Problems of Monetary Control in Norway

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Abstract: This paper discusses the framework and problems of monetary policy in Norway. In the recent past the particular instruments employed and the operational targets and monetary indicators observed by the authorities did not prevent undesired monetary developments. To reduce the gap between actual and desired developments, the author suggests that the policymakers use a monetary approach instead of the traditional credit approach. Theoretical and empirical arguments are put forward to enhance this proposition, including the derivation of a monetary base concept for Norway. The monetary instruments are critically examined and improvements are suggested which could increase the effectiveness of monetary policy.

1. Introduction

Monetary policy in Norway was not always as effective as intended by the monetary authorities, particularly not in the recent past when a restrictive policy was pursued. In general terms, this could have resulted from the use of inappropriate policy instruments; or from the attempt to steer an operational target variable which does not exhibit a stable relationship with the monetary indicator variable. In the case of Norway, this leads first of all to the examination of the causal chain: reserve requirements — bank liquidity — bank credit extension — private sector investment and prices, and to the comparison with alternative channels of monetary transmission.

This paper attempts to present an overview of the reasoning of “mainstream” monetary and credit policy in Norway and the problems involved in its conduct. It puts forward an alternative approach to the conduct of monetary policy compared with the one currently employed by the monetary authorities. Section II briefly describes the main features of Norwegian credit policy, outlines its main instruments and objectives, and evaluates its shortcomings. In Section III, a monetary approach is elaborated by defining a monetary base concept for Norway, and comparing theoretically and empirically the traditional credit concept with the monetary concept. In the final section, this leads to a few conclusions.

1) The main body of this paper was prepared while the author was a staff member of the International Monetary Fund. However, the views presented in this paper do not necessarily coincide with the official views of the Fund.


3) Some of the problems are briefly mentioned in various issues of Norges Bank’s Economic Bulletin, e.g.: 1973/1, p. 16; 1974/1, p. 11; 1974/4, p. 170; and 1975/1, p. 8.
2. The Conduct of Monetary and Credit Policy

2.1 Main Features of Norwegian Monetary and Credit Policy

The ultimate objective of overall economic policy in Norway has for most of the postwar period consisted of maintaining full employment and a reasonable rate of economic growth combined with an equilibrarian distribution of disposable income. Price stability and, even more so, external balance have been considered to be of secondary importance. While there may have occurred some shift in emphasis from the goal of full employment during the immediate postwar years to growth in the 1950s and to price stability thereafter, a deficit in the current account has usually not been regarded as a matter of great concern.

To achieve the ultimate objective the authorities have applied in the first place fiscal and incomes policies, while monetary policy has ordinarily accommodated these policies. Toward this end, the responsibility for the monetary effects of fiscal policy (through the way the budget balance was financed) has not rested with the central bank, but ultimately with the Government.

Monetary policy itself has traditionally been guided by the following main objectives (see Eide [1973] p. 30):

(i) to limit the supply of credit to the private nonbank sector and the municipalities so as to make total demand of goods and services correspond to the supply of real resources;

(ii) to allocate credit in accordance with the policy targets for the longer-term development of the economy;

(iii) to keep interest rates stable and at a low level mainly for social considerations and to avoid sharp investment fluctuations.

The link between the real and financial sectors of the economy as viewed by the monetary authorities may be termed a “modified Keynes-type channel” of monetary influence with credit, not money, as the predominant financial determinant of economic activity, or, more specifically, of private and municipal investment. However, interest rates are — since they are kept at low levels — usually not regarded as a constraint to investment. Cyclical control over the volume of credit is exercised by steering the availability rather than the cost of credit. The availability of bank credit to the private sector is either controlled directly (lending by state banks) or indirectly (lending by commercial and savings banks). In addition, bond issues are subject to authorization, and commercial and savings banks are obliged to hold a certain share of their assets in government bonds and government-guaranteed bonds. This secures that the financing needs of the Government are met in spite of long-term interest rates which are kept lower than market rates. A consequence of this specific combination of

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4) The huge increase in the current account deficit in 1975 and 1976 has revived discussion on the balance of payments. However, in view of the prospects of the surge in crude oil and natural gas exports, the current account deficit is considered temporary. Compare Handler [1976].

5) In a sense, the Norwegian view can be said to be “anti-Keynesian” since it resembles important elements of the “credit availability doctrine” which was developed, mainly by Roosa, shortly after the War as a reaction to the Keynesian view of the monetary process.