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How to manage the oil fund – a never ending struggle

Jacob Viner: ”… men are not narrow in their intellectual interests by natur; it takes special and rigorous training to accomplish that end.”

OUTLINE

1. HOW COME SO SUCCESSFUL?
2. … BUT THEN LEHMAN COLLAPSED
3. TRANSPARENCY AND ACCOUNTABILITY
4. WHAT DOES THE OIL MONEY DO TO US?
5. BEING IN CHARGE
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1. HOW COME SO SUCCESFULL?

The Government Petroleum Fund – now The Government Pension Fund Global (GPFG) – has been surprisingly successful.

Why surprisingly? Because the internal fight of vested interests following discovery of oil, has been so modest. White Paper to the Storting, number 25, 1973-74: The oil belongs to the people.

Why this modesty? Because of a strong state with legitimate power.

- The Governement appopriates the bulk of the oil rent (about 80 %)
- Succeeding in not spending it all
- OK management of the fund
- The model is accepted by people at large - legitimate

- Clever and honest civil servants
- Responsible politicians have carried the day
- Corruption at a low level
- And employers’ as well as employees’ organizations being concerned with overall macro effects

EACH DAY – about 200 million NEW dollars to be invested

The fund is on a NET basis, i.e. no liabilities. Each year the fund writes a check to the government, so as to make the budget balance – exactly.
Should equal about 4 % of the fund at the start of the year.

All the money is invested abroad. Alan Greenspan on 25 January 2001 did not catch this idea, when recommending tax reduction to Congress.

Government Petroleum Fund in the beginning – only foreign bonds.

Then, 40 % in foreign stocks and 60 % in foreign bonds

2007: Reversal, 60 % in stocks and 40 % in bonds

2010: Real estate new asset class. Aiming for 5 %, by taking bonds down to 35 %.

2. …. BUT THEN LEHMAN COLLAPSED

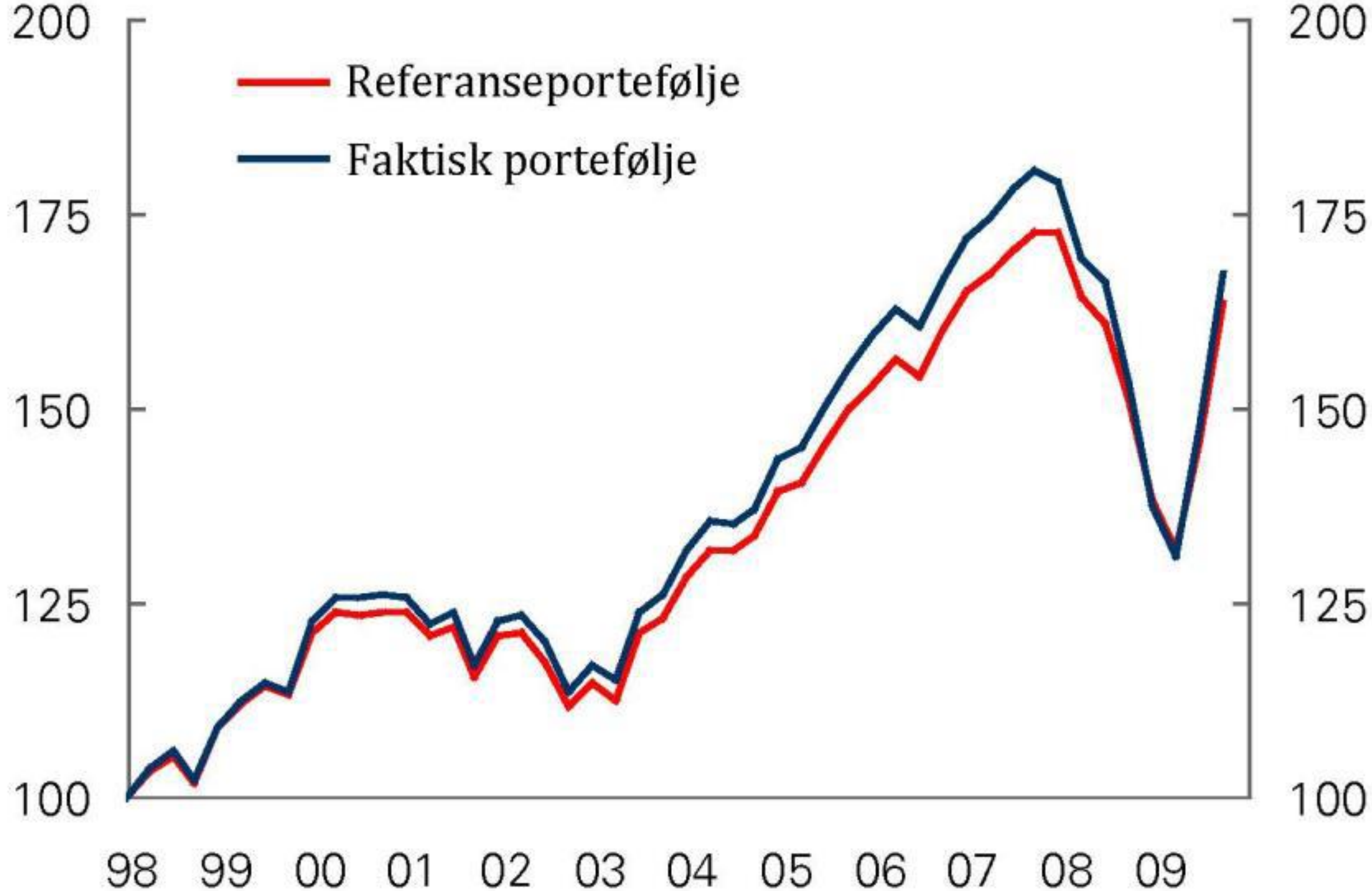
2008 – GPFG lost 633 bn. NOK of which 70 bn through ”active management”. Took ”tale risk”, perhaps without really knowing or understanding. When interest differentials between government bonds and commercial bonds stay put, ”tracking error” does not pick up the risk.

