

Structural change and economic policy: the Norwegian model under pressure

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Abstract

During the 1950s and 1960s, a coherent system of economic policies was implemented in Norway. The article analyses the origins and functioning of this Norwegian model and shows how it broke down under the influence of both external and internal pressures from the mid-1970s onwards. By the early 1990s no new coherent system could be found, while financial deregulation had created huge problems in the banking system and unemployment persisted.

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1. Introduction

Most analyses of macro-economic policies focus on general factors that are assumed to be important in all developed, capitalist economies. This paper demonstrates another approach; combining structural and institutional factors, it searches for peculiar patterns of national economic policies routines which tend to become stable models in certain historical periods. We relate the process of macroeconomic policy formation to the industrial structure of the country, the geographical location of its population and industry, as well as to the class structure, the party system and the system of public administration. The concept of the "Norwegian model" (Cappelen, Fagerberg, Mjøset 1984; Mjøset, ed. 1986; Mjøset 1987; Fagerberg, Cappelen, Mjøset, Skarstein 1990) designates the set of economic policy routines which developed in response to these structural factors in Norway after the second world war. The model crystallized in the early post-war period under Labour administrations. It enjoyed quite widespread public support until the early 1970's, being implemented by non-socialist governments (1965-71) as well. But in the seventies and eighties the model came under increasing pressure, and many of its basic elements were modified and changed. We explain this with reference to the interaction between changing external conditions, problems in the model brought forth by increasing internationalization, and changes in the Norwegian industrial and class structures.

2. The Norwegian model

In the nineteenth century, the Norwegian economy consisted of a few modernizing islands within an ocean of traditionalist agriculture and fisheries. The institutional framework, however, was less backward: a relatively large share of the population had the right to vote, there was no aristocracy, and the quite autonomous state apparatus was imbued with an ideology of modernization. The major industries were forestry, mining, fisheries, and shipping. The capitalist bourgeoisie linked to these sectors had strong ties to both bureaucrats and petty bourgeoisie, and like the latter, much of their activity took place scattered around in rural regions or in small coastal towns.

In the early 19th century this liberal constellation was shattered. Norwegian water-power became an attractive resource in modern energy-intensive production processes (fertilizers, aluminium, steel, chemicals, pulp and paper). This influenced the location of Norwegian heavy industry, with plants close to the great waterfalls. The political and economic elites which had dominated the liberal phase were to a large extent unable to exploit the new options (Sejersted 1991). The new ventures therefore became heavily dependent on foreign capital. It was in fact the petty bourgeoisie forces which succeeded in passing laws to secure some control for Norwegian

authorities over natural resources such as forests and waterfalls (Lange 1977). Still, linkages between the heavy industries and the rest of the economy were weak: output was exported and inputs - apart from energy and labour - imported. These industries formed an "enclave" within the Norwegian economy. In addition; Norwegian shipping adjusted and became as important in the 20th century as it had been in the 19th century. This sector shares some of the same features as the enclave.

Like other European countries, Norway experienced economic and political instabilities during the interwar period. The Norwegian economy was strongly affected by the international economic recession. Domestic factors added to the international pressure: In the 1920s, a very restrictive monetary policy aimed to restore the pre first world war gold value of the Norwegian currency, the banking system was weak and crisis-ridden, and the savings rate was very low by comparative standards (Bjerke 1966). By the early 1930s, it was plain that the main victims of the crisis were the workers, facing a downward pressure on wages and high levels of unemployment, and the farmers, experiencing falling prices and increasing real debts. These classes became the pillars of a new political constellation evolving in the mid-1930s: a political alliance between the labour movement and rural groups (farmers and fishermen), paved the way for a Labour government, with parliamentary support from the Agrarian party, in 1935. Through legislation and political control, Labour aimed at creating a welfare state based on equal citizens' rights for all. Subsidies served to bolster the support of small farmers and agricultural labourers for Labour's policies. Simultaneously, a class compromise between labour and capital (administered by their respective federations) was consolidated at the industrial level: the 'Main Agreement' of 1935 established a general framework for collective bargaining. The Norwegian trade union federation (LO) experienced a strong increase in membership (union density increasing from 18 to 34 percent between 1930 and 1936). The links between the Labour party and LO grew increasingly close. The Labour party, relating both to the labour/capital compromise and the worker/farmer-alliance, stayed in office for nearly thirty years. The only interruption was a national coalition government which held office about five months in 1945 after the end of the war.

After the second world war, Labour's industrial policy gave priority to the growth of the established export sectors, the enclave. There were several reasons for this choice. The industries of the enclave, based as they were on cheap energy, were considered very competitive internationally, even in periods of recession. Most decision makers feared that recessions of the interwar type would reappear. The enclave was therefore preferred as a relatively stable earner of hard currency. Parts of these export incomes could be used to finance necessary imports to other sectors of the economy. The state played a key role in the expansion of the enclave, partly due to the nationalization of German property after the war, and partly because of the traditional unwillingness of the private sector to finance the large capital requirements of the enclave. Due to expected labour scarcity, the high capital intensity of these industries was not seen as a problem. In contrast, the large agricultural sector, with its low productivity, was considered a major

structural problem. Labour market and regional policies were designed to promote structural change, that is to reduce the share of the population working in agriculture.

