



FINANSDEPARTEMENTET

Petroleum's impact on the national economy

Dili, May 2010

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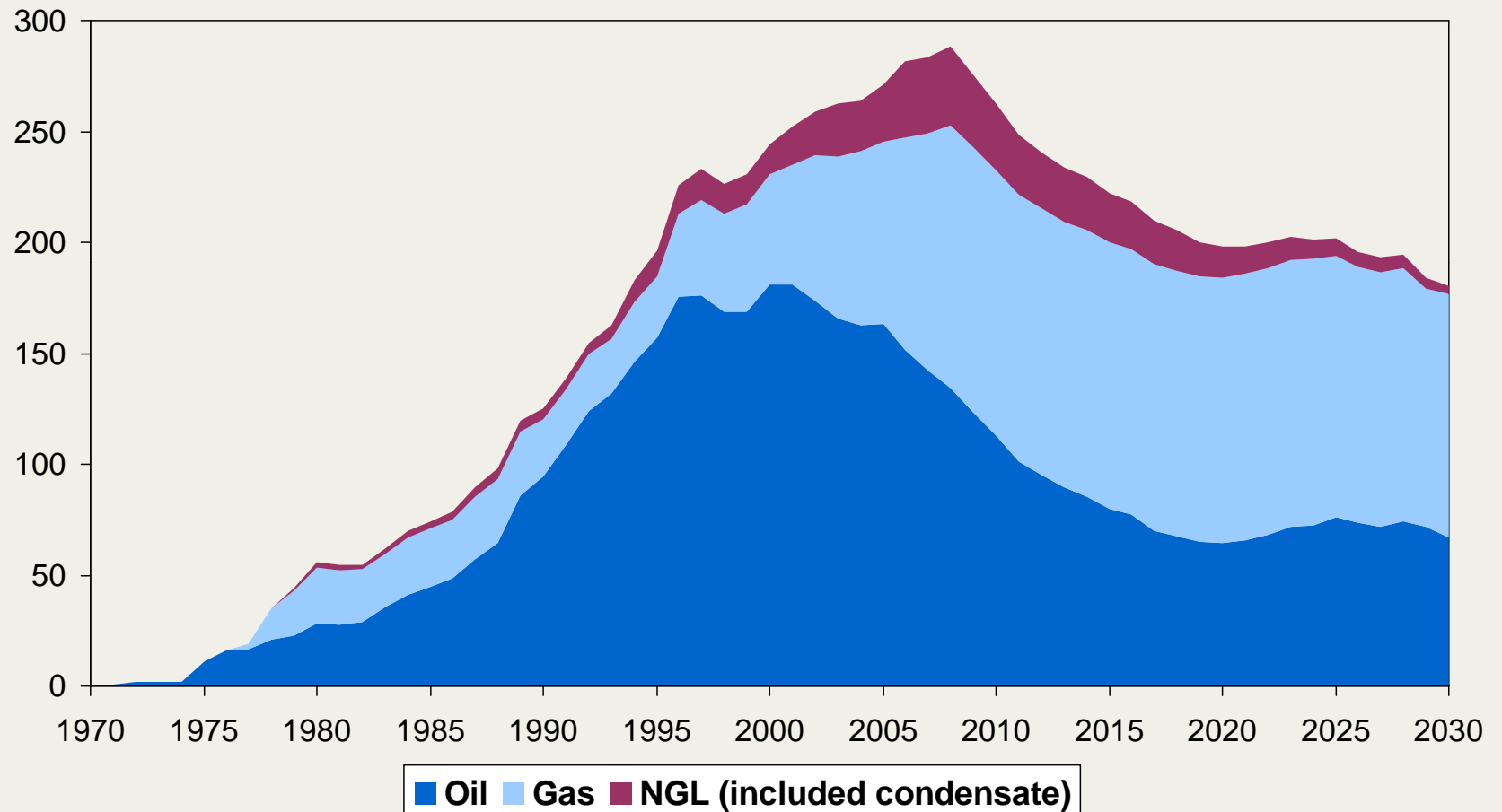
Asset Management Department

Overview

- Part 1
 - Key challenges in managing petroleum revenues
 - Important governance principles
- Part 2
 - A framework for fiscal policy and managing savings
 - Petroleum fund

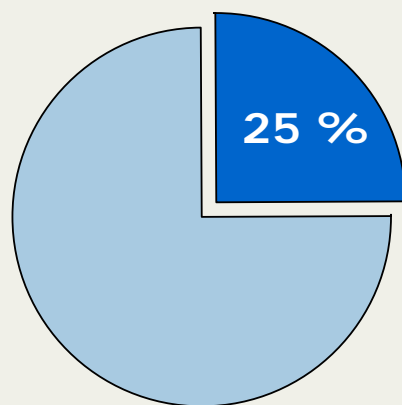
Crude oil production in Norway has peaked

-Total petroleum production in Norway, mill. Sm³ o.e.