Accumulated excess returns over ten years evaporated.

Professor Andrew Ang to a Norwegian blogger:

” … the rolling analysis shows that a large part of the fund’s active losses could have been anticipated because of the large factor exposures computed ex ante.”

Ex ante are the crucial two words here.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3. TRANSPARENCY AND ACCOUNTABILITY

Two pillars

- The Budgetary Rule – only 4 % of the fund on the budget
- NBIM with monopoly on management.
    - FIN is the owner
    - NBIM is the fund manager

Political discussions continuously.
Left and Right must be ”reasonably happy”.
Green technology, Ethical Council, Companies out of the list,
Responsible investments, Norfund, etc.

Boeing and Walmart taken out. Not to the liking of the US ambassador.

Mantra: ”The investment strategy is based on achieving the highest international puchasing power from the capital in the fund, with a moderate level of risk.”

Annual report to the Storting about the activities of FIN and NBIM. Solid piece of work. Accountable to the Storting.

BUT: Not easily accessible to the public at large. Transparency can be improved.

Norges Bank Watch (NB Watch) as a model for FIN/NBIM Watch?
NB Watch – independent evaluation of monetary policy in Norway.

- Report presented in public seminar
- Then commented on by the Governor or Deputy Governor
- Followed by an open discussion

Should the The Supervisory Council of Norges Bank take action here, seeing to FIN/NBIM Watch? I think it should.

4. WHAT DOES THE ”OIL MONEY” DO TO US?

What to do with the ”oil money” – the topic of many seminars.

We all do have pet ideas for the use of the fund

- Better roads
- More people educated abroad
- Better universities at home
- Better schools
- Better hospitals
- More research
- Fund for innovation
- Regionale funds

Equally important: What does the oil money (resource rent) do to us?

- Labor market participation rates are on the decline
- Expectations and demands on the rise
- ”This is not acceptable in the world’s richest country ...”

Criteria for success of the GPFG – that people are not so much concerned about it, i.e., they go about with their daily chores as usual

Lobbying and corruption, two of a kind? Money is used to achieve a desired outcome where money should not be used

Ex. : Norway should develop a financial sector based on our ”raw material” – money from oil. Stupid argument if you ask me. London, NY, HK, have the expertise and capabilities.

Financial sector in the US, more than 7 % of GDP, 3 % in the 1950s.

Greenspan: Do people get value for their money?

Alternative use of these talented people is lost.

GPFG invests all its money abroad.

Norwegian banks and asset managers only modestly involved

5. BEING IN CHARGE

- Oil production – learning the trade ourselves. Statoil.
- Similar strategy with the money – Government Petroleum Fund established. Manage the money ourselves, i.e. FIN and NBIM.

1537 – 1814 Denmark in charge

1814 – 1905 Sweden in charge

Now, we will be in charge ourselves. History matters

Approaching 3 % of Europe's stocks. And more than one per cent on a global basis. Politically – is there a limit?

More in real estate? What kinds of real estate? Concerned about ownership rights in the long term. Ring road around Nairobi? Or Rockefeller Centre in New York?

Learning – to stay in charge

Continuous debate. Like a research project. Learning by doing

New committee to look more closely at the budgetary rule.

- Four percent too much?
  - Real return less than four percent?
  - The economy cannot absorb that much?
- What purposes does the money serve? Improve competitiveness and enlarge knowledge. Better able to meet the future

CEO of the Fund now on fix pay . A little less than one million USD a year.

Public sector in Norway – far from extravagant

- Kindergarden in Oslo - focus on leadership and efficiency.
- ”Labor in focus” – work hard to have everybody working.

6. SUMMING UP

Huge pile of money - 5.600 bn NOK

China’s reserves of foreign exchange, 4.000 bn USD

- Five times as big as Norway’s
- 260 Chinese per Norwegian
- More than 50 times more forex behind each Norwegian

Anbang Insurance Group bought Waldorf Astoria in New York for 1.9 bn USD or 12 bn NOK. Ten such, 120 bn NOK or 2 % of GPFG.

Successfully handled, so far. An ongoing ”research project”.

Transparency and Accountability employ centre stage, to retain legitimacy.