Incomes policies were largely directed by the state during the early years of reconstruction. From 1953, settlements were made sector-wise, with the exception of 1958. The state largely withdrew, but continued to influence wages and prices through active use of subsidies and duties. In the 1963-74-period, settlements were made at the central level. A number of corporatist institutions were established: In 1962, a 'Contact committee', chaired by the Prime Minister, was set up between the government and the main labour market partners. In 1965 a non-socialist government set up a 'Technical Calculations Committee' to consider the effects on incomes settlements in an era of growing international inflation. The so-called 'Scandinavian model of inflation' (Aukrust 1977), mainly formalizing the post-war labour/capital-compromise, concluded that 'responsible' wage growth was determined by the growth of world market prices and productivity growth in the exposed sector of the economy. The exposed sector would be the wage-leader. This secured steady growth in per capita consumption along with growth of productivity. The composition of consumption was in line with the 'Fordist' pattern which was then spreading from the United States to Western Europe (Boyer 1986, Maddison 1986). A sector of small factories producing durable consumer goods had developed already in the late 1930s (Hanisch/Lange 1979). This sector diversified and expanded further under the influence of American technologies and production methods in the early post-war period, and was even quite successful as a producer of typically 'Fordist' consumer goods during the 1960s when trade was significantly liberalized.

The twin goals of structural change and an institutionalized welfare state (Esping-Andersen & Korpi 1987) were underpinned by a system of fiscal and monetary policies that might be termed 'credit socialism'. According to the ideal type of a credit-based, government-directed system (Zysman 1983), the private financial sector played a subordinate role, since both the volume of credit and the rate of interest were determined by the state. The rate of interest was deliberately kept very low, which implied that credit had to be rationed. Among the few tasks left for private financial institutions were partly to administer this rationing (mainly investments in the corporate sector). Unlike in most other western countries, state banks played an important role. Credits for the expansion of the local public sector, education, housing, agriculture, fisheries, rural areas and so forth were granted by state banks, to a large extent financed by public sector budget surpluses. The state also issued bonds, and purchase of such bonds was compulsory for private financial institutions. Even before the war, there were state banks for farmers and fishermen, and in the postwar period, state banks for housing (1947), agriculture (1948), education (1947) and regional industrial development (1960) were organized. Besides these formal institutions, there were also several large scale regional support schemes, starting with the 'Northern Norway plan' of 1952. Thus, the most important instrument in regulating the ups and downs of the economy was credit policy, not fiscal policy. For example, the state would finance inventories in

the export enclave when prices slumped, or the housing bank would stimulate construction if demand slackened.

Table 1. Population and employment 1930-1990.

	1930	1950	1960	1970	1980 ¹	1990
Population in sparsely populated areas (Total population=100)	52,7	47,8	42,8	34,1	30,0	- ²
Employed persons, 15 years and over (Total population, 15 years and over=100)	57,8	56,0	52,8	50,9	61,0	62,1
Employed persons above 15 years according to sector						
Agriculture, forestry, fishing and hunting	35,8	25,9	19,5	11,6	8,0	6,2
Manufacturing, mining, quarrying	19,7	26,4	26,1	27,3	20,7	17,0
Water transport	4,5	4,8	6,1	4,5	2,4	1,9
Construction	6,2	9,3	9,5	8,8	7,7	7,1
Wholesale and retail trade	9,9	9,5	11,6	13,6	17,6	18,7
Public and private services	6,2	9,8	13,1	20,4	28,0	34,4
Personal services	12,3	6,4	5,3	3,9	2,4	1,8
Other ³	5,4	7,9	8,8	9,9	13,2	12,9
	100,0	100,0	100,0	100,0	100,0	100,0

Notes:

1 Data for 1980 and 1990 are not fully comparable to earlier years. The 1980 and 1990 censuses included more part time workers in the category "employed" than the earlier censuses. This also makes labour force participation higher. If we compare 1970 census data with data from the 1980 or 1990 census, omitting all employed persons who worked less than 1000 hours, the shift from industry to the service sector between 1970 and 1980 (1990) is somewhat reduced, but the trend remains the same.

2 Not available by December 1991.

3 Electricity, gas, water, sanitary services, transport and communications other than water transport, financial institutions and real estate.

Source: 1930-1960: Historical Statistics, NOS [Norwegian Official Statistics] XII 291, Oslo 1978; Table 3, Table 6; Population and Housing Census 1980, Vol. II, NOS B 299; Population and Housing Census 1990, NOS B 961 (preliminary aggregate numbers).

The Norwegian model for economic policy, as described above, was deliberately set up to accommodate and bolster public support for structural changes in the economy. In that respect the policies were quite successful. From the late forties to the early seventies, the Norwegian economy underwent major structural changes. The share of population living in sparsely populated areas declined by one third between 1950 and 1970 (Table 1). Employment in the primary sector as a share of total employment was more than halved during the same period. The expanding sector was services, especially the public sector, which doubled its share of total employment, while the share of manufacturing remained more or less constant. This implied important changes both in the class structure of society and the electorate, with "white collar" groups growing at the expense of traditional "blue collar" groups. The economy also became gradually more exposed to international competition, especially since the launching of EFTA in 1960 and GATT's Dillon- and Kennedy-rounds (1961 and 1967). Some industrial sectors which had earlier been more or less sheltered, now had to face more aggressive competition from abroad, and the shares of domestic demand served by imports increased in most industries. The shares of production devoted to exports also increased.

