Executive summary

Norway has ridden out the financial crisis better than most OECD countries, with a shallower recession and unemployment likely to peak below 4%. Its advantageous fiscal position made room for a massive budgetary stimulus complementing steep cuts in interest rates and substantial liquidity measures. The key challenge is now to withdraw the extraordinary policy support sufficiently early to avoid overheating. Norway's bold embrace of green growth objectives deserves praise, and the search for more cost-effective ways to pursue these objectives must continue.

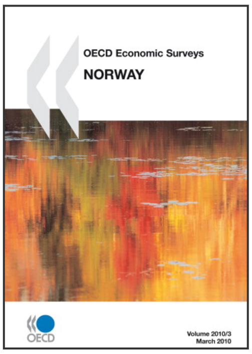
Fiscal policy *stimulus was supplied generously in 2009 and somewhat more is built into the 2010 budget. With the recovery well in train, the stimulus should be gradually withdrawn, especially as further fiscal expansion would risk entailing a tighter monetary stance and higher exchange rate, with adverse consequences for exposed industries. If the recovery unfolds as projected, some tightening should come soon. After that, it would be wise to bring the structural deficit back to 4% of the Government Pension Fund Global value by 2013, or even earlier. Rapid return to the 4% path would strengthen credibility of the fiscal guidelines and help meet aging costs. Completion of the pension reforms and sustained effort to reform the sickness and disability schemes are needed to improve labour supply and secure the public finances in future years.*

Monetary policy *also needs to return to normality. This has in fact already begun and the extraordinary liquidity measures have been phased out, as financial markets no longer need them in order to function. The appropriate pace of tightening will depend on the development of the Norwegian economy and associated inflationary pressures, the fiscal stance and, since Norway is small and very open, the pace of tightening in Europe. The inflation targeting framework is well adapted to the task, and the authorities should continue to pay attention to the developments of housing and commercial property prices when setting policy interest rates.*

In the financial sector, *a sound regulatory and supervision framework and memories of the Nordic banking crisis meant banks had little exposure to the worst of the toxic assets and risky loans. The three institutions with responsibility for financial stability work well together on macro-prudential issues. Financial regulation and supervision is being reformed at the European and worldwide levels and Norway is closely involved, including through its participation in the new EU supervisory architecture. Areas for strengthening regulation before international recommendations are finalised should be explored, for instance requiring Norwegian banks to meet higher capital ratios.*

Climate change policy *in Norway features laudably ambitious targets for emission reduction and the promotion of technologies and projects that may reduce the cost, for all countries, of mitigating greenhouse gas emissions. Meeting ambitious unilateral targets, with their valuable demonstration effect for the rest of the world, requires long-term political commitment. Policy would be most effective by adopting cost-minimising policies, notably by removing exemptions and special rates from the* CO_2 *tax and widening the coverage of emissions trading. Care must also be taken to ensure that Norwegian policies remain consistent with the evolving provisions of the European Economic Area agreement.*

Fisheries policy *contributed to the successful recovery of important northern fish stocks, but others, mainly fish stocks managed in co-operation with the EU, are overexploited. Norway will have to work closely with other countries, notably those in the EU, to set more cautious catch limits with effective monitoring and enforcement. Domestically, the governance of the industry is well designed from the point of conservation, but further rationalisation of the quota regime and ending exemptions from competition law could further enhance productivity without jeopardising sustainability.*



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