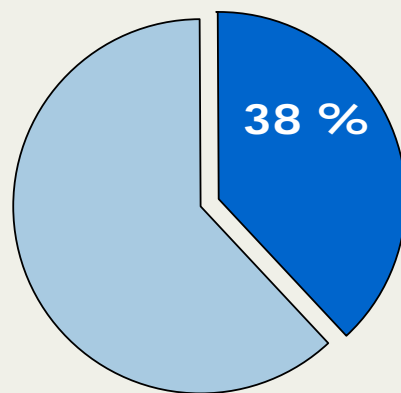


Source: Norwegian Petroleum Directorate

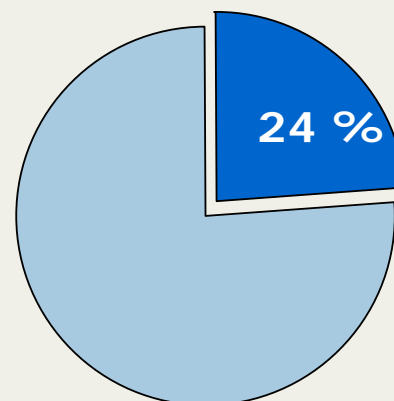
Macroeconomic indicators for the petroleum sector



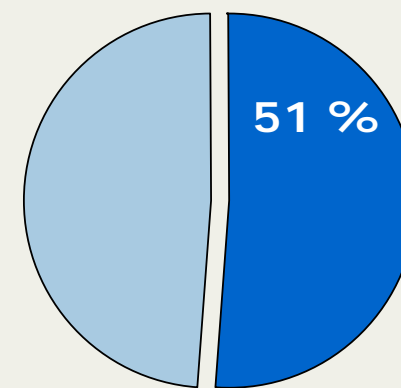
The petroleum sector's share of GDP



The petroleum sector's share of state revenues



The petroleum sector's share of total investment



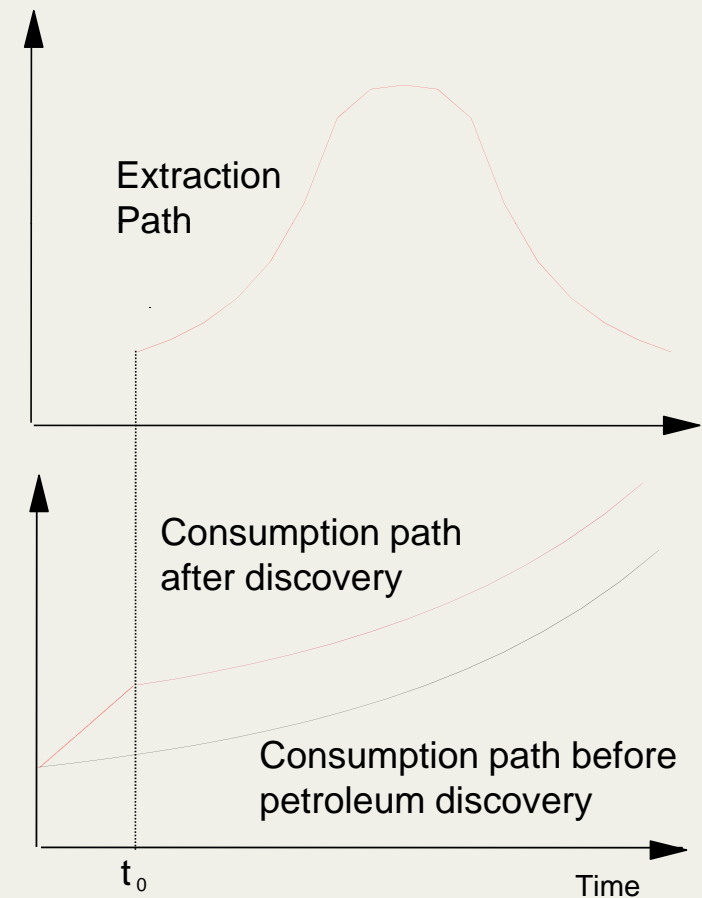
The petroleum sector's share of total exports