3. The Slump of the Seventies

In the early 1970s a heated and sharply divisive debate broke out on whether to follow Norway's major trading partner, Britain, into the European Community. The pro-EC bloc brought together the two main elements of the post-war labour/capital-compromise: the Conservative Party as representative of business elites and Labour as representative of the working class, whose 'hegemonic' groups worked in the exposed sectors. However, the farmers and most parts of the rural population were against, as were large parts of the urban intelligentsia and some parts of the labour movement. Still, it came as a surprise to many when Norway - as a result of the negative outcome of a referendum in September 1972 - became the first European state to reject EC- membership. The Labour government resigned, giving way to a minority government of the centre parties (the Agrarian, Christian and Liberal parties). In the general election one year later Labour lost nearly one out five seats in parliament, but this loss was more than outweighed by the gains made by the newly formed left socialist front, later to become a party. With a socialist majority in parliament, the centre government resigned, and Labour once again took office.

Table 2. Economic indicators. Norway and the OECD area.

		1970-73	1974-77	1978-81	1982-86	1987-90
Unemployment	Norway	1,5	1,7	1,9	2,4	3,9
	OECD-Eur	2,8	4,2	6,2	7,8	8,9
Inflation ¹	Norway	6,8	9,6	9,2	6,3	5,4
	OECD-	7,2	12,2	11,4	6,4	4,7
Current account surplus/GNP	Norway	-1,6	-9,8	-0,4	3,1	-1,4
	OECD-Eur	0,4	-0,7	-0,4	0,2	0,3
Gross savings/GNP	Norway	27,9	26,2	27,9	28,7	24,5
	OECD-Eur	25,4	22,9	22,0	20,5	21,6 ²
Exports of oil and gas as a percentage of GDP						
	Norway	-	2,6	11,2	15,1	10,8

Notes:

1 Private consumption deflator

2 1987-89.

Sources: OECD, Economic Outlook, various issues.

Over the next four years a number of factors motivated Labour to conduct expansionary economic policies: not only did it wish to regain lost votes (Dahl 1989:31-34), the recession anyway called for counter-cyclical policies and Norwegian oil exploration gave rise to an investment boom and expectations of large increases in export revenues. Between the early seventies and early eighties the share of export of oil and gas in GDP increased from virtually nothing to 15 per cent (Table 2), much helped by the oil price hikes of OPEC I and II.

One important element in this expansionary policy was a generous incomes policy that allowed the real disposable income of households/employees to grow at a record average of five per cent a year between 1974 and 1977. This was secured through centralized ('combined') incomes policy settlements with governmental participation (combined with price and profit controls and generous tax policies). Farmers' income levels also shot up, doubling in the 1974-77-period, as a result of a broadly supported parliamentary decision to equalize earnings in manufacturing and farming. Reforms in social policy (shorter working hours and retirement age) also benefited households. Partly as a result of these reforms the public sector - particularly local government - expanded strongly throughout these years. At the same time monetary

policies, including adherence to the European exchange-rate cooperation (the so-called 'snake'), resulted in a revaluation of the Norwegian currency. Inflation was lowered, and below the OECD-average, but imports became cheaper and exports more costly, thus worsening the cost-competitiveness of Norwegian manufacturers. There were also defensive, 'back-door' measures to shore up export sectors such as shipping, shipyards and fisheries that were affected by the slump. The combined effect was a veritable boom in consumption and the largest current account deficit in the whole OECD area (Table 2). By the end of 1978, total foreign debt reached a record 47 per cent of GDP.

In the 1977 general elections the expansionist policy paid off. Labour regained most of what had been lost in 1973, mainly at the expense of the left socialists. With a socialist majority in parliament, Labour continued in office. The other great winner in the election was the Conservative party: the 'blue wave' was approaching. The stagnation in manufacturing (Table 1) now began to alarm industry leaders and observers. Indeed, the view that the 1974-75 downturn had not been the usual mild recession, but rather the start of a long-term structural crisis, gained support. The counter-cyclical policy, it was argued, harmed rather than benefitted industry in the long run since it prevented necessary structural changes.

Partly as a response to this growing criticism the Labour government announced steps to tighten economic policy. The first adjustments were made in the credit market. By December 1977 higher interest rates and various restrictions on private bank lending were introduced. One of the consequences of these restrictions was a dramatic increase the share of the state banks in total credits (from 36 per cent in the first half of the 1970s to 56 per cent in 1978). There was also a change of exchange rate policy. Norway left the 'snake' and turned to devaluations. Both in 1977 and 1978 the government devalued the Norwegian krone by about 8 percent each year (OECD 1978, 1980). Combined with a wage freeze between September 1978 and January 1980, this resulted in a decline in the real incomes of workers which lasted until 1981. Fiscal policies were also tightened somewhat. However, since these policies were carried out in a situation of increasing demand internationally, a sharp increase in unemployment was avoided. The second oil price shock in 1979 relieved Norway of current account problems.

