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RFD 252

Board of Governors of the Federal Reserve System

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

May 17, 1955

Recent Financial Measures In Norway

12 pages

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NOT FOR PUBLICATION

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Recent Financial Measures In Norway

Frederick R. Dahl

Early in 1955, the Norwegian Government effectively reversed the financial policies which had been followed throughout the postwar period. Prompted by the deterioration in Norway's external accounts and an increasing inability to finance the growing balance-of-payments deficits, the Norwegian authorities adopted a series of measures designed to restrict domestic consumption and investment. In contrast to the earlier postwar period, when fiscal policy supplemented by direct controls provided the major anti-inflationary weapon, the new measures are almost exclusively of a monetary or financial nature. Of these measures, the raising of the Bank of Norway's discount rate on February 14th, had particular symbolic significance: until that time, Norway was the only country in western Europe with the exception of Switzerland which had not altered its discount rate in the postwar period, and low interest rates were a cornerstone of Norwegian financial policy.

The following paragraphs review briefly the development of the Norwegian economy in 1954 and describe the measures recently adopted. Some tentative conclusions are then offered as to the probable efficacy of these measures in restoring a greater degree of equilibrium in the Norwegian balance of payments.

The Norwegian economy in 1954

In 1954, virtually every sector of the Norwegian economy set new records of production and employment. Overall industrial production rose by 6 per cent while the export industries registered a 13 per cent increase in output. Although the cod fisheries were a relative failure, the herring catch was the highest ever recorded. The number of dwellings completed equaled the record set in 1953, and at the rate of 10.5 units per thousand inhabitants was (with Western Germany) the highest rate of housing construction in Europe. A 2 per cent increase in employment was registered, and unemployment fell to exceptionally low levels. The growth in real national product was probably 4 per cent.

This expansion of production and economic activity, which greatly exceeded that forecast in the National Budget for 1954, was the result of an increase in both foreign and domestic demand. The high level of business activity in western Europe led to an increase in Norwegian exports of about 15 per cent in both value and volume. At the same time, domestic consumption rose by about 3 per cent in volume, and gross fixed investment increased by some 7 per cent.

The rise in domestic and foreign demand proved greater than that of domestic production. As a result, imports increased by 12 per cent and upward pressures on prices appeared: the cost of living rose by slightly more than 4 per cent while wage rates increased by 5 per cent.

The insufficiency of domestic resources relative to demand was also illustrated by reported shortages of labor in some lines of production and by a shortage of electric power which developed late in the year.

Early in 1954, the National Budget had stressed (even with its more modest forecast of economic expansion) the necessity of restraining domestic consumption and investment in order to protect the balance of payments. In view of subsequent developments, those measures which were taken were clearly insufficient for the purpose of restraining private internal demand. The suspension of the duty-free provisions on machinery imports failed to curb such imports. The level of construction activity was at least equal to that of 1953, even though new housing starts were reduced by a cutback in new government housing loans. Bank credit to the private sector increased by about 9 per cent, despite sterner credit directives from the Minister of Finance and the reduction in bank liquidity effected by the balance-of-payments deficit and by government loan flotations.

The Norwegian balance of payments in 1954 clearly reflected the above developments. As will be noted in Table 1, the current account deficit of kr. 1,141 million in 1954 greatly exceeded the kr. 770 million deficit forecast in the National Budget. This deterioration lay exclusively in the merchandise account (excluding ships), where the value of commodities imported was kr. 700 million greater than expected. Moreover, had it not been for an improvement in the commodity terms of trade even above that forecast, the deficit would have been much greater. In comparison with 1953, then, the improvement in the commodity balance of trade was insufficient to offset the rise in ship imports with the result that the current account deficit deteriorated by more than kr. 100 million.

Although influenced by seasonal factors, the quarterly estimates of the current account deficit reveal the deterioration throughout the year. In Table 2, it will be noted that the deficit was particularly severe in the fourth quarter. During that period, moreover, imports appeared to be rising, promising a further deterioration in the balance of payments.