Wealth management – from theory to practice

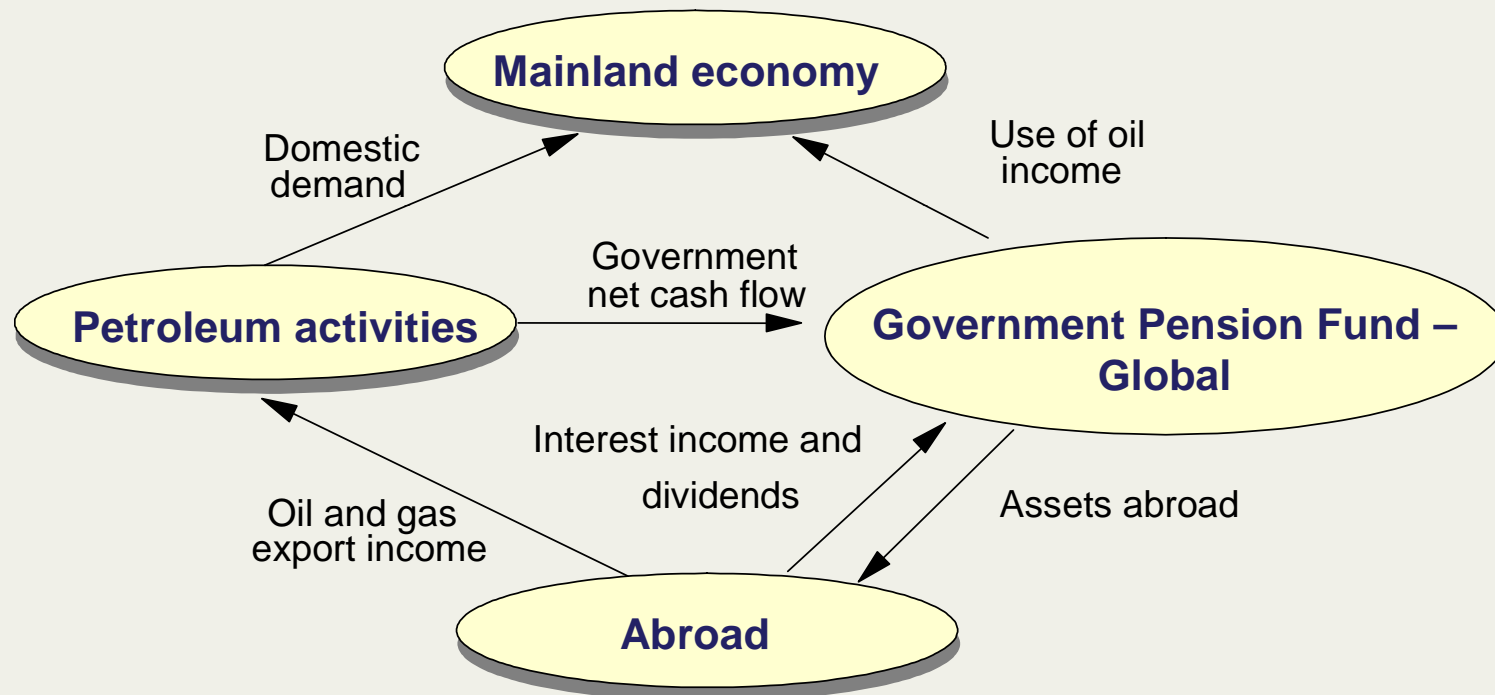
Petroleum revenues are different:

- "Free money"
 - ✓ do not reduce spending in the private sector
 - ✓ may weaken the fiscal disciplinary mechanism
 - ✓ governance challenge
- More volatile and uncertain
- Income stemming from depletion of wealth

Need to save a large part of the petroleum revenues. Necessary to separate spending from the current income from oil & gas activities.