In housing policy Labour faced problems which turned out to have important political repercussions. State controls and financing had kept the price of cooperative flats (allocated according to fixed rules of seniority, length of time in the queue, etc.) far below the market price. Compared with owners of private houses and flats, members found themselves unable to reap the wealth effects of inflation and increases in the real price of houses. A number of ingenious techniques were developed to evade the regulations. This undermined Labour's policy goal of a regulated, low-price market for urban housing and the government attempted to ban the various irregular transactions. The Conservative Party was able to capitalize on the pressure for abolition of price controls, and this was probably one of the factors behind Labour's reduced support in the 1981 local elections.

In sum, throughout the mid-1970s, the Labour governments implemented the strongest dose of Keynesian counter-cyclical policies yet to be seen in Norwegian post-war history. But the actions taken were not all in line with the Norwegian model. For instance, according to the model, wage growth should not exceed the sum of productivity growth in the exposed sector and growth of world market prices, with the aim of keeping the cost competitiveness of traditional export industries roughly constant (Aukrust 1977). Fiscal policy should be tight, while credit policy should be used to increase economic activity in case of an international recession. To some extent, the Labour government did just the opposite: wages were allowed to grow at a much faster rate than the rule and fiscal policies were very expansionary. But according to the rule, the government continued to keep the rate of interest at a low level, so credit policy was also expansionary. Inflation, however, was now at a much higher level than earlier. As a consequence, the real rate of interest turned negative, especially after tax. Together with rapidly growing incomes, caused by the very expansionary fiscal and incomes policies, this created a consumption boom and a large current account deficit. Booming demand for credit overburdened the old system of credit rationing and spurred the growth of grey credit markets.

The Labour government responded with a fumbling revision of its economic policy. To save the system of credit allocation, it would have been necessary to adjust the real rate of interest upwards through changes in its nominal level and a reform of the tax structure. The rate of interest was increased, but Labour found it politically impossible to increase it significantly. As for the tax system, a plan to reform it was launched as late as in the 1980 National budget. This plan was discussed in parliament, but the government was at that time in a very weak position, and it did not propose the more controversial parts (less generous rules for tax deductibility of interest payments) of the plan, parts which were strongly opposed by the Conservatives. Only the less controversial aspects of the tax reform had survived in the 1981 budget.

While more constructive reforms of economic policies were barred, the measures taken pointed towards increasing direct regulations, particularly in the credit market. The growing impact of the state banks was not really a conscious policy. In fact, many leading social democrats were discouraged and started to support proposals for deregulation of the credit system. The wage freeze and new restrictions on independent housing cooperatives also implied more direct intervention. Some of these regulations were attacked both by business interests and by non-socialist politicians. These years, 1977-78, were the take-off phase of the blue wave (Mjøset 1989: Fig. 8).

Another important condition of the Norwegian model was weakened in this period: the trade union federation (LO) was for the first time in the post-war period challenged by competing federations. In 1976 a central association of academics (AF) was founded, and in 1977 a central organization of craft organizations (YS) more directly began to compete with the LO for members. The membership of these federations grew, while the relative decline of LO's membership continued. By 1986, the distribution of organized wage earners was 62 percent in LO, 12 in YS, and 11 in AF (Fennefoss 1988).

4. The Right in Power

The 1981 election gave the three non-socialist parties a majority - this time with the Conservatives as the dominant force. However, the Christian Party split with the Conservatives over the abortion issue and, although they agreed to provide parliamentary backing for a non-socialist government, neither they nor the Agrarians would accept office. The result was a minority government of the Conservatives.

The approach of the new government rested on the well-known neo-liberal logic, with a strong emphasis on traditional supply factors. In order to curb inflation, improve competitiveness and to spur economic growth, it was deemed necessary to reduce growth in public spending, cut taxes for high-income households and the business sector, and deregulate markets, especially in the strongly regulated areas of credit and housing. As the government took office, Norwegian production and exports of oil and gas were in the midst of a strong upswing, with increasing tax revenues and current account surpluses. This came to have a strong impact on how this neo-liberal program was implemented.

In every budget from 1982 onwards, the government took steps to restrain the growth of the public sector and to reduce taxes for higher incomes and for firms. Most important, perhaps, was the restrictive attitude towards local government: between 1981 and 1983 local government investments declined by three per cent per annum in real terms. Taxes, in particular for higher income households and private business, were reduced, partly financed by increased tax revenues from the oil sector. The increase in oil income was also used to increase the liquidity in the private banking system, which the Conservative government wanted to strengthen at the expense of the state banks. While private bank lending soared, the share of state banks in total credit declined dramatically. Furthermore, while the stock market in a credit-based, government-influenced financial system played only a minor role, the government now took steps to make it more vigorous. Under new tax rules, the volume of transactions at the Oslo Stock Exchange quadrupled between 1981 and 1983, and the average share price climbed 70 per cent. Deregulation of major segments of the housing market soon brought down the number of flats under price control, and made home-ownership changes a very profitable activity. Since the rules of tax deductibility of interest payments had not been changed, private lending for such purposes soared.

As a result of OPEC II the world economy faced a new recession. In 1981-82, average GDP growth in OECD Europe did not exceed one per cent on an annual basis. Despite the fact that Norway was earning higher oil incomes during an international downturn, austerity was continued. Firms began to face problems of surplus capacity, and workers were laid off. At the same time, growth in public-sector employment slowed down. As a consequence, the rate of unemployment doubled from 1.7 per cent in 1979 to a post-war record of 3.3 per cent in 1983.

