headquarters in Norway (see also Chapter IV).

31. Some parts of the new legislation do not distinguish between Norwegian residents and other EEA nationals on the one hand, and nationals of other countries on the other hand. This applies notably to financial services, industrial acquisitions and real estate, with the exception of acquisition or leasing of secondary residences by non-residents, which is subject to a concession. Regarding corporate structure, the manager and at least one half of the directors must have been residents of Norway for the last two years, or be EEA nationals with permanent residence in an EEA State. In the area of transport, the new rules apply only to EEA nationals. Norway has announced its general intention to apply any liberalization of capital movements, including FDI, required by the EEA Treaty without discrimination among third countries. This has so far been achieved in many areas, but not in all.

Norwegian investment abroad

32. Outward foreign direct investment by Norwegian residents had increased almost without interruption as percentage of GDP in the ten years prior to the last Trade Policy Review of Norway. However, in 1992, the trend was sharply reversed, falling to US\$411 million (Table I.3). However, outflows subsequently recovered to earlier levels.

33. Most Norwegian investment abroad is held in the United States and the EU.¹⁶ Outward investment flows in the period 1986-94, by destination and sector, are shown in Chart I.4. In this period the major destination was the United Kingdom (25.4 per cent), followed by Denmark (20.4 per cent) and the United States (13.9 per cent). More than half of the stock of Norwegian outward investment is in manufacturing, especially in the chemicals sector.¹⁷ However, in the period 1986-94, the share of Norwegian investment flows going into manufacturing overseas was below 30 per cent, while investment in financial services took 21.2 per cent, transport 12.6 per cent and petroleum and mining 9 per cent.

(4) Outlook

34. The recent impressive performance of the Norwegian economy can be attributed to fiscal and monetary policies designed to foster non-inflationary growth, and this is expected to continue in the absence of external shocks. Real GDP growth, particularly in the non-oil (mainland) sector, is projected to moderate in 1996-97, partly in response to continued budgetary restraint, while inflation is expected to remain low. However, the fiscal budget excluding oil and gas is expected to remain in deficit. This implies that there is a need to continue to strengthen public finances against the long-term decline in petroleum and gas revenues, expected to occur after the year 2000, as well as to counter the effects of an aging population on the financing of social security. The plan to activate the Petroleum Fund and the proposals for reform of the National Insurance Scheme are indicative of the intent to address these issues.

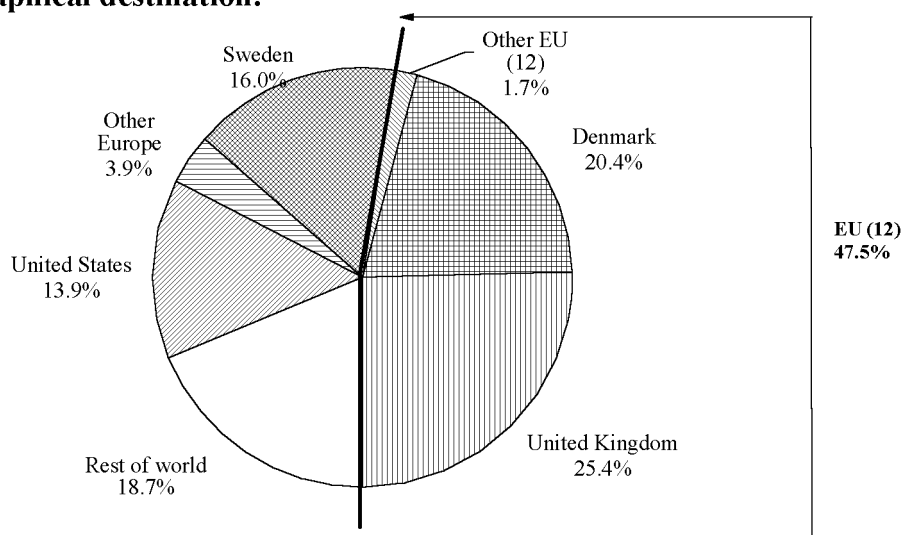
¹⁶OECD (1995).

¹⁷OECD (1995).

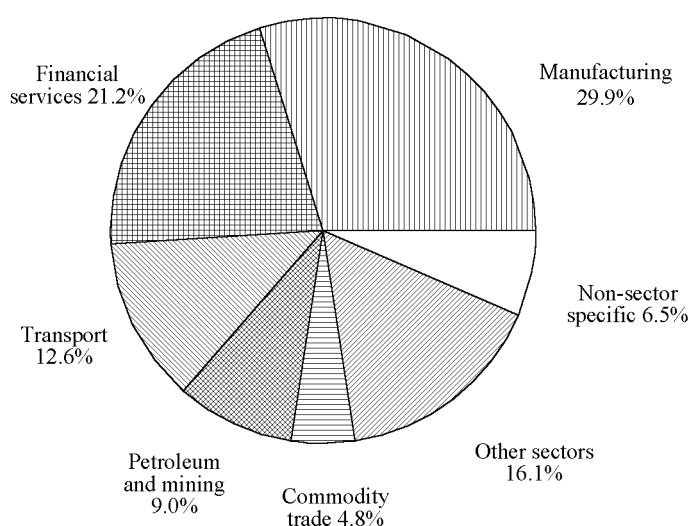
Chart I.4 Outward investment by Norway, 1986-94

NKr million and per cent

By geographical destination:



By sector:



Average annual investment:	NKr 8,407 million
of which:	
Investment loans:	NKr 2,663 million
Other equity:	NKr 5,744 million

Source: Central Bank of Norway.