The current account deficit in the fourth quarter was accompanied by severe pressure on the country's foreign exchange reserves. In the first half of the year, the deficits had been covered by foreign loans and credits to an extent that foreign exchange holdings actually increased. In the second half, however, short-term credits were much smaller than previously while other official loans were only sufficient to cover payments in connection with the consolidation of debt to the European Payments Union. This is shown clearly in Table 3 where the residual item, which includes unregistered capital items, declined from an inflow of kr. 284 million in the first half-year to an outflow of kr. 36 million in the second half. This shift is ascribable in part to two factors. First, short-term commercial credits were probably easy to obtain early in the year in Western Europe; as demand in the rest of Europe continued to

TABLE I

Norwegian Current Balance of Payments
(In millions of Kroner)

	1953	1954 (National budget forecast)	1954 (Preliminary results)
Commodity imports	5,716	5,355	6,094
Ship imports	886	1,400	1,263
Total imports	6,602	6,755	7,357
Commodity exports	3,704	4,055	4,242
Ship exports	167	200	205
Total exports	3,871	4,255	4,447
Trade balance	-2,731	-2,500	-2,910
Net freights	+1,722	+1,700 1/	+1,750
Other services	---	+ 30	+ 19
Current account balance	-1,009	- 770	-1,141

1/ Adjusted to conform with revisions in the previous years' figures.
Source: National Budget of Norway 1954, Storting Report No. 1, 1954.
Statistike Meldinger No. 2, 1954.

TABLE II

Quarterly Balance of Payments
(In millions of Kroner)

	Commodities	Ships	Trade Balance	Current Account
1953 - I	- 546	- 212	- 758	- 306
II	- 501	- 157	- 658	- 255
III	- 364	- 149	- 513	- 44
IV	- 601	- 201	- 802	- 404
1954 - I	- 409	- 319	- 721	- 264
II	- 353	- 209	- 562	- 148
III	- 455	- 209	- 664	- 190
IV	- 635	- 321	- 956	- 539

Source: Aktuell Statistikk, January 22, 1955

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TABLE III

Quarterly Balance of Payments 1954: Capital Account
(In millions of kroner)

	I	II	III	IV
Balance on Current Account:	-264	-148	-190	-539
U. S. aid	+ 27	+ 18	+ 7	+ 8
Amortization	- 25	- 25	- 64	- 26
Borrowing on ships	+100	+100	+120	+130
Official loans	---	+136	+111	+ 30
E.P.U.: Credit	+ 48	+ 19	+ 67	+ 91
Funding	---	---	-110	- 20
Foreign exchange 1/	- 90	-180	+150	+271
Total capital	+ 60	+ 68	+281	+484
Residual item	+204	+ 80	- 91	+ 55

N.B. Division of capital items on quarterly basis partly estimated.

1/ (-) = inflow; (+) = outflow

Source: Aktuell Statistikk; National Budget of Norway 1955.

rise, however, interest rates rose toward the end of the year with the result that Norwegian credits may not have been renewed, with repayments having to be effected, or that new credits were not as readily granted. Second, the rise in freight rates during 1954 together with the steady decline in the number of laid-up ships improved the shipping outlook to an extent that, contrary to all expectations, Norwegian shipowners began placing new orders in foreign yards; an outflow of capital then took place for the down payments on these contracts.

The Government's program for 1955

The developing balance-of-payments crisis in the last few months of 1954 was obviously the governing factor in the formulation of the Government's economic and financial policy for 1955. The accelerating outflow of foreign exchange threatened to reduce Norway's already low reserves 1/ to dangerously low levels at a time when a

1/ At the end of 1954, gold and foreign exchange assets of the Bank of Norway totaled kr. 985 million, the equivalent of less than two months imports.

general European movement toward currency convertibility was being seriously considered.1/ Moreover, a further deterioration in the balance of payments was threatened if the rising cost of living led to an increase in wage rates in the spring of 1955.

The National Budget for 1955 sets out the aims of economic policy for the year and in a general way indicates the policy measures by which these aims are to be effected. It recognizes, at the outset, that the large deficit in the balance of payments has arisen mainly because of an excessive rate of investment. But it realizes that because of past commitments and investment projects in progress, investment can be neither easily nor sharply cut within a short period of time; and that, consequently, the balance of payments deficit can not be immediately eliminated. Nor is the complete elimination of the balance-of-payments deficit considered desirable: the long-term development program adopted in 1953 had not envisaged a restoration of equilibrium in the balance of payments until 1958.

TABLE IV

National Accounts
(In millions of Kroner)

	1953	1954 p	1955 e
Private consumption	13,451	14,250	14,675
Government consumption	2,585	2,846	2,850
Gross fixed investment	8,230	8,859	8.675
Changes in inventories	- 150	- 50	-
Exports	8,181	8,900	9,560
Less imports	9,161	10,000	10,110
G.N.P.	23,136	24,805	25,650

p - preliminary

e - National Budget forecast at end-of-year prices.

Source: National Budget for Norway 1955.

