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25 January 2005

FROM OIL TO CASH – EFFECTS ON HUMAN BEHAVIOUR

NORWEGIAN SCHOOL OF MANAGEMENT

FROM OIL TO CASH – EFFECTS ON HUMAN BEHAVIOUR

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1. Introduction

- Stanford University
- Norwegian Institute for International Affairs
- Ministry of Finance
- Norges Bank
- Norwegian School of Management
- Elcon Securities
- Lithuania
- IBM pension fund
- Brookings
- China

One can share experiences.
But learning from other peoples mistakes is not easy.

2. Some observations on Kazakhstan(I)

- Size of Western Europe
- 15 million inhabitants
- Independent in 1991
- Tough situation
  - **Agriculture**
  - **Industries woven into the Soviet system**
  - **Nuclear testing grounds**
  - **Environmental challenges, e.g., the Aral sea**

No border disputes (except for a minor one with Russia in the Caspian Sea). On good terms with the “big four”: Russia, China, EU and USA.

Strategically important because of location and petroleum

2. Some observations on Kazakhstan(II)

- The economy is growing at an impressively rate of 9 percent – like China
- Oil is 2/3 of exports and 1/4 of GDP
- Most people in the agricultural sector, producing 8 percent of GDP – half of China
- Received FDI of more than 6 billion USD from the US since 1993

- Good news:
  - **Transparency on where the oil money goes, cf. the initiative of Tony Blair**
  - **Serious efforts to promote democracy, i.e., building relevant institutions**
  - **People have free access to Internet (unlike China), i.e., a society that is opening up**

2. Some observations on Kazakhstan(III)

- Bad news:
  - **Some way to go to have a democracy that works well.**
  - **On the election on December 4, 2005, when the president was re-elected in a land-slide victory, OSCE concluded that the election did not meet international standards.**
  - **Tax receipts down from 23 percent of GDP in 2001 to 16 percent in 2003. How can you then build up an oil fund?**

3. Income versus Wealth (I)

- The production of oil is not the work of man. Getting it out of the ground is.
- Millions of years have elapsed – and petroleum in different forms has developed. Man puts effort into getting oil and gas out in the open.
- Commits capital and labor that is remunerated with, say, 15 dollars per barrel of oil.

- Those 15 dollars are the **income component** of oil money
- Selling it at 50 dollars, and there is a **wealth component** of 35 dollars.
- This wealth component makes oil unique.

- How to share this wealth?
  - **Foreign versus domestic**
  - **Private versus public**

In Norway, about 80 percent of this wealth (or oil rent) accrues to the government.

4. Balance sheet for a country (I)

Human Capital (70 % ?)	**Debt to ROW**
Natural Resources with a rent component	Public
Petroleum	Private
Physical Capital	**National Wealth**
Machinery	
Factories	
Houses	
Infrastructure	
Claims on ROW	
Public	
Private	

4. Balance sheet for a country (II)

Reallocation on the Asset side:

Taking petroleum out of the ground and putting the money int other assets

- **Education (Human Capital)**
- **Infrastructure (Real Capital)**
- **Financial claims on ROW (Financial Capital)**

• From oil to cash
– some general observations (I)

Grandpa sells off his forest, receiving 10 million KZT.

Is he any richer today than he was yesterday?

What are the perceptions of that amongst other members of the family?

Welfare or Happiness is a function of the difference between expectations and reality.

Welfare = W (Expectations – Reality)

From oil to cash

– some general observations (II)

- More money to grandpa, although his wealth is unchanged – he has only changed the composition of wealth into more liquid assets – makes his family expect more.

- Now, if expectations outrun what grandpa is prepared to put on the table, the family members will be less happy.

- Infighting is likely to start.

• From oil to cash

– some general observations (III)

This is the natural resource curse:

- Countries richly endowed with natural resources tend to experience modest economic growth, cf. most of the OPEC countries.
- Rent-seeking and corruption become the order of the day, rather than focused efforts to increase production. Remember that wealth of nations is in their labor – not in their natural resources. Or, why do you think Japan was able to have an annual growth rate of 8—9 percent for more than 30 years?

David Landes (The Wealth and Poverty of Nations):

"Easy money is bad for you. It represents short-run gains that will be paid for in immediate distortions and later regrets."

6. The Norwegian experience (I)

- 1976—1980: Spent money we did not have.

  Deficit on current account in 1977: 14 percent of GDP
  (USA 2005: Less than 7 pecent)

  Foreign debt more than 50 percent of GDP
  (USA 2005: About 30 percent)

- 1980—1986: Saved by the bell. Then, the day of reckoning

- 1986—1996: Getting our act together

- 1996—2001: Oil fund is filling up …..

- 2001—: ….. and we start spending expected real return

6. The Norwegian experience (II)

On the micro level, two events should be recorded:

1. On allocation of fields in the early days, a variety of considerations came into play. Lack of transparency. An invitation to rent-seeking

2. 2001: Norsk Investorforum – a rich man's club – tries to get their hands on cheap money. All kinds of populist arguments were put on the table:
   - Why passively invest abroad when we actively can invest in Norway?
   - By buying stocks and bonds of foreign companies we make life easier for competitors of Norwegian firms
   - Why not buy an investment bank as a vehicle for doing strategic investments abroad for Norwegian companies?

6. The Norwegian experience (III)

Alan Greenspan, January 2001, when it looked like the US government in the not too distant future would have paid down its debt:

> "… the federal government should eschew private asset accumulation because it would be exceptionally difficult to insulate the government investment decisions from political pressures."

By investing the money abroad, the State Petroleum Fund of Norway gets around this problem.