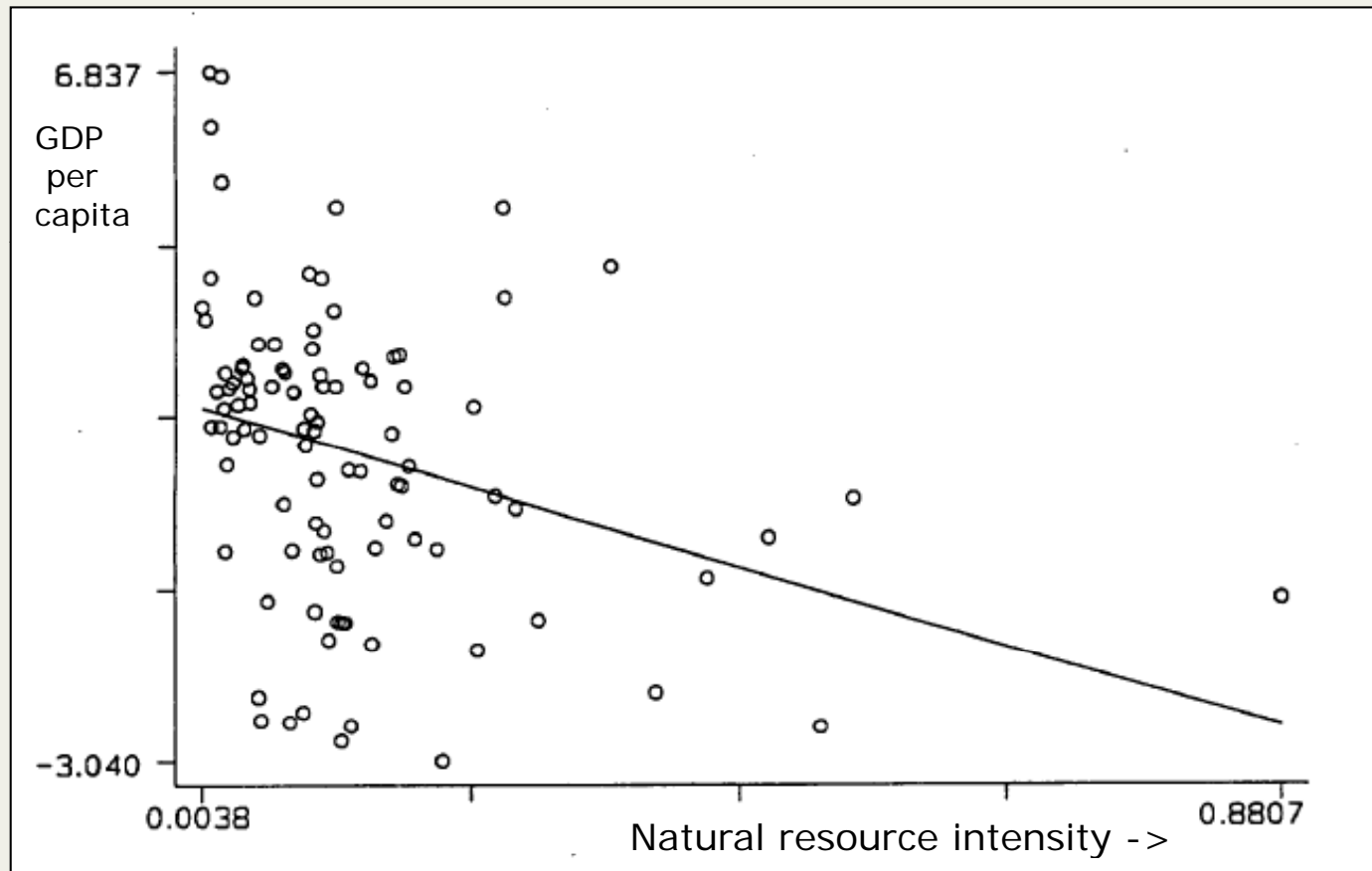


Interaction between the petroleum sector, the Pension Fund and the mainland economy



Higher natural resource income & lower GDP growth

GDP/capita 1970-89 vs. share of natural resource export in GDP in 1971 for 97 developing countries



Source: Sachs and Warner (1995)