The aim of this year's National Budget is therefore to reduce the balance-of-payments deficit to that amount which can be covered easily by foreign loans -- in this instance to kr. 550 million or

1/ Norwegian leaders have for some time stressed that Norway would have to join in any general movement toward convertibility because of its trading relationships and dependence on multilateral trade. See e.g. Erik Brofoss, "Omkring konvertibilittetsproblemene," Statskønomisk Tidskrift, November 1954.

approximately one-half the 1954 deficit. To effect this improvement, the rate of growth of the national product is to be cut from the 4 per cent increase attained in 1954 to 2 per cent, primarily by effecting a 2 per cent reduction in investment. Private consumption is expected to rise by 2 per cent. Imports are expected to fall slightly while exports are estimated to expand by 7 per cent. The terms of trade are predicted to remain favorable.

The policies designed to give effect to these aims are noteworthy in that they are almost exclusively of a monetary and financial nature. In the early postwar years, direct governmental controls supplemented fiscal policy in restraining inflationary pressures. With the rise in the cost of living in 1954, sections of the trade unions began to clamor for stricter price controls; these controls had gradually been relaxed in recent years, however, and the Government did not wish to reimpose them.1/ In the foreign trade sector, the Government felt constrained by its obligations under the O.E.E.C. trade liberalization program and by its adherance to the G.A.T.T.; non-liberalized imports, however, are to be further restricted.

1. The fiscal budget—In the budget for the fiscal year, 1955-56, total government expenditures are set at a slightly higher level than in the current year. Although the Government found it extraordinarily difficult to trim expenditures because of recent wage and price increases, the State's purchases of goods and services are expected to decline by about 4 per cent. Transfer payments, on the other hand, will rise, mainly because of larger debt repayment.

The small rise in total expenditures notwithstanding, the cash budget (including debt redemption) is to be balanced whereas the budget for the current fiscal year envisaged a deficit of kr. 291 million. While most tax rates will remain unchanged, tax receipts are expected to rise as a result of higher incomes and economic activity. In addition, the 10 per cent turnover tax has been extended to cover all building construction (except housing); the automobile tax has been increased; and a 10 per cent tax has been levied on all new ship contracts.2/

1/ Permanent price control legislation was enacted in 1953; however, the powers given to the Government under this legislation have not as yet been generally utilized. Legislation for the control of interest rates was passed at about the same time, but the only feature of this act likely to be of importance is the authority giving the Bank of Norway control over capital issues.

2/ At the time of the budget submission, the Government was willing to wait until March or April for parliamentary approval of its tax proposals. On February 14th, however, the Finance Minister asked for, and obtained, provisional approval of these measures, and they became effective immediately.

TABLE V

Budgets
(In millions of Kroner)

Total income	4,147	4,471
of which: Taxes	(3,825)	(4,120)
Current expenditures	3,903	3,901
Balance	+ 244	+ 570
Capital expenditure	535	570
of which: Deficit of St. enterprises	(267)	(238)
Debt repayments	(267)	(332)*
Overall surplus/deficit	- 291	---

* This amount includes installments on foreign debt of c.100 million kroner; on domestic debt of c.200 million kroner; plus a sinking fund of kr. 30 million for payments on debt yet to be contracted.

Source: Fiscal Budget Proposal for 1955/56.

During the calendar year 1955, however, a cash deficit is expected because of the overlapping of fiscal years. Moreover, expenditures under past appropriations are likely to increase, especially for defense purposes. The State's claim on resources will therefore probably increase in calendar 1955 while the financing of the deficit could add to the liquidity of the economy. In addition, loans of the State Banks will probably not be significantly reduced because of past commitments even though new commitments are to be curbed.

2. Debt management and monetary policies—Cognizance of the fact that the Government's fiscal operations were likely to be an expansionary factor during the greatest part of 1955, was a major parameter in the formulation of the Government's debt management and monetary policies. Debt management policies have been designed both to finance the deficits of the Central Government and the operations of the State Banks and to mop up the excessive liquidity of the public and of the financial institutions. Monetary policy has been reformulated to curb the inauguration of new investment projects and the expansion of imports financed by bank credit.

The Government has decided to extend its loan operations and recently received authority from Parliament to float up to kr. 750 million in new internal loans. The loans now in process have been designed to attract the widest public and institutional support, first, by higher interest rates, and second, by more attractive redemption terms.

Early in March, a 20-year kr. 400 million bond loan was issued bearing a 4 per cent rate of interest. The loan was quickly over-subscribed.1/ In December 1953, the rate of interest on long-term government bond flotations was raised to 3.5 per cent from the 2.5 per cent rate which had prevailed from the end of World War II until that time. The new rate thus represents a further 0.5 per cent increase in the long-term bond rate. The terms of the loans were also made attractive: redemption is to take place in half-yearly installments chosen by lot, beginning the third year.