In the spring of 1983, the middle parties decided that the crisis had become so grave that they had to take action and a new coalition government was formed in June 1983. The new administration began to concern itself more with the welfare state and the fate of rural areas, but the turn came too late to prevent a serious setback for the coalition parties in the 1983 local elections.

Many basic elements of the Conservative policy continued after the 1983 elections. Tax cuts for companies and high income groups, as well as fiscal incentives to stock market trading, were maintained in the 1984-86 budgets. Oil revenues were a crucial condition for these tax cuts. But the restrictive attitude towards local government expenditure, especially investments, was eased. Between 1983 and 1986, public real investment grew at an annual rate close to five per cent, having declined between 1981 and 1983. At the same time, a boom in the world economy had positive consequences for Norwegian exports and industrial production. With the rise in foreign and domestic demand, unemployment gradually declined to pre-1982 levels, reaching 2.0 per cent of the labour force in 1986.

The new government continued the previous efforts to deregulate the credit market by lifting direct regulations on bank and insurance company lending in early 1984. Later in the year, foreign exchange controls were eased. It became much easier for foreign citizens to buy shares in Norwegian firms. By early 1985 seven foreign banks had been authorized to operate in Norway. In September 1985, government control of interest rates was abolished. In incomes policy, the government relied more on the market mechanism, with the result that wage drift accounted for a larger share of total wage increases than before.

The combination of internal and external stimuli to the economy, under a government whose deregulation policies were designed to break the main pillars of the Norwegian model, produced a range of effects without parallel since the war. The household savings rate turned negative in both 1985 and 1986, as private consumption picked up during 1984 and rocketed by 16 per cent between 1984 and 1986. Much of this was due to the liberalization and very rapid growth of credit. The stock market also boomed as much of the credit expansion went into speculation. Thus the volume of stock transactions rose to 32 bn kroner in 1985 from a mere 2 bn in 1981. Between mid-1983 and mid-1986, the average share price increased by 60 per cent. The value of transactions in bonds and bank certificates climbed from 5.8 bn kroner in 1983 to 103.3 bn kroner in 1986.

The 1985 parliamentary election took place in the middle of the boom. Although support for the three governing parties was somewhat down compared with 1981, it held up much better than in the local elections two years earlier. The decline was sharpest in peripheral areas (especially the north, which was not so much affected by the boom) and least marked in the central areas of the country. The centre-right coalition continued in office, but as the hostage of the small populist right-liberal Progress Party.

Although the government consistently refused any cooperation with OPEC, it made Norwegian policies dependent upon OPEC's ability to keep oil prices high by restraining the output of member countries. And indeed, total OPEC production of oil was nearly halved between 1979 and 1985, whereas the production of non-OPEC Western countries, including Norway, increased. Until the middle of 1984 Norway followed Britain's pricing of North Sea oil. In October, however, about half a year before the Statfjord C platform was due come on stream, problems of overproduction caused Statoil to announce a cut in its reference price. This was one of the factors behind the price war on the international oil market, culminating in the dramatic falls of late 1985 and early 1986 (Skarstein 1986).

By early 1986 it had become fairly evident to observers that the government had lost control over the economy. Declining oil prices in the winter of 1985-86 strongly suggested that the current account would turn from a comfortable surplus in 1985 to a large deficit in 1986. In its annual report on Norway, the OECD severely criticized the expansionary fiscal policy, the loss of control over credit policies, and the failure to reduce transfers or the tax-deductibility of interest payments. Given the diversity of interest groups behind the three coalition parties, the government could not bring itself to propose major changes in any of these areas. In April 1986, the Conservative Party supported a lock-out in the iron/metal sector (including shipyards and off-shore deliveries). The lockout failed and NAF (the employers) had to accept both wage increases and a reduction of the normal working week. This outcome was a setback for the government, not least because it reduced international confidence. In April 1986, amid wild speculation against the Norwegian krone, the government lost a parliamentary vote over a minor tax issue and - gladly it would seem - withdrew from office. It was replaced by a minority Labour government in May.

Did the Conservative government succeed in its aims, that is: changing the basic elements of the Norwegian model in order to reduce inflation, increase growth and competitiveness? It clearly succeeded in strengthening the private banks and in giving new life to the stock market and the financial community in general. There could be no better illustration of this than the employment statistics. Between 1983 and 1986, in spite of the boom, employment hardly grew at all in the manufacturing sector, while in the financial sector and other business services - which traditionally accounted for a small share of total jobs - employment increased by more than forty per cent. Furthermore, although precise figures are hard to come by, the invigoration of the stock market had led to a number of mergers both within and between the financial and industrial sectors. New shares, however, far from dominating stock exchange transactions, actually make up a quite modest proportion of total investment in the industrial sector. Thus, while the volume of transactions in nominal terms rose fifteen fold between 1981 and 1986, the nominal value of new shares did no more than double. On average, new shares did not account for more than one eighth of investment in the manufacturing sector. Thus, the major achievement of these years, then, was the rise of a speculation economy in which it became far more profitable to engage in asset-stripping, or in home- ownership changes, than to create

new real assets in the industrial sector. There was no improvement of cost competitiveness in spite of several devaluations and only slow growth in manufacturing output. The share of manufacturing in total employment continued to decline (Table 1). Full employment was attained in 1986, but with a large deficit on the current account.