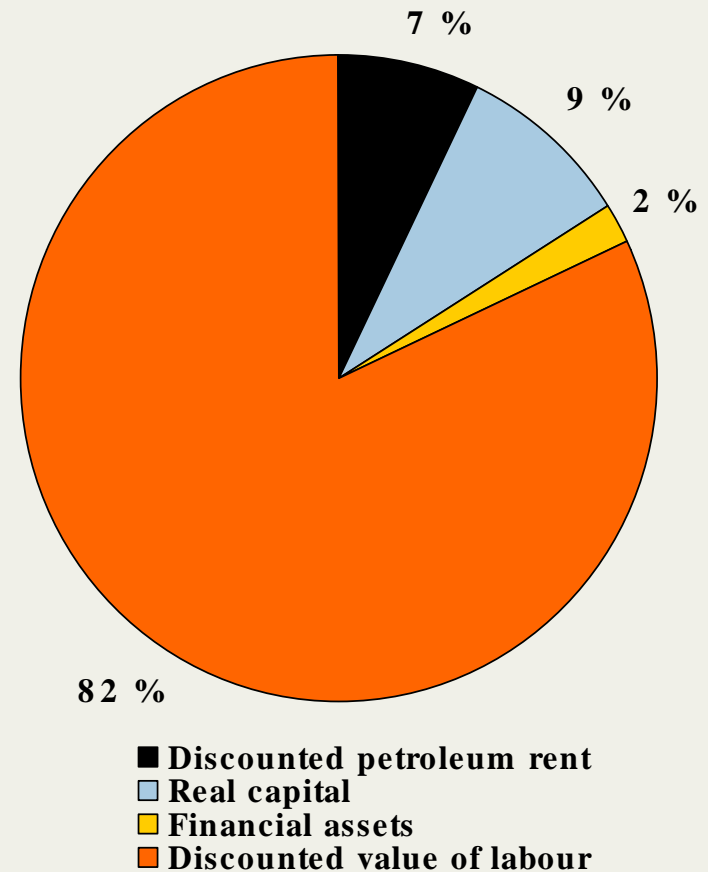
Common pitfalls in oil producing countries

1. Lack of fiscal discipline
 - Challenge: How to transform a windfall to a permanent income?
 - Overheating instead of sustained higher growth
 - Dutch disease
2. Bad investments
 - Large scale industry investments with high political prestige
 - Public infrastructure projects with vague/low economic return
3. Loss of focus in structural policy
 - Main focus on how to grab a part of the oil revenues
 - Productivity growth in non-oil activity suffers
 - Labour supply falls
4. Poor governance
 - Resource wealth often associated with weak government institutions
 - Rent-seeking activities
 - Increased risk of corruption

Manpower is our most important resource

National wealth per capita in Norway. 2007

- Pension and tax reform must strengthen work incentives
- Welfare scheme reforms: More people at work - fewer on benefits
- Good policy fundamentals - sustainable macroeconomic policy



Source: Ministry of Finance, NB09

Revenue management – key principles

- An appropriate system for resource management
- An appropriate system for "government take"
- A long-term fiscal policy strategy (integrating oil revenues)
- A good budget process (integrating oil revenues)
 - Set priorities within an open budget process
 - Project management cycle: Planning & budgeting, execution, accounting, reporting, evaluation & assurance
- Public sector institutions of high quality
- An informed public. Public ownership of the long-term strategy of managing the petroleum wealth
- Transparency and accountability

Key idea

- A petroleum fund is no substitute for sound fiscal management. Main priorities:
 - ✓ a good budget process integrating oil revenues
 - ✓ a sustainable fiscal policy strategy
 - ✓ institutions that are competent, transparent and accountable
- A well-designed fund can help build public awareness and support for a policy of wise and long-term management of the petroleum wealth
 - ✓ distinguish between savings instrument and savings policy
- A poorly designed fund can do more harm than good.