In April, a kr. 75 million lottery loan was issued to the public in kr. 50 denominations. Prizes equivalent to a 3.5 per cent rate of interest will be drawn three times yearly for a period of 15 years; these prizes will be tax-free. The last attempt at a lottery loan was unsuccessful in Norway, but the present terms evidently prove attractive to small savers. Another lottery loan will be issued in June.

In addition, the commercial banks agreed to lend kr. 100 million to the Government for a period of three years. The rate of interest was set at 2.75 per cent or 1 per cent above the rate of interest of the last government loan of this maturity. Because of already straitened liquidity conditions, however, the banks were only able to furnish kr. 80 - 90 million.

The revival of monetary policy is perhaps the most striking aspect of the present program. Even though there has been a shift from direct to indirect controls in Norway during the course of the past few years, the adoption of more traditional methods of monetary management still seems a radical departure from previous practice. Throughout the postwar period, for example, the Norwegian authorities had maintained that low interest rates were essential for the maintenance of full employment in Norway and the achievement of a high rate of investment and development. Moreover, the revival of monetary policy seems fairly complete. Within the first two weeks of February, a series of monetary measures were introduced and others announced as being contemplated, all of which portend a greater amount of flexibility

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1/ The full anti-inflationary impact of this loan may have been considerably modified since it was intimated that the savings banks would be allowed to convert part of their holdings of 2-1/2 per cent bonds into the new issue.

in Norwegian monetary policies than has hitherto obtained. The Norwegian authorities insist that these measures are to be made affective in curbing bank lending.

As of February 1st, commercial banks were required to maintain balances with the Bank of Norway equivalent to up to 10 per cent of their sight liabilities. This measure first received parliamentary sanction in 1952, but its implementation had been successively postponed. The Government may raise the reserve ratios to a maximum of 25 per cent, and the Minister of Finance has strongly intimated on at least two occasions that they would be raised if the banks failed to restrain credit.

On the same date, the Minister of Finance issued a new credit policy directive to the banks which stated that it was essential not only to exercise greater restraint in granting new credits but also to reduce existing lines of credit. More specifically, the directive requested the greatest restraint in the extension of credits for instalment finance, house construction, import financing, and new investment projects.

Two weeks later, on February 14th, the discount rate of the Bank of Norway was raised from 2.5 to 3.5 per cent. The previous rate had been in effect since the end of the Second World War. The increase in the discount rate effectively ended the cheap money policy which had been consistently followed. Following the rise in the discount rate, the commercial banks raised their discount rates by 0.5 per cent and their loan rates by 1 per cent; interest paid on time deposits was also raised by 1 per cent. In addition, agreement has been reached for raising bank commitment fees by 0.5 per cent.

3. Price and wage policy.--Part of the impetus in arriving at the new measures was the desire to avoid further increases in wages. These would have more or less automatically taken place this spring if the cost of living continued to rise. To avoid such a contingency, or to delay price rises until the other financial measures could become effective in curbing demand, the Government undertook to lower retail prices by negotiation with business; these efforts were in part successful. In addition, prices have been lowered by small and selective increases in subsidies, abolition of import duties, and postponement of higher transport and utility rates. Although the Government has not reimposed price controls, it has stated -- probably for political reasons -- that the price situation would be watched and no unreasonable increases would be allowed.

The Norwegian balance of payments in 1955

By the new financial measures, it is hoped to reduce the current account deficit in the Norwegian balance of payments to kr. 550 million. Some reservations must however be registered to this estimate.

In the first place, the measures introduced early in the year could not have been expected to be immediately effective. Preliminary balance of payments figures for the first quarter of 1955 bear out this contention: the current account deficit in the first quarter totaled kr. 395 million, or well over one-half the total deficit expected for the year and kr. 121 million higher than in the corresponding period of 1954. This movement was accompanied by further pressure on Norway's foreign exchange reserves: in the three month period, gold and foreign exchange assets declined by kr. 200 million. Secondly, the estimate assumes no essential change in either import or export prices during 1955. Rising raw material prices in world markets at the end of 1954 suggest the possibility of some deterioration in Norway's terms of trade in 1955, particularly since Norwegian participation in world lumber markets is at present limited.