5. The recession of the late 1980s and early 1990s

The new Labour government lived through a difficult first year. But in June 1987, the three major non-socialist parties finally gave up their half-hearted attempts to bring it down. However, following the general election in September 1989, a new three-party non-socialist government was formed. But the conflicts between the Conservatives and the Agrarians over the question of the Norwegian relationship to the EC, an issue that had become more pressing after the negotiations between the EC and EFTA on new institutional arrangements with supra-national elements (The European Economic Space - EES) had started, destroyed that government from within. In November 1990 the government resigned, giving way to a new minority Labour government. Thus, for the five year period 1986-1990 as a whole, the Labour Party was in office in four out of five years, although always in a minority and even with declining popular support (both the 1989 and the 1991 election).

In spite of the turbulent political atmosphere, the Labour government that came to power in May 1986, managed to get parliamentary support for a rather dramatic change in economic policy in the direction of austerity. Reacting to several small devaluations in the preceding years, and to the grave state of the Norwegian economy as oil prices slumped in 1986, international investors required a high premium above dominant international interest rates to place their funds in Norway. Thus, the Norwegian interest rate differential escalated. Following the devaluation (12 per cent) of May 1986, the government signalled that it was now committed to a fixed exchange rate. Following this hard currency decision, the government proceeded to complete the external deregulation of the Norwegian credit market, that is: allowing free capital movements.

The devaluation was the first element of the austerity cure. The second element was tighter fiscal policies: growth in public consumption declined from 3.7 per cent in 1987 to 1.1 per cent in 1988. The third was the 1988 reform of personal income taxes based on a compromise with the Christian party. This reform reduced the advantage of credit-financed consumption and investments for high and medium income groups. Fourth, the government also managed to persuade the LO to accept a very moderate income settlement in April 1988, which was generalized by law to include all other areas, effectively barring any possibility for the non-LO organizations to reach better terms. Fifth, a strict monetary policy prevented the nominal rate of interest to decline along with inflation. As a consequence, both the real rate of interest and the difference in real interest rates between Norway and other countries increased markedly.

It took some time for these changes in policy to work through the economic system. But during 1988, the recession began to bite. The number of employed declined by 0.8 per cent. The unemployment rate increased by more than 1 per cent, to 3.2 per cent. The inflation rate declined from 8.7 per cent in 1987 to 6.7 per cent in 1988.

While the Norwegian economy turned into recession, international demand was growing, with favourable effects for traditional Norwegian exports. Oil prices also picked up. The external balance improved, from a large current account deficit in 1986 and 1987 to roughly balance in 1989 and large surpluses in 1990-91. As a consequence of growing unemployment and improvements in the external balance, the government began to adjust policy in a more expansionary direction. However, the central bank still adhered to a strict monetary policy, and the real rate of interest remained at a high level. During 1988 and 1989, both private consumption and investment fell markedly, and so did the rate of inflation. At the same time unemployment jumped to a post-World War II record level of nearly five per cent in 1989.

In the spring of 1990, LO and NAF agreed on a 4-5 per cent increase in wages (a first settlement close to this was turned down by the LO members in a referendum). This implied growth in real wages, and private consumption picked up somewhat. Exports continued to grow at a high rate. However, private investments continued to decline also in 1990. At the time of writing (December 1991), unemployment continues to increase, although slowly, in spite of a more expansionary policy. If people engaged in labour market programmes are included, the rate of unemployment is now around 8 per cent.

The change in the economic policy stance from 1986 onwards could be described as a shock therapy. The therapy was more effective than anyone had dreamed of, and had many unforeseen consequences. In particular, declining real incomes, an increasing real rate of interest, and simultaneous changes in the tax system (reducing the value of the deductibility of interest payments from taxable income) forced many households to use a much larger proportion of real income to service debts than what they had earlier foreseen. Most households decided to decrease their level of indebtedness, or at least not increase it. This had two consequences. First, expansionary fiscal and income policies were now relatively inefficient as means to increase total demand and the level of economic activity, since households would use the additional income mainly for savings in order to reduce debts. Second, and as a consequence, households were generally unwilling to make new investments in housing. Demand for housing declined, and so did prices, with a drop in prices of around one third in a few years. This reduced the wealth of households, leaving them even more exposed than before, strengthening the tendency towards recession. As the recession widened, many firms ran into difficulties, a fact which, among other things, led to reduced demand and prices of business property. This led to collapse for many property investors. In the end, the losses were carried over to the banks. During 1988, the first banks realized that they were trapped. Although they were rescued by a safety fund accumulated by the banks, the problems aggravated. By the autumn of 1991 it was obvious that the whole financial sector was on the verge of collapse,

and the government had to rescue the three largest commercial banks by means of large cash-injections. One of these banks is now formally owned by the state.