Different types of funds

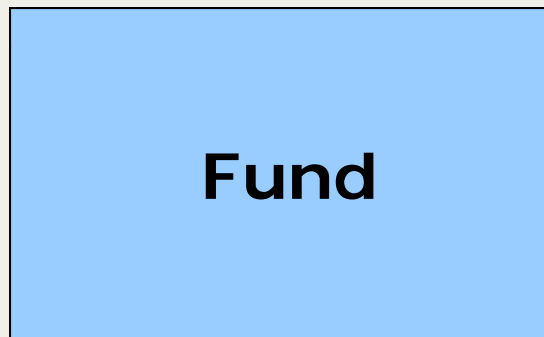
- Savings fund:
 - ✓ aim to build up wealth for future generations
 - ✓ fixed inflows/discretionary outflows
- Stabilization fund:
 - ✓ aim to reduce impact of volatile revenues
 - ✓ inflows/outflows contingent on whether revenues are “high/low”

BUT

- Money is fungible:
 - ✓ Government borrowing means fund can be misleading (and lead to inefficient cash management)
 - ✓ rigid rules on inflows and outflows may become inappropriate
- Financing fund:
 - ✓ aim for both saving and stabilization role
 - ✓ integrated with state budget. Net inflow equals overall fiscal balance

The Fund mechanism – integrated with fiscal policy

Return on investments



Petroleum revenues



Transfer to finance non-oil budget deficit

Revenues



Expenditures

- consumption
- investment (infrastructure, human capital)

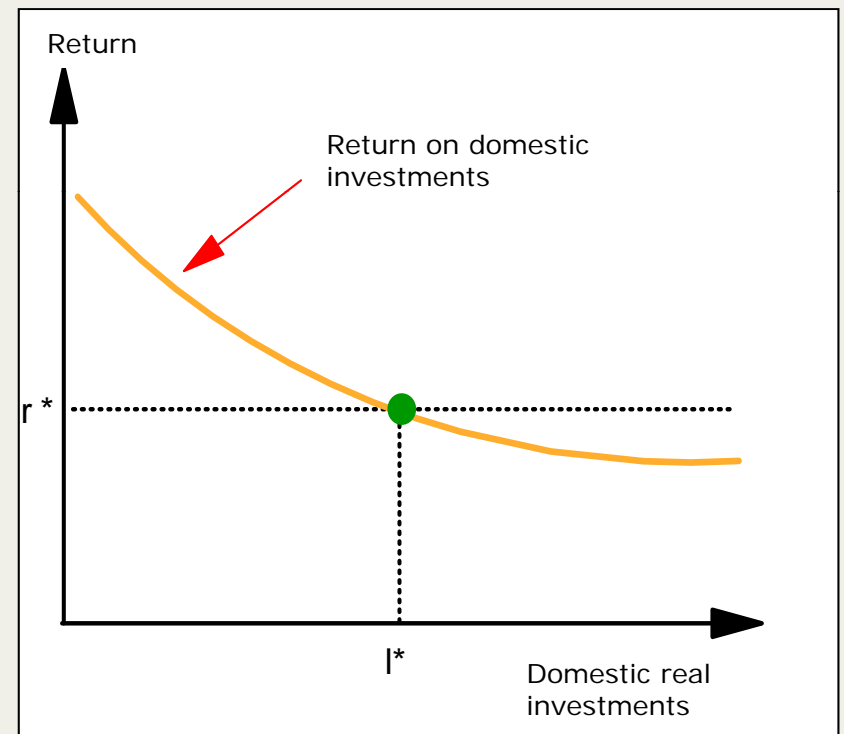


Fiscal policy guideline

(over time spend real return of the fund, approximately 4%)

The Global fund does not invest in Norwegian assets

- An efficient way of achieving capital outflow reflecting the current account surplus
- To expand domestic real investment carries the risk of reducing the return on investment
- Not a lack of capital for private projects in Norway, and the fund should not be a second budget for "less qualified" projects
- Shelter the domestic economy from overheating and deindustrialisation



Investment alternatives for the Pension Fund - Global

	Physical	Financial
Domestic	Done through Budget (infrastructure, human capital)	Make economy more cyclical, risk of bad governance (not national savings)
Foreign	Liquid investments, less transparent (real estate)	Liquid and efficient markets, spread risks, protect domestic economy (bonds, equities)

Summary

- Get the basic organizational issues right
 - Separate the state's roles
 - Clear lines of responsibility. Accountability
- Focus on the non-oil economy
 - "Protect" it from petroleum revenues
- Establish a robust and long-term fiscal framework that integrates oil revenues
 - Separate income and spending of oil revenues
 - Invest surplus oil savings abroad
- A well-designed petroleum fund can be a useful tool to support wise and long-term budget decisions
- Convince the public that the policy is in their interest