The Management of the Norwegian Petroleum Wealth
- avoiding the resource curse

Siv Jensen, Minister of Finance

Columbia University, 15 April 2015
Outline

Petroleum revenues and fund mechanism

Governance

Investment strategy

Fund performance

Responsible management
Discovery of oil in 1969 – the Ekofisk oil field

Photo: Kjetil Alsvik/Conoco Phillips
Blessing or curse: Poor performance in resource-rich countries

Transmission channels
- Dutch disease – lack of fiscal discipline
- Bad investments - fund invested domestically
- Loss of focus on structural policy
- Poor governance & weak institutions (rent-seeking)
Petroleum revenues are temporary and volatile

Petroleum revenues not income in traditional sense

- Income stemming from depletion of non-renewable natural resources
- Transform windfall gain to permanent increase in consumption
- Need for separating current accrual from spending

Necessitates saving a large part of petroleum revenues
GPFG is fully integrated with fiscal policy

Return on investments

Petroleum revenues

Fund

Transfer to finance non-oil deficit

Petroleum revenues

Non-oil revenues

State Budget

Expenditures

Fiscal policy guideline
Over time spend Fund real return (estimated at 4 percent)
Sharp increase in public pension expenditures coincides with declining funding contribution from the GPFG – a long term challenge to government finances

Number of elderly (67 years and above) in proportion to the number of people of working age (20 – 66). Percent

Source: Ministry of Finance (National Budget 2015)

Percent of trend GDP for mainland-Norway

Source: Ministry of Finance (National Budget 2015)
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Responsible management
Governance structure marked by clear lines of responsibilities

**The Storting – Norwegian Parliament**
- Government Pension Fund Act
- National Budget
- Annual Report to the Storting
- Material changes presented to Parliament prior to implementation

**Ministry of Finance**
- Management mandate
- Regulation on risk management, reporting and responsible investments
- Quarterly and annual reports
- Investment strategy advice

**Norges Bank (NBIM)**
*Operational manager*
High degree of transparency in Fund management

- Prerequisite to ensuring broad support for and trust in the management of Fund
- Management mandate states; ...greatest possible degree of transparency within the limits defined by a sound execution of the management assignment
  - Reporting
  - Holding lists
  - Voting records
- Contributes to a robust investment strategy
  - Anchoring of risk profile with stakeholders
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**Investment strategy**

Fund performance

Responsible management
Investment strategy premised on Fund objective, investment beliefs and Fund characteristics

Highest possible long-term financial return within a moderate level of risk.

The investment strategy is in particular characterized by:

- Diversification
- Harvesting risk premiums
- Exploitation of the Fund's long-term horizon
- A moderate degree of active management
- Responsible management
- Cost efficiency
- A clear governance structure
The investment strategy of the Fund has been developed gradually

- **1998**: 40 % equities
- **2000**: Some emerging equity markets*
- **2002**: Non-government bonds
- **2004**: More emerging markets ***, Ethical guidelines
- **2005**: Inflation-linked bonds
- **2006**: High-yield bonds, Commodity derivatives, New risk management requirements
- **2007**: 60 % equities, small-cap
- **2008**: First investment in real estate
- **2009**: Real estate
- **2010**: All emerging equity markets*
- **2011**: New framework for responsible investments
- **2012**: New geographical distribution for the equity and bond index
- **2014**: 60 % equities, small-cap

*Benchmark index
**Investment universe

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*Benchmark index
**Investment universe
The investment strategy

GPFG strategic benchmark index

Global Equities (excl. Norway)
«Market weights»
60 %

FTSE Group
Index vendor

Global Fixed Income (excl. Norway)
70 % Govt. (GDP weights)
30 % Corporates (Market weights)
35-40 %

Barclays
Index vendor

Global Real Estate (excl. Norway)
0-5 %

IPD
Index vendor
Broad geographical distribution of Fund investments

Actual investments at yearend 2014

Source: Norges Bank
Real estate investments

- First investment in unlisted real estate completed in April 2011 – Regent Street, London

- First unlisted property investment in the US in February 2013 – New York City, Washington D.C. and Boston

- Objective: Global real estate portfolio
The Fund holds significant ownership shares in global markets
Yearend 2014

Average holdings in equity markets

Average holdings in fixed income markets

Sources: Norges Bank and Ministry of Finance
Investment strategy – Equity proportion

- No “optimal” equity allocation
- Return and risk considerations
- Single most important decision for total portfolio risk
- High risk bearing capacity – The Fund is highly resilient to short-term return volatility
- Large fund → Harvesting risk premia to a large extend confined to «classical» listed equity and fixed income markets

Source: Dimson, Marsh and Staunton
New assessment of real estate and infrastructure investments

- We will assess whether the 5 pct. limit on real estate should be increased and if we should open up for infrastructure investments

- Has appointed an expert group:
  - Stijn Van Nieuwerburgh, NYU
  - Richard Stanton, UC Berkeley
  - Leo De Bever, ex. CEO AIMCo

- The government will conclude in the annual report to be presented in the spring of 2016.

Equities 60 %
Bonds 37.8 %
Real estate 2.2 %
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GPFG is among the largest funds in the world

Market value development 1996-2014. NOK billion (lha) and per cent of GDP (excl. oil) (rha)

Fund size as share of GDP (excl. oil) (rha)

Sources: Norges Bank and Ministry of Finance
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Responsible management
Framework for responsible management

Ministry of Finance

General framework on responsible management

Management framework & Guidelines

Guidelines

Reporting

Recommendations

Exchange of information

Responsible management

Norges Bank (Central Bank)

Recommendations on observation & exclusion

Council on Ethics
Exercise of ownership rights

- Exercise of ownership rights is based on international recognised principles
- Overall purpose of active ownership is to safeguard the Fund’s financial values
- Strategic focus areas
  - well-functioning, legitimate and efficient markets
  - equal treatment of shareholders
  - shareholder influence and board accountability
  - children’s rights
  - climate change risk management
  - water management

Markets

Corporate governance

Environmental and social issues
Exclusion and observation of companies

- **Product-based exclusion**
  - produce weapons that violate fundamental humanitarian principles in their normal use
  - produce tobacco

- **Conduct-based exclusion** – serious or systematic violations of fundamental ethical norms
  - human rights including child labour
  - individuals’ rights in situations of war or conflict
  - gross corruption
  - severe environmental damage
  - other particularly severe violations of fundamental ethical norms
Fossil-fuel investments and ownership tools

- Report from expert group
- Public consultation process
- The Ministry’s assessments in Report No. 21:
  - Strengthen ownership and dialogue
  - New conduct based exclusion criteria
Norway: Cruise control

By Richard Milne

There are fears that the country’s reliance on oil wealth is threatening its growth prospects
Summary

- Norway has established 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 fund mechanism serves as a tool to support wise and long-term budget decisions

- A sound governance framework is a prerequisite for good management over time
  - Clear lines of responsibility

- Transparent management and an investment strategy with widespread support
  - High degree of transparency
  - A strategy developed “step by step” based on comprehensive professional assessments
  - Risk should be managed, controlled and communicated
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Links

Ministry of Finance
www.regjeringen.no/en/dep/fin

Government Pension Fund
www.government.no/gpf

Norges Bank Investment Management
www.nbim.no/en

Council on Ethics
www.etikkradet.no/en