In addition to the faltering credit system, the main problems of the Norwegian economy are the high level of unemployment (by a post-war standard, at least) and the stagnating manufacturing production. The government has made some attempts to face these challenges by pushing for structural reforms in selected areas. The most important initiative has been a supply side oriented tax reform, broadening the tax base and reducing tax rates. While the need for a tax reform has been generally acknowledged, the introduction of a reform that makes credit-financed investments more costly at a time when the economy is in deep recession, has been criticized. Another recent initiative has been a new energy law which aims to achieve a more efficient allocation of resources. However, the law does not reduce the large difference in energy prices between the enclave and other domestic users of energy. Although a part of this difference may reflect differences in transmission costs, independent analysts agree that the difference in price is much larger than required. Thus, one of the oldest elements of the Norwegian model, the priority given to the enclave, still dominates Norwegian industrial policy. This is also reflected in the renegotiation of a series of long term contracts on energy supply to firms in the enclave, many of which were renegotiated well in advance of their date of expiration. One likely explanation is that this was done to avoid problems with changes in competition policy which were expected as a result of an EES-agreement. Recent debates on industrial subsidies via low electricity prices show that the kind of 'iron triangles' which have been found in research on local corporatism - in this case between local communities with large energy resources, MP's from that area, and the particular specialized ministry - is still a very strong factor in Norwegian politics. In particular, the Conservative party in late 1991 proved to be the most enthusiastic supporter of subsidized energy prices to the enclave. Following the recent round of negotiations in GATT, the government has also argued for reductions in the transfers to agriculture, and some (very) minor policy changes in that direction have been announced.

6. The Norwegian model - an assessment

Our notion of a model is an analytic concept: it refers to a coherent system of macroeconomic policies, based on international conditions and relating to domestic processes of structural change. We trace such a system in Norway in the 1950s and 1960s. Since the 1970s, the coherence of the old system has been lost, but no new coherent system has yet been established. Given our definition of an economic policy model, it was no surprise that the Golden Age model should change. In this article, we have shown how both changing external conditions and domestic structural changes put pressure on the model. The challenge for policy makers was to alter the system of economic policies, while maintaining the goals of social welfare and equality which

had been institutionalized during the first post-war decades. Various options were possible, and we have tried to show that the concrete outcomes depended on interplay between state bureaucracy and socio-economic interests, especially mediated through the party system.

A problem of industrial renewal can be traced back to structural changes which started even before the 1970s crisis. Social democratic policy makers first developed the idea of a specific Norwegian approach to macroeconomic regulation in the early post-war years, when there were still many trade barriers. While the enclave would earn most of the export income, more labour intensive manufacturing industry would secure employment for Norwegian workers. When this mode of integration was replaced by a more open free-trade system from the 1960s onwards, the Norwegian model worked in a way which put pressure on the sheltered manufacturing industries. The model was based on the assumption of an exposed sector (the enclave), with wage growth equal to productivity growth and growth in world market prices, as well as of a sheltered sector, in which wage growth was assumed to be the same as in the exposed sector (Aukrust 1977). However, during the 1960s and 1970s, the distinction between exposed and sheltered sectors became increasingly blurred. To the extent that the industries of the enclave continued as wage leaders, and given that the enclave could afford to pay higher wages, the remaining part of Norwegian manufacturing industry would be caught in a squeeze. This is probably what happened, not because the industries of the enclave were so immensely productive, but because they were subsidized with cheap energy and often with cheap loans as well. The crisis for manufacturing firms producing typical 'Fordist' consumer products did not become manifest before the slump in demand of 1974-5, but the way income distribution and resource allocation was handled in the Norwegian model probably contributes to the explanation.

These problems were in fact reinforced by the fact that Norway was blessed with the discovery of a new natural resource just at that time: North Sea oil. Although the oil sector created new options for manufacturing industry (especially shipyards) in the short run, in the longer term it shares many of the characteristics of the enclave: capital-intensive production of raw materials (or semi-finished products) for exports, dependence on imports of machinery and know how, and capital from the state and/or foreign sources. But compared to the earlier part of the energy-based sector, the resource rent in oil exploration was not just large, it was immensely large. How much of the oil revenues should be spent by government? Should workers in this sector get a share of the resource rent? If they got a share, what would the spill-over effect to other sectors be? This was a much debated issue at the time, but as we have shown, the Labour government in the mid-1970s chose the (extreme) option of allowing wage-growth in the economy as a whole to be dependent on expectations of future oil rents. We have argued that this cannot be explained simply as a counter-cyclical policy option in an international recession. It must be seen as a way to buy back support from Labour's electorate after the party's defeats in 1972-1973. As such it was effective, but it clearly tightened the squeeze on manufacturing industry outside the enclave. The share of manufacturing in total

employment declined from 27.3 percent in 1970 to 20.7 percent in 1980 and 17 percent in 1990 (Table 1).

Many would probably argue that much of this would have happened anyway, following the 'Dutch disease' argument (Cappelen & Gjelsvik 1991). In principle, however, it would have been possible to have an expansionary policy that relied less on wage growth and more on growth in public consumption. For instance, the effects of expansionary policies for the credit system could have been avoided if the government had used oil revenue to increase public welfare activities (for instance, free public transport, better medical services, better care for the elderly, more kindergartens, etc.). It is possible to imagine such an alternative, despite the fact that public spending already grew strongly in that period. Total consumption might not have grown very differently, but a different balance between private and public consumption could have relieved manufacturing industry from the cost-squeeze that followed from the chosen policy mix. This would have been consistent with a greater role for state banks and public investment funds which could have channelled resources towards long-term productive investments in manufacturing industry. Thus, what happened was - although easily understandable - probably not inevitable.