Finally, the 7 per cent rise in Norwegian exports may prove to be overly optimistic. The increase seems to have been predicated on a continued rise in economic activity in Europe. Recently, however, the United Kingdom, Norway's major trading partner, adopted more restrictive internal policies in an effort to curb rising imports. Denmark and Sweden, too, have adopted similar policies. Should other European countries follow suit, the demand for Norwegian exports could slacken.

On the other hand, the 11 per cent increase in shipping receipts seems a judicious estimate. Freight rates have been steadily improving since the middle of 1954, and this has been accompanied by a steady decline in the number of laid-up Norwegian ships.

But even should the balance-of-payments position improve as much as expected, serious financing problems remain if the present foreign exchange reserves are to be maintained. In addition to the estimated current account deficit of kr. 550 million, amortization and other repayments of about kr. 200 million bring the total financial requirements to nearly kr. 800 million. As in the past, the Norwegian authorities hope to cover the payments deficit by foreign loans and credits, and hope to avail themselves of the credit facilities of the European Payments Union, the International Bank, ship builders, and private capital markets in the United States and in Europe.

Norway's credit availabilities through the European Payments Union at the end of 1954 stood at about $29 million or the equivalent of kr. 207 million.[1] To receive credit, however, entails equal

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[1] By the end of March the unused credit quota had been reduced to about kr. 143 million.

payments in gold and dollars for each unit of credit. In addition, after June 30, 1955 increased gold payments will in all probability be required.

Ship mortgage loans of kr. 420 million are expected during the coming year to help finance the expected ship imports of kr. 1,300 million. Whether or not Norway will be successful in raising this amount abroad will depend on conditions in the respective foreign capital markets. With the adoption of more restrictive credit policies in the United Kingdom and Sweden, Norway's main sources of ships, such credits may prove more difficult to obtain in 1955.

Early in April, Norway received a loan of $25 million from the International Bank for Reconstruction and Development, a sum identical with that of the 1954 loan. At the same time, the Norwegian Government successfully floated a $15 million bond issue in the New York market.

Sweden, Norway's traditional source of loan capital, has again been approached for permission to float a loan in the Swedish capital market. In both 1953 and 1954, Norway raised kr. 68 million in loans on the Swedish market. Whether the Norwegian Government will be successful again this year will depend on conditions in the now tightened Swedish capital market. Even should a direct floation in Sweden prove impossible, however, some foreign exchange will probably accrue during the coming year from Swedish investment in Norwegian power and transport facilities.

Conclusion

There are several striking aspects to the recent change in Norwegian financial policy. The first is that the policy shift was accomplished in the face of unfavorable political conditions. Apparently, a major reshuffling of the Cabinet was required before the new policies could be fully adopted, and this change in Cabinet occurred in the midst of introducing the new program. Furthermore, the illness of the new Finance Minister delayed for several weeks parliamentary debate on financial policy. Despite these hindrances, the new measures were introduced and implemented.

The second noteworthy aspect concerns the personalities involved in affecting the change in policy. The chief architect of the new policy seems to have been Erik Brofoss, now Governor of the Bank of Norway. Yet as a member of the Cabinet, Governor Brofoss had been mainly responsible for the previous policy which inter alia adamantly opposed higher interest rates. Upon succeeding to the governorship of the Bank of Norway, he seems to have revised much of his thinking on the usefulness of traditional monetary policies.

Finally, the Norwegian authorities, having adopted more orthodox monetary and financial measures, seem to have achieved a flexible attitude toward their utilization. Mention has already been made of the several occasions on which the Finance Minister warned that reserve ratios would be altered if necessary. A clearer illustration is offered in a recent speech of the Governor of the Bank of Norway. In that speech, Governor Brofoss stated his extreme uncertainty as to the ability of the present restrictive measures to restore greater financial stability in the Norwegian economy, and stressed the need for a further reduction in the rate of investment and for greater encouragement of domestic saving. To accomplish this, he envisaged a central role for the Bank of Norway, one which it has hitherto not played in postwar Norway. And in order for the central bank to become the key financial institution in the country, certain reforms were suggested: the present reserve requirements should be made more comprehensive; an effective money market for Treasury bills should be established; and Government bond issues should be better tailored to the investment needs of financial institutions. These reforms would permit a comprehensive and more flexible financial policy which could make an important contribution to stable economic development in Norway.

> The adjustments which must be undertaken are strictly necessary and cannot be deferred. But the policies now being planned will continue to be a program for a growing Norway.1/

1/ Excerpt from the Governor's annual address to the Supervisory Council of the Bank of Norway on February 21, 1955 reprinted in a supplement to Økonomisk Revy, February 1955.