The Norwegian Government Petroleum Fund

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Costs of KP for Norway
(from White paper in 2001)
- Yearly abatement costs: US $ 430 mill.
  (international emissions trading)
- Lost income because of response measures in 2010: US $ 2,1 bn.

The Petroleum wealth
-Smooth consumption

But - the consumption must be separated from the oil production
A main purpose with the Petroleum fund

Possible solution: Petroleum fund as a Pension fund

- Unsustainable pension system
- Possible solution: Petroleum fund as a Pension fund
Background

- The Norwegian Government Petroleum Fund was established by law in 1990
- The inflow to the Fund is the annual surplus of the central government account
- The first transfer occurred in May 1996
- The fund, currently about $85 bn, is invested in financial assets outside Norway

Why not invest the Fund in Norway?

- The fund is an instrument of national financial savings. As a nation, we can only save financially abroad
- Few profitable investment opportunities, in Norway in view of the large size of the fund. One could artificially bid up financial assets prices …
- … so as to lower the required return on investments in Norway, and instigating capital outflow from the private sector

The fund management model

- The Ministry of Finance acts as “owner” of the Fund and decides the investment strategy, the benchmark portfolio and the relative risk limits
- Norges Bank, the operational manager, is responsible for “value added” against the benchmark
- Norges Bank reports results, risk and costs quarterly. The reports are released at press conferences and on the Internet

Important concerns in the management of the Fund

- Clear lines of responsibility between the Ministry of Finance as owner and Norges Bank as manager
- Openness on the management by public disclosure of goals and regulations, public reports on the management and full disclosure of the Fund's holdings annually
- Control of the management by
  - consulting the Parliament on important issues
  - independent performance measurement
  - audits by the Auditor General
The Petroleum Fund’s investment objectives

- Objective: to maximise the Fund’s long-term international purchasing power, assuming acceptable risk
- Short-term return variations are less important
- Parliament has decided on a transfer rule: The expected long-term real return (4 per cent p.a.) is to be transferred to the General budget each year
- US $ 140 mill. in special Environmental Fund (will be evaluated this year)

Investment of the Fund

Benchmark portfolio

Equities 40%
- America 30%
- Europe 50%
- Asia/Oceania 20%

Bonds 60%
- America 30%
- Europe 50%
- Asia/Oceania 20%

The equity portfolio is distributed between countries according to market capitalization weights.

The bond portfolio is distributed between countries according to GDP weights.

Norges Banks Investment Philosophy

- Highest possible return at lowest possible risk
- Many small positions rather than a few large ones
- Greatest possible independence in position-taking
- Specialisation of expertise
- Reasonably safe revenues receive highest priority

Results
Return on the Fund's Investments
Accumulated return since 1998, Local currency basket

Annualised rates of return

Table 1: Annual nominal and real return on the Petroleum Fund in the period 1997-2002, measured in terms of the Fund's currency basket. For cost

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<tbody>
<tr>
<td>Real return</td>
<td>2.62%</td>
<td>2.48%</td>
<td>2.45%</td>
<td>2.9%</td>
<td>4.2%</td>
<td>4.4%</td>
<td>3.6%</td>
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<td>Consumer price inflation</td>
<td>4.1%</td>
<td>4.7%</td>
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<td>Net real return</td>
<td>0.08%</td>
<td>0.09%</td>
<td>0.07%</td>
<td>0.11%</td>
<td>0.09%</td>
<td>0.04%</td>
<td>0.15%</td>
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<td>Management costs</td>
<td>7.8%</td>
<td>7.7%</td>
<td>7.6%</td>
<td>7.5%</td>
<td>7.4%</td>
<td>7.3%</td>
<td>7.5%</td>
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Lessons to be learned

- It is important to be prepared for lower income from petroleum production
- In the case of Norway, financial savings are used because of the need to meet financial obligations in the future
- Other types of Fund constructions may be wiser in other countries with other circumstances and other needs.
Websites:

www.norges-bank.no

odin.dep.no/fin/