Einar Lie
University of Oslo
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Learning by failing. The origins of the Norwegian oil fund

Abstract

The Norwegian Government Pension Fund, established in 1990, is the world largest sovereign wealth fund. The structure of the fund and its relationship to long term fiscal policy is widely recognized as a successful means to distribute Norway's resource gains between generations and protect the relatively small Norwegian economy from a too rapid spending of the present riches. This paper examines why and how the fund got its characteristics, based on public debate and material from Government archives.

Einar Lie

Learning by failing: The origins of the Norwegian oil fund

The Norwegian Government Pension Fund Global is the world's largest sovereign wealth fund.[1] At present, it has a market value of about 4 600 billion NOK (770 billion USD), which is around 140 per cent of Norway's GDP. This is a result not only of high levels of petroleum revenue, but also of a solution whereby government revenue is channelled straight into the fund and invested abroad, with clear rules for how capital can be fed back into the Norwegian economy through annual political decisions on balancing the government budget. And it is only the return on the fund that can be used in this way; the capital invested is not available for consumption and must remain in global capital markets.

The principles behind the fund have won international recognition as clearly a well thought-out solution for managing large inflows of commodity revenue in a small economy. A recent survey article in the *Financial Times* claimed that "the fund was created as part of Oslo's effort after discovering its first oilfield in 1969 to avoid 'Dutch disease': the curse that has blighted many of the world's biggest oil producers with problems such as inflation and weak manufacturing."[2] Many will identify with the principle that the fund offered a solution to the problems that have plagued other countries following a temporary inrush of wealth.

It's remarkable if Norway has been able to learn from the mistakes of others without having to make the same mistakes itself. History is littered with examples of the reverse, where countries learn only from their own mistakes, as experienced by economic actors, voters and politicians. This is not just a matter of learning. Every country has significant institutional idiosyncrasies where values, interests, power and decision-making structures collide. Ideas and solutions, good or bad, must adjust to the system if they should be implemented.

A number of common patterns in the Western World can be discerned from studies of the development of welfare states, of how ideas about economic regulation and management evolved after the Second World War, or how the principles for the distribution of wealth and wage-setting work. However, a variety of historical and social science studies reveal persistent differences between, for example, the Nordic social democracies, the big European economies

[1] Fund rankings are available from the Sovereign Wealth Fund Institute's website, http://www.swfinstitute.org/fund-rankings/.
[2] *Financial Times* journalist Richard Milne, 19 August 2012. The article was based heavily on Chambers, David, Elroy Dimson and Antti Ilmanen: "The Norway model", *Journal of Portfolio Management* 1/2012: 67-81.

and the Mediterranean countries, both in this and other areas, that are as striking as the similarities born of recent joint endeavours.

I sometimes suspect that economists and economic commentators nevertheless have an affinity with the thoughts behind Keynes' claim that "the ideas of economists […] are more powerful than commonly understood", expanded on in that wonderful aphorism: "practical men […] are usually the slaves of some defunct economist."[3] This view, which favours the idea and the thinker over the politician, the businessman and their historically inherited environment, lends support to an understanding that grand solutions can be guided by good – or bad – ideas rather than by national trajectories driven by the mess of historical events and patterns.

I think Keynes' words mislead more often than they help, and they certainly miss the mark when it comes to the story of the Norwegian oil fund.

The key principles of greatest relevance to macroeconomic policy – that oil revenue should go straight into the fund and then be invested abroad – came about through Norway's own hard-won experience in two different areas. One is the spending of oil money in the Norwegian economy in the 1970s and 1980s, which was excessive at times and did not, in practice, follow any clear guidelines or limiting principles. The other is the reality of what is now the Government Pension Fund Norway – the fund set up in 1967 for the Norwegian national insurance scheme. The authorities had high hopes at the time for the future size and importance of this fund, but it was managed in a way that led to it becoming part of the funding of a variety of government objectives at the expense of its potential to constitute an economic resource or reserve for future use.

The oil fund came about as an antithesis, to some extent a reaction, to the way the national insurance fund was managed. For those doing the groundwork for the oil fund in the 1980s, one key principle was to avoid the mistakes made in 1967, either by not setting up a fund at all, or by making it as unlike its predecessor as possible.

The process behind the creation of the two funds is, in this respect, more than just an interesting piece of political and administrative history. I would like to begin by spending some time looking at the formation and structure of the first of these funds, both because it provides important background to why the oil fund turned out the way it did, and because the very thinking about a financial fund building bridges between current revenue and future expenditure is so fascinatingly different for the two solutions.

[3] Keynes 1936: 386.

Background to the National Insurance Fund: the national insurance scheme

Norway's national insurance scheme and national insurance fund were set up in something of a rush in the mid-1960s following a long drawn-out process.

The Second World War had lent fresh impetus to old ideas about universal welfare legislation guaranteeing everyone a living income. These thoughts came together in the Welfare Programme of 1948, where the fundamental objective was to bring together the existing social security arrangements in a single system. All members of society would be covered by the new national scheme. Benefits would be coordinated and at a level that assured each individual of an acceptable standard of living following a loss of income due to unemployment, illness, disability, old age, etc.[4]

In 1948, investment to ensure long-term growth was more of a priority than a major upgrade of the welfare system itself. The 1950s therefore saw the gradual expansion of the welfare system, albeit carefully tailored to other government reforms.

The process of creating a national insurance fund finally got off the ground in 1963 following the formation of the first right-wing government since the War. In his counter-manifesto, the leader of the Labour Party, which had until then been in power continuously since 1945, promised the imminent introduction of a "pension plan for all the people". This new national insurance scheme would provide pensions for the elderly and surviving dependants of two-thirds of earned income, and he also went into the principles for funding the scheme in some detail. When the Labour Party returned to power just 14 days later, the groundwork began to gain real momentum.

The existing welfare schemes to be included in the new universal system were funded in different ways. Retirement pensions, disability pensions, death-of-parent benefits for children and some other minor schemes were jointly financed through members' contributions and contributions from employers, municipalities and the government. The occupational injury scheme was funded by contributions from employers, while several other schemes, the most expensive by far being child benefit, were financed directly by the treasury. This complex system was now to be coordinated. In addition, it was effectively decided that several schemes, in particular retirement pensions, should have a broader base and higher rates when the new national insurance scheme was rolled out. One requirement that stood firm throughout the preparatory process was that the national insurance scheme should be independently financed.

[4] Seip 1994: 152ff.

National insurance contributions were to be kept separate from ordinary taxes to underline that they were earmarked specifically for the great welfare reform that was to benefit all.

The Ministry of Finance set out the key principles in the preparatory work on a parliamentary bill. The point of departure for the ministry's civil servants was that the nation's aggregate saving should not decrease as a result of the introduction of the national insurance scheme – we will return to the reasons for this later. The calculations that were made assumed that there would be a substantial reduction in private pension saving following the introduction of a graduated old-age pension in the national insurance scheme.[5] This would be offset by a substantial initial transfer to a new fund, which would then be built up rapidly.

The national insurance fund – the "grand vision"

It was relatively common misconception in Norway that what would later become the national insurance fund was intended to provide the capital to cover future pensions. The idea was *not* what we would these days refer to as "pre-funding" of contributions with a view to higher benefits at some point in the future.[6] Such an idea was not just far from the minds of those who created the fund; had it been put forward, it would have been viewed as technically flawed based on prevailing economic theory.

One of the best-known criticisms levelled by economics professor Ragnar Frisch[7] at the "economic fiction" delusions of the inter war period concerned the view that government deficit budgeting and borrowing "passed some burden to future generations". If the government boosts demand and output through its economic policies, he reasoned, the country will be richer, providing a better starting point for future generations. The actual borrowing was a different matter, primarily an accounting issue. In economic terms, the nation would be neither richer nor poorer for assets and repayments being passed back and forth between individuals and institutions in the domestic economy. It was the effects on the "real economy" that would determine whether a measure was sound or not, be it for current or future generations.[8]

Hermod Skånland, the economist at the helm of the Economic Policy Department at the Ministry of Finance, built on the same insight when he explained the fundamental principles

[5] Ministry of Finance to the Ministry of Social Affairs, 18 December 1965; ØA, 107.43, FIN/Ra.

[6] In one of his books of memoirs, former prime minister Kåre Willoch, a generally reliable observer, wrote in detail about the debate in the 1960s while he was trade minister. Here, however, he is discussing the national insurance fund as though its intention were to accumulate capital for use in the payment of future pensions. Willoch 2002: 145ff.

[7] Ragnar Frisch (1895-1973), Nobel Laureate 1969, was the founder of the new economics study at Oslo University in the mid 1930s. Frisch was a free market skeptic throughout his career, and he had a strong influence on the theoretical and political orientation of post war economists in Norway.

[8] Andvig 1977: chapter 11; Bergh and Hanisch 1984: 189; Nordvik 1977: 295.

behind the national insurance fund in a speech in 1964. The individual can always save in private bank deposits in order to have something to fall back on in old age or illness. "Society as a whole cannot do quite the same. It cannot lend money to itself, pay itself interest and make repayments to itself." No, the whole point was that there was a need to expand the future revenue base in order to finance future pensions, and this was to be achieved with the help of real revenue through an increase in output. The way this was to be done was that payments into a national insurance fund would help ensure sufficiently high real saving. Social security contributions would erode purchasing power that could otherwise have been used for consumption, and go into a fund that would finance long-term real investments and pave the way for greater growth. "When workers reach retirement, they can then take out a larger share of aggregate output than would otherwise have been the case, without putting those still in work in a worse position than if this pension saving had not taken place," Skånland explained.[9]

The Swedish social-democratic government launched its fully public national insurance scheme a few years before Norway, and the groundwork and public debate in Norway were heavily influenced by the solutions arrived at by its neighbours. The mechanism that would link the present to the future was, however, unique to Norway in both concept and design. It assumed that government-forced investment was the secret to robust economic growth. This approach to growth policy was well rooted in the economic policy pursued in Norway in the 1950s and 1960s. One key tenet was that low interest rates, a high rate of investment and correspondingly low levels of private and public consumption were the best way to build the country's production capacity and future welfare capacity. This principle can be seen fairly clearly in all of the parties' views of the fund.[10] In the debate on the national insurance bill in the summer of 1965, one Labour Party MP described the fund as "the grand vision on which the state pension builds […], namely that the fund itself will form the basis for an economically stronger and richer Norway".[11]

It is worth pausing for a moment to consider the very reasoning behind a fund that was to ensure high real saving for the benefit of future generations. It starts as a robust technical argument and ends up as a questionable principle of economic policy. Frisch's point about the "saving fiction" largely follows a definitional framework reflected in national accounts contexts, that the only way of saving in a closed sector is to invest. (The alternative use of revenue being consumption, which, by definition, is non-saving.) Rhetorically, the stress on the "saving fiction" probably gains some of its force from Keynes' arguments about "excessive savings" as developed from *The Treatise of Money* onwards. In Keynes' eyes, a saving rate in excess of the

[9] Skånland 1964: 2.
[10] Recommendation to the Storting No. 247 (1964-65) and Recommendation to the Odelsting No. VII (1965-66).
[11] Storting Gazette 1964-65: 4147.

investment rate was not a desirable situation but characteristic of an economy in, or heading for, recession.[12]

But was it a given that a government fund would be better suited to facilitating high long-term growth than, say, several private funds in which contributions were invested directly? Payments from the fund or funds were to be determined by the same welfare rules, so this was not part of the argument. One would then have to assume that the government fund's investment profile made it a stronger guarantor that the capital would be invested in and support businesses with a strong growth potential.

This was not how it was. Within the Ministry of Finance, the fund's true function gave rise to both discussion and doubt during the brief exploratory process. Internal memos soon posited a number of striking counterarguments to the reasoning presented in public. The most important was that high investment was hardly the best way to achieve higher growth in a Norwegian context. The very *problem* with the Norwegian economy was that investment was record-high. For much of the post-war period, the country had tried to curb investment in order to avoid excessive imbalances between the domestic and external economies. [13]

A ccontemporary comparative study published by T.P Hill in *The Economic Journal* had also noted a striking feature of Norwegian economic policy and development: a very high level of investment and correspondingly low level of public and private consumption.[14] The remarkable thing was that this had not led to higher growth in Norway. Although Norwegian investment rates generally topped the table in the OECD, the country's growth rates had been more ordinary.

Fig. 1

This study was known and read within the ministry.[15] Investing even more in volume terms to safeguard the pensions of those working in the 1960s did not therefore spring to mind as a grand vision. If one considered it a challenge that investment levels were unreasonably high, and also producing very limited returns, it was difficult to see how the solution could be more of the same, namely even higher investments.

The problems associated with high investment creating pressures in the economy and producing relatively low returns was closely linked to Norwegian monetary and credit policy.

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[12] Skidelsky, Robert 1995: *John Maynard Keynes: Volume 2: The Economist as Savior, 1920-1937*. Penguin.
[13] Glesne to the secretary general, 13 April 1964; ØA, 107.43, FIN/Ra.
[14] T.P. Hill 1964, 'Growth and investments according to international comparisons', *The Economic Journal,* vol 74: 287-304.
[15] Norwegian economic growth were slightly below the OECD average in the 1950s and only slightly above in the 1960s. Detailed up-to-date accounts are presented in Eitrheim and Øksendal (2013).

Norway had chosen to maintain politically-controlled low interest rates, partly to promote rapid economic growth through high levels of long-term investment. Doubts about the validity of this approach were gradually spreading at the Ministry of Finance. The first person to put forward arguments against the low interest rate policy – around the same time as the national insurance fund was being developed – was the head of the Economic Policy Department, who questioned the low interest rate dogma internally, partly because it was not clear that it contributed to long-term growth.

So why did the ministry go along with this fund structure? It was not because they were captivated by Frisch's ideas about what led to saving in a closed economy – this would have lent clear weight to Keynes' formulation about practical men being the slaves of defunct economists. The ministry's thinking on the fund was both simpler and more complex than expressed in the public debate, and it was closely linked to the relationship between fiscal policy and credit policy. One key problem in all of the years the country pursued an active low interest rate policy was obtaining sufficient amounts of credit for the institutions lending at these low rates.[16] In the 1950s, around half of the capital had been created through highly restrictive fiscal policy. Large operating surpluses made it possible to transfer capital as loans from the treasury to the state banks. The remainder was funded through bond loans from private banks and insurance companies to the government, which forwarded the money on to the state banks. But these private institutions often had to be put under considerable pressure to get this to work.[17] The loans went out to consumers and firms at low interest rates, and so the terms set by the Ministry of Finance on behalf of the state banks were not particularly attractive to the private institutions.

In the 1960s, however, the ability of fiscal policy to finance the state banks gradually deteriorated. Government expenditure grew much more quickly than in the 1950s, and revenue failed to keep up. At the same time, European interest rates started to rise, while Norwegian authorities insisted on keeping borrowing costs low. In this context, the national insurance fund had the potential to be a useful, if not essential, instrument, precisely because it would accumulate large amounts of available capital administered by the State.

Fig 2 and 3.

What kind of objectives were the fund's investments to address? It was always the intention that the national insurance fund would be able to provide capital for investments that were a government priority, such as housing and regional industrial development.[18] From late 1965,

[16] Nestaas 1966.
[17] Lie 1995, cf. discussion of credit policy on pp. 374-398.
[18] Report to the Storting No. 75 (1963-64): 49.

however, the Ministry of Finance's memos to the government were portraying the fund not as an independent instrument for achieving general policy goals but as a means of getting other instruments to work. Now the role of securing reasonable funding for the state-run credit system was presented as the fund's dominant practical objective.[19] This met with resistance from the cabinet members. That winter brought a heated debate about the guidelines for the fund, which the ministry staked everything on winning.

The fund acquired a complex administrative structure, with three different offices covering different parts of the country. The idea at political level had been to keep the fund in close proximity to the credit and investment market. In the final solution, however, the ministry did get its way that the fund's guidelines should not allow local investments. Direct loans would not be issued, and the funds were given very limited scope to invest anywhere other than in the bond market. The ministry had close control over this market through rules in the Credit Act regulating what bonds could be issued.[20] "In my opinion, this is an excellent solution," commented Skånland in a handwritten note when the draft was ready. "We would have had to concentrate on funding the state banks in the coming years, but we can do this through the section 15 rules [on bond issuance]." "Yes, much has been salvaged," agreed the ministry's secretary general.[21]

The deterioration of the national insurance fund

This rescue mission for the policy of large-scale state lending at low interest rates set the direction for the use of the fund in the ensuing years. The Norwegian national insurance scheme also quickly proved more expensive than anticipated at inception. Costs increased without financing keeping up – in fact, contributions were substantially reduced. The grand vision, the fund, therefore had far less money transferred to it than originally intended – and after a few years the inflow of new capital dried up altogether.

This is one side of the financial deterioration: the national insurance scheme's expenditure moved entirely independently of current or future revenue. The principle of national insurance contributions being tailored to the need to build up a fund which, based on the views of

[19] Important in this respect is a government paper dated 4 January 1966 prepared by the Economic Policy Department. This outlines probable developments in the so-called surplus before loan transactions in the coming years, and compares these figures with estimates for how much borrowing could be expected from private institutions. A key factor in the latter estimate was an expected reduction in saving due to the national insurance system. The sum of all this was set against the government's own borrowing requirement in the years ahead. The conclusion was that a large national insurance fund was required for the whole thing to work; FIN, ØA-131.

[20] "Recommendations of the government committee on the management of the state pension fund", 21 September 1966; EE 34.

[21] Handwritten notes on the government paper cited above.

the time, would help make it easier to pay future benefits, did not survive long. In 1973, the social security budgets were closely coordinated with the government budget. The year after, the budget presented pragmatic ideas that it was actually just a matter of expediency whether the national insurance scheme was funded through separate contributions or through ordinary taxes, so making it possible for the government to finance the scheme as standard expenditure through the government budget. In the years that followed, employers' national insurance contributions were geographically differentiated as an instrument of regional policy. The mid-1970s saw Norway become one of several OECD countries to experiment with neo-Keynesian countercyclical measures. These included increasing wage-earners' disposable income by lowering national insurance contributions in the hope that this would result in lower wage demands.[22] With this, one of the main pillars of the fund concept – solid and stable contributions – was blown out of the water.

Capital of some significance was still transferred to the national insurance fund through to 1975. Modest amounts were then transferred in three of the next four years, but after 1979 no capital at all went into the fund. At the same time, the return on the fund was very weak. In most years up until the low interest rate policy was abandoned in the 1980s, the real return was deeply negative. This was down to the fund's main function of financing government lending of a type, and on terms, that the private market was unwilling to supply. This was very much on the cards from the outset, once the true function of the national insurance fund became resolving the problems associated with funding the state banks.[23]

Fig. 4

The more specific motivation behind this was to obtain capital for the state banks. This was also an important contributing factor in the long-term erosion of the fund. The shortage of funding for the state banks was no secret to political decision-makers. Looking at the newspapers and even parliamentary debates where ordinary members spoke from the floor, however, one is left with the impression that many truly believed that the intention was for the fund to grow to a large size and pave the way for the strongest possible economic growth. There is an obvious democratic issue in this under-communication of the fact that, in reality, the fund would invest its capital in the market's weakest returns in order to finance activities dominated by regional and social policy objectives. Presumably this discrepancy between the grand vision and ongoing credit policy practice contributed to none of the parliamentary groups seriously defending the fund in

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[22] Dahl, Svein: *Kleppepakkene* [The Kleppe packages].
[23] Norwegian Public Reports NOU 1998: 10: 64.

the critical years from the end of the 1960s. The fund had a role in the low interest rate policy, but whether it otherwise served the purpose of stronger growth or in any other way paved the way for the future use of revenue must have been deeply unclear.

Oil revenues and the new fund debate

One of the first reviews of the finances of the national insurance scheme and the national insurance fund came with the Social Security Funding Enquiry of 1982, which was critical of the way that what was intended to fund future pensions was, in practice, being used to get other government instruments to work. However, the enquiry did not spark any major debate. A far bigger public issue was how the nation's new-found oil riches could be saved in the long term for future needs and future generations. The national insurance fund and the oil fund were not linked together in the public debate. At the Ministry of Finance, however, the memories ran deeper.

The idea of investing oil wealth abroad was mooted as early as in a wide-ranging parliamentary report in 1974, although this did not look in detail at how this should be done. The actual practice in the years to follow was to spend revenue as it came in and instead control the rate of development and production. Unexpectedly large discoveries and another surge in oil prices in 1979/80 then created a strong impression that the government's spending of this revenue was dependent on transitory external factors. The so-called Tempo Committee, chaired by the ever-present Hermod Skånland, proposed a new principle for how accrued revenue and current government expenditure should be linked, or rather decoupled. Revenue should be determined by industrial considerations with respect to the rate of development and production, and then transferred to a fund that invested in global capital markets before being channelled back into the Norwegian economy at a tempo suited to fiscal and economic considerations.

This proposal immediately found favour with a wide range of academics and politicians, but not the civil servants at the Ministry of Finance. There were quite determined attempts to torpedo Skånland's fund in 1984 and 1985. The reasons have to be considered "political" as much as economic. One of the big issues of the day was how the state could contribute financially to the internationalisation of Norwegian industry. As an extension of the Tempo Committee's recommendations, key members of the Labour Party presented ideas for how oil money could be used

to take the country forward with big industrial and infrastructure projects.[24] The ministry's fear was that the fund would become a readily available source of capital that could be used to finance measures through channels that were not controlled via the standard budgetary process, where the ministry was the coordinating hub. "An oil fund […] would seem deeply attractive to groups that consider themselves unfairly treated in the prioritisation of the government budget," explained the Economic Policy Department in a memo to the secretary general and the finance minister. "All so-called non-inflationary expenditure proposals would see the oil fund as an alternative source of funding to the standard budget."[25]

Memos from the ministry portrayed experience from the national insurance fund as a dark scenario, and not without some reason. The national insurance fund was set up as a reserve outside the government budget. Proposals for new welfare measures were therefore tabled outside the budgetary process during its first years. What was left in the fund had been used to cross subsidise popular purposes, at costs that were neither revealed nor fully known. The civil servants did not point out that it was their predecessors at the ministry who had consciously designed the fund with this in mind 20 years earlier but this was, of course, well known to the key actors.[26]

This fear of a fund to serve domestic objectives became more acute when a parliamentary report from the Ministry of Petroleum and Energy presented paragraphs on how oil revenue could be used to boost Norwegian infrastructure, growth capacity, industrial expansion abroad, and so on. Following sharply worded counterarguments from the Economic Policy Department, the Ministry of Finance was asked to set up a ministerial committee with two civil servants from its own ranks, two from the Ministry of Petroleum and Energy, and a chairman from a third ministry.

The mandate from the government was not whether there should be a fund but what kind of fund there should be. The majority returned with a recommendation to set up a fund that was not really a fund: it should take the form of a standard government deposit account at the central bank under ordinary fiscal policy control. Alternatively, the fund could invest its money in foreign currency purchased from Norges Bank at market rates, which was effectively the same thing. Oil revenue

[24] Cf., for example, Finn Lied's lecture "Norges valutareserver – passiv plassering eller vekstimpuls for landet" [Norway's foreign exchange reserves – passive investment or growth stimulus for the nation], manuscript, 11 October 1984; TM 8.
[25] Economic Policy Department to the minister via the secretary general, 4 September 1984; SG 2.
[26] The Ministry of Finance had the same secretary general, Eivind Erichsen, in 1966/67 and in 1983/84. In a conversation between the author and Erichsen in 1996, Erichsen highlighted the significance of the national insurance fund's "sad destiny" in the Ministry's attitude towards the new oil fund.

would be transferred to a (foreign currency) account managed outside the existing administrative apparatus.

The minority, two department heads from the Ministry of Oil and Energy, presented an institutional solution which was a fund in the normal sense of the word. This would be organised as a separate organisational unit and serve partly as a buffer fund for fluctuations in government revenue and partly as a long-term investment fund if the assets under management grew to a large size. The main thrust of this proposal was that capital should be invested abroad in fixed-income securities or shares in large companies, but it also opened up the possibility of investing in development contracts for foreign companies wishing to invest in Norway, and less specifically for "purchases of large shareholdings/corporate takeovers".[27] While the Ministry of Finance made little reference to international models, the Ministry of Petroleum and Energy produced an extensive annex with international experience of commodity funds. These funds, the bulk of them in the Middle East, were divided into three types according to whether they were to (i) replace oil revenue once it came to an end, (ii) even out fluctuations in oil revenue, or (iii) be used here and now to develop the domestic economy.

The proposal from the mandarins at the Ministry of Petroleum and Energy embraced all three variants, and representatives of the Ministry of Finance were dismissive of a model where the fund would play any role at all in doing anything "strategic" in the domestic economy.[28] Memos written while the committee was at work suggest, however, that the Economic Policy Department did not actually fear a consistent realisation of what they referred to as the Skånland model. What they really feared was that the popular variant, a fund that would invest in infrastructure and Norwegian industry, would win acceptance.[29] And in their concrete advice, the baby went out with the bathwater.

The episode highlights the thin line between learning from history and being confined by it. When facing extremely rare events – like deep financial crises, warfare, or resource booms – advisors and politicians might find little guidance in general theory made for business-as-usual activities. Then historical lessons, analogies to past experiences, are mobilised. Barry Eichengreen has recently discussed how analogies from the inter war crises shaped

[27] "Petroleumsfond som styringsinstrument i finanspolitikken" [A petroleum fund as an instrument of fiscal policy]. Report from the civil service committee appointed by the Ministry of Finance, 23 January 1985; ØA box D9-442. Petter Nore was also one of the secretaries in the Tempo Committee. His loyalty to its conclusions was therefore not that surprising.

[28] Engebretsen, Marit and Petter Nore: "Internasjonale erfaringer med petroleumsfond" [International experience of oil funds], annex 1 to the report cited above.

[29] For example, Economic Policy Department to the minister, 27 September 1984; TM 8.

interpretations and policy responses during the financial crises from 2008. With references also to foreign policy making, he underlines the problem related to choosing one dominant analogy in the analyses of a specific challenge.[30] This analogy normally appears as a consequence of its accessibility and prominence in individual and collective consciousness. Military history provides other examples, as most officers train for war and large battles they can read about but very rarely experiences themselves. The debated and victorious General George S. Patton was an intense reader of military analyses of Julius Caesar, Scipio Africanus, Lord Nelson, Napoleon Bonaparte and many others, whom he tried to learn, but never copy, from.[31] The French General Joseph Joffre – the strategist behind the Maginot-line, the heavy fortressed defence line built along the French border with Germany in the 1930s – was not known to be a dedicated reader of military history. But he was a veteran from two wars, the Franco-Prussian in 1870/71 and the First World War. He would not let France get defeated ones more by superior forces pouring in over the French-German border. His fortress lines thus became a perfect defence against the attacks made in the two previous wars. However, the damaging WWII -assault came, as we know, through Belgium and Holland, which had a friendly and lightly armoured border with France. The Maginot-line was never defeated in combat. But France was.[32]

Returning to our case, the high ranking bureaucrats in the Ministry of Finance fell more or less automatically into the Joffre model. The civil servants had a relevant and costly experience, and they felt responsibility for the defense line. This formed their stance and arguments. They learned from historical experience, and they were confined by historical experience.

Consequently, they did what they could to block the proposals for a new fund. After the first heavy objections from the Ministry of Finance, a long internal debate followed. One of Prime Minister Kåre Willoch's high-profile political advisers was a clear advocate of a Skånland fund.[33] The Ministry of Finance's parliamentary secretary, however, was clearly behind the civil service view.[34] And it was this view that had the greatest influence over the formulation of the new bill for a Petroleum Fund Act following lengthy internal discussion within the government apparatus. This stated that "the fund's assets will be managed in the same way as other government capital", in other words placed in

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[30] Eichengreen 2012, 'Economic History and Economic Policy*, *Journal of Economic History*, vol. 72289–307.
[31] Axelrod, Alan 2009, *Patton.* New York: Macmillan, Grossman, Mark, 'Jospeh Jaques Césaire Joffre', in *World Military Leaders. A Biographical Dictionary.* New York.
[32] Joffre, Joseph J.C. 1932, *The Personal Memoirs of Joffre: Field Marshal of the French Army*, Volume 1Harper & Brothers, 1932
[33] Osmundsen's memo to the finance minister of 6 September 1984; SG. 2.
[34] Reiten's memo of 10 September 1984; SG 2.

government accounts at Norges Bank in line with existing deposits.[35] Not only had Skånland's idea been diluted, but the solution had taken its time.

It may seem paradoxical that the civil service backed a fund that was, in reality, nothing more than a formal structure for standard government reserves managed by the central bank. However, the fear was not only that the fund could pave the way for domestic use of oil revenue by financing measures outside the budgetary process, but also that it might help raise the profile and visibility of the capital available for public spending. This general scepticism from the early eighties is support from international experiences from the last 20 years or so.. A general feature of large sovereign wealth funds is that direct involvement of politicians in their management results in greater investment in local, domestic objectives.[36]

Literature on resource booms often discusses institutional qualities and characteristics when analyzing long term effects on politics and economy. It is, however, worth noting that funds like the Norwegian national insurance fund, held up by the economist within administration as a an example of what it feared, cannot be labelled unambiguously as a weak institutional solution in the light of the growing literature on institutions and resource booms/courses. A key criterion tends to be whether the institutional arrangements facilitate rent-seeking at the expense of production, paving the way for "grabbers" within or outside the public sector. There is an obvious problem with the lack of transparency when the national insurance fund was set up. But its subsequent management took place openly, with annual reports and parliamentary papers. Nor is it possible to find examples of individuals or institutions enriching themselves through the arrangement – other than the state banks, which benefited from cheap funding that would not otherwise have been available. But this came as a result of majority decisions in a well-functioning parliamentary system. What the economic advisors in the Ministry feared, therefore, was attention being drawn to the riches that the fund entailed, and the fund making it easier, rather than harder, to spend money without proper prioritisation of needs.[37]

What would become Proposition to the Parliament No. 53 (1985-86) was completed just after the slide in oil prices of winter 1986. In this new situation, the government feared that a fund could create the impression that the drop in oil prices was only temporary, and this was not the kind of

[35] "Om lov om Petroleumsfond" [On a Petroleum Fund Act], Proposition to the Odelsting No. 53 (1985-86) (draft).
[36] Bernstein, Shai, Josh Lerner and Antoinette Schoar: "The investment strategies of sovereign wealth funds", NBER Working Paper 14861, Cambridge, Mass.: NBER.
[37] Jeffrey A. Frankel: "The natural resource course: A survey", NBER Working Paper 15836, Cambridge, Mass.: NBER. Mehlum, Halvor, Karl Moene and Ragnar Torvik: "Institutions and the resource course", *Economic Journal* 116: 1-20, 2006;

signal it wanted to put out ahead of the year's pay talks. The bill therefore had to wait until the pay deals were done and dusted.[38] By then, the government had changed. Thanks to these chance circumstances, the civil service's original line won the first round.

The petroleum fund comes about

The second round came in 1989 when a new right-wing government came to power. The finance minister was quick to announce that he wanted an oil fund set up, but without giving clear guidelines for what it should look like. A bill was prepared by the mandarins at the Ministry of Finance without any great enthusiasm. However, as the head of the Economic Policy Department put it in a memo when the government paper on the matter was drawn up, the political signals that a fund was coming were "so clear that there is no avoiding it".[39]

However, all of the civil service's misgivings from 1984-86 were written into the new bill. The key principle, which has held to this day, is that revenue from petroleum activities should go straight to the fund. All investments from the fund's holdings should be made abroad, without exceptions. All spending of the return of capital invested must be approved by parliament as part of the balancing of the government budget. Any route from fund to consumption other than through the government budget was expressly ruled out. These regulations should protect the domestic economy from overspending of oil revenues, as well as avoid making the fund a source of "cheap money" for political purposes.

Those who created the fund had real doubts as to whether any capital would ever be transferred to it.[40] The Norwegian economy was in a parlous state in 1989/90, with huge imbalances in the economy on the back of a strong credit-driven boom in the middle of the decade, and a looming bank crisis. Experience over the previous 15 years had also indicated that Norway had been in a position to spend large amounts of oil revenue domestically, even though the macroeconomic consequences had been unfavourable. In the first half of the 1970s, there was extensive debate about how Norway could avoid going the same way as the Dutch, but this did not dominate subsequent developments. "We

[38] Presthus' handwritten notes on the draft bill, 20 March 1983; SG 3.
[39] Gjedrem's memo to Skauge via Hermansen, 8 September 1989; "SG memos 1989".
[40] Oral information from then head of department Tore Eriksen and Svein Gjedrem, Ministry of Finance.

carefully plotted a course and then immediately headed in a different direction," as Hermod Skånland, then central bank governor, elegantly put it.[41]

Expectations of substantial oil revenue had fuelled very high levels of public consumption and large trade deficits in the late 1970s. Policy was tightened, but from the early 1980s there was a further strong upswing in the domestic economy. The reasons were complex, but actual and anticipated oil revenue put constant pressure on the economy, along with low prices for credit and a tax system that favoured borrowers.

This was presumably a contributing factor in the fund turning out the way it did in 1990: the civil service did not actually want one at all, but would as an alternative accept a fund investing outside the Norwegian economy. There was limited interest among politicians, because there was such uncertainty about whether the fund would ever be of any real significance. In 1984/85, the government was busy accumulating reserves in deposits at Norges Bank, but five years later the economic and fiscal situation was quite different. For the finance minister, it was probably most important to underline a desire to return to a situation of government saving. There is, however, nothing in the preparatory work to suggest that the political leadership in 1989/90 was particularly closely involved in the discussions on the concrete design of the fund in the final phase.

There have since been a plethora of adjustments to the rules for the management of the fund, especially when it comes to the types of asset in which oil revenue may be invested. The allocation to equities has been increased, and the fund has moved into real estate. Ethical guidelines have been drawn up to stop the fund from investing in companies that sell arms or produce tobacco, or whose operations violate key ethical standards.[42] Within this framework, the fund's managers are to obtain the greatest possible return. But the principle that has been most widely debated – that the fund's capital may only be invested abroad – has been unchanged. This debate has taken on a different, and to some extent stronger, form since the so-called budgetary rule was introduced in 2001. This rule means that only the expected "normal return" on the fund, set at 4 per cent, should be transferred from the fund for spending via the government budget. Previously there was no clear rule on withdrawals of oil money. Fiscal policies aimed at keeping low unemployment rates without too high inflationary pressures, and oil revenues were used at a discretionary basis to provide finance for occurring deficits in state budgets.

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[41] Skånland 1988.

[42] http://www.regjeringen.no/en/sub/styrer-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277

With a hard and fast rule in place, proposals for using oil money for domestic investment were back on the agenda. Since 2001, advocates of spending oil money on industry, research, infrastructure and suchlike have often argued that more should be invested domestically. This debate – which is outside the scope of this article – has been partly about securing capital for investment in infrastructure, and partly about financial investments in research foundations, innovation funds and so on. But the distinction from the 1980s has held: investment must still be made exclusively abroad, and the way back into the Norwegian economy must be through existing or new rules and procedures in the budgetary process.

Conclusions

"The Government Pension Fund comprises the Government Pension Fund Global and the Government Pension Fund Norway. The Government Pension Fund Global is deposited in an account at Norges Bank, while the Government Pension Fund Norway is deposited with the National Insurance Fund."

Such is the text on the Ministry of Finance's website presenting the arrangements for Norway's government-managed financial wealth. The funds come across as two different but well-balanced funds, like the yin and yang of government saving. The division between the two seems straightforward and sensible enough. Many private-sector equity funds are divided along the same lines, with some having built up management expertise and portfolios focusing on the domestic or Nordic market, and others concentrating on distant continents or global markets. But this seemingly neat division of labor is not a part of a harmonious planned process. The history of the two funds shows that the differences are between them a result of a perceived failure of the first arrangement, which resulted in quite an opposite solution for the latter.

The national insurance fund dates from an age of very limited transparency. The oil fund came about in a world of liberalised capital markets, and there is great openness about the fund's objectives and assets. At the same time, experience from one was important in the late and reluctant establishment of the other. Just how important, is impossible to say with any certainty. Perhaps we would have had an oil fund reminiscent of the national insurance fund, or another variant where one of the aims was to develop Norway's economy and infrastructure. It seems likely that the fund would, in one way or another, have been more accessible for political investment objectives. But we will never know what kind of oil fund we would have had without the sad story of the national insurance fund. History does not allow for controlled experiments.

But we do know that the fund did not come about solely through intelligent assessment of best practice. It was the result of costly, hard-won experience from the previous fund arrangement and the costly and unstable macroeconomic policy of the 15-year period after it became clear in 1973 that oil would make Norway rich. The main positive to be taken from this episode is probably that the hardest lessons were learnt before the massive influx of oil revenues over the last fifteen years. And if one have to learn by failing, it’s better to do so before the stakes get too high.

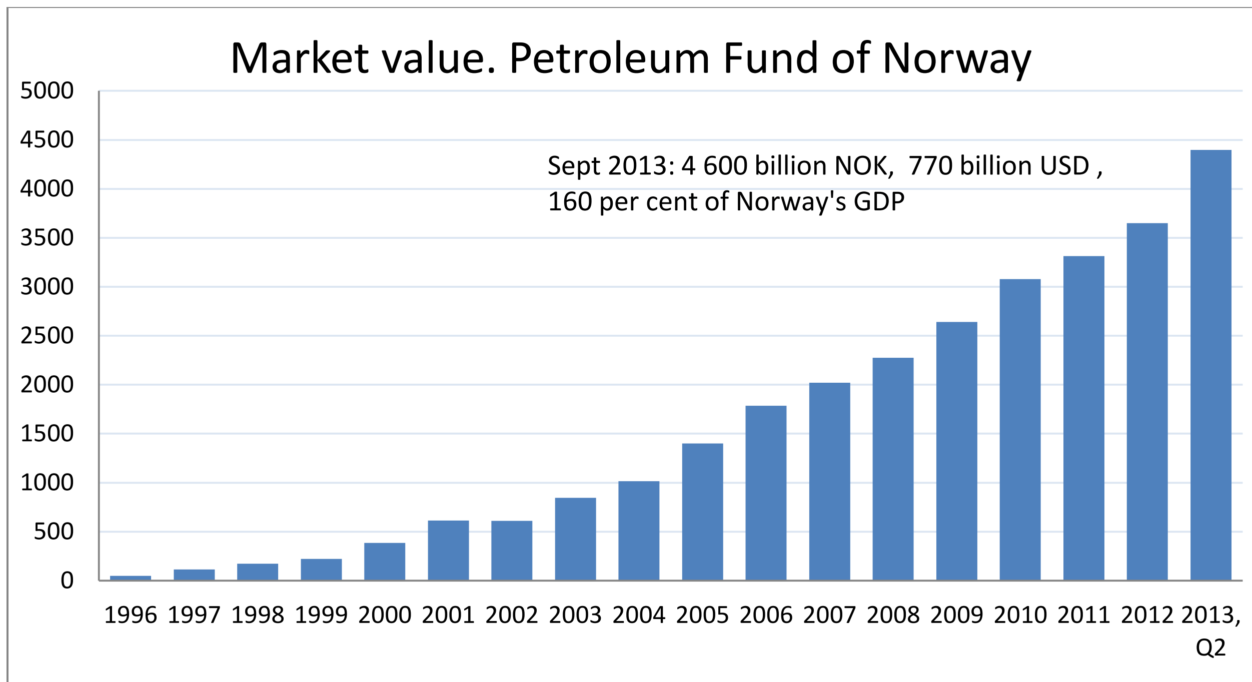