Furthermore, it may be argued that the specific Norwegian way of regulating the economy - through credit rationing and state banks - would have to be changed anyway as a result of the international trends towards deregulation and internationalization of banking. But as we have shown towards the end of section 3 above, it was other, mostly domestic factors - not international trends as such - that undermined the Norwegian system of 'credit socialism'. It is, however, impossible to judge whether other policy choices during the 1970s would have prevented the electoral setbacks for Labour, the blue wave and the spread of an anti-regulationist mood even among social democratic policy makers. As events unfolded, the Conservatives could relate to the problems which accumulated under social democratic rule during the late 1970s, thereby staging a more thorough attack on regulations in housing and credit markets. As shown in section 4, the non-socialist governments largely completed the internal deregulation of the credit system. The next step, however, the external deregulation surveyed in section 5, was largely accomplished during social democratic rule. Until 1990, the currency was pegged to a basket reflecting the composition of exports, and during the short-lasting non-socialist government 1989-90, the few remaining controls were dismantled and the NOK was pegged to the ECU, signalling a commitment to maintain a stable nominal exchange rate, which is what really matters to financial investors. There is no sign that the present social democratic government intends to alter this hard currency approach. Monetary policies are presently no longer an instrument in the hands of Norwegian policy makers. The interest rate is a dependent variable, serving only the defence of a stable nominal exchange rate.

In sum, a main element of the Norwegian model, the regulation of financial markets, has been completely dismantled. Other elements of the earlier Norwegian model were reintroduced by the social democrats in the late 1980s. Incomes policies are still important: the wage laws of 1988-9

tried to reach back to the main track of the Scandinavian inflation model. But there are other legitimization problems, both towards white collar groups (since YS and AF had to be forced into the agreement) and towards LO-members (since full employment is not restored). Furthermore, the late 1980s and early 1990s have seen strong Keynesian, countercyclical policies. But as we showed in section 6, the crisis of the financial system undermines the employment-creating effects of such fiscal policies. The welfare state is in no way dismantled, but the pressure on it is much greater since the Norwegian welfare state was connected to an economic policy model which promised full employment: it was not designed to finance mass unemployment.

The deregulation of the credit market during the 1980s - perhaps the clearest break with the earlier Norwegian model - did not, as argued at the time by Norway's leading economists, lead to higher efficiency, but to a more unstable economy and a misallocation of resources without precedent in modern Norwegian history. The full effects of this, as we saw in section 5, appeared when in the early 1990s it was obvious that the banking system would have collapsed had it not been for large cash injections from the state. If there is something to learn for Norwegian politicians from this sad story, it is that the credit market is not just like any other market, where 'the invisible hand' can be assumed to produce the best result for all: the market for credit is inherently unstable and has to be regulated. Indeed, this is one of the main lessons that the fathers of the Norwegian model learnt from their experiences with the crisis of the interwar period.

Together with Japan, Norway stands out with a particularly high rate of savings in GDP (Table 2). This reflects the priority given to the capital-intensive industries of the enclave. It is possible that such a priority was once a consistent part of a policy to create 'dynamic efficiency' in the sense that it led to an investment programme that secured high growth in national income through exploitation of Norwegian natural resources. But this was only so in a period where these resources, especially hydro-electric energy, were not tradeable. Today most of the traditional Norwegian export industries are relatively 'mature' in the sense that they are characterized by tense price competition and slow growing markets (Vernon 1966, Fagerberg 1986, 1987). Technologies which make exports of electricity possible have already been available for some time. From this perspective, it may be argued that what is needed in Norway for the years to come is a programme of renewed growth based on investment opportunities in other areas, probably more based on knowledge than on resource rents.

It is difficult, however, to see where such investment funds should come from, given not only the current state of the Norwegian banking sector, but also the inherent weakness of the private banking sector as a source for investments in areas characterized by high risk and uncertainty, as well as the subsidies still granted to the enclave. It is ironic that the attack on Norwegian credit socialism ended by the early 1990s with the state taking over or bailing out the largest banks. Many major decision makers still retain their neoliberal convictions, a fact which indicates that the state might behave as a quite passive owner. But on the other hand, at least social democrat decision makers must be quite disillusioned, recognizing that a deregulated credit system has not worked at all. In a situation in which capital controls are deregulated and the old

system of credit socialism cannot be recreated, the only way the state can influence the allocation of credits is via its own funds, via its influence in large firms and its ownership or control of banks. Social security funds have recently been used to buy shares. The three largest commercial banks are now controlled by the state. There is a growing attention to the close informal relations between leading government members and the top managers of large state-owned (e.g. Statoil, Hydro, UNI-Storebrand). This could be the start of an informal system of regulation in order to secure reliable shareowners, willing to take risk and stick firmly to serious business ventures. Whether such a scenario of 'Norway, Inc.' could really function as state activism in disguise remains to be seen. Such an informal system seems vulnerable to changes both in economic and political business cycles. However, if there shall be any chance at all for Norwegian politicians to develop a strategy to counter the trend towards stagnation in manufacturing production and employment, they will have to break with two major elements still remaining from the Norwegian model of the 1950s and 1960s: the priority given to the enclave and the large transfers to the primary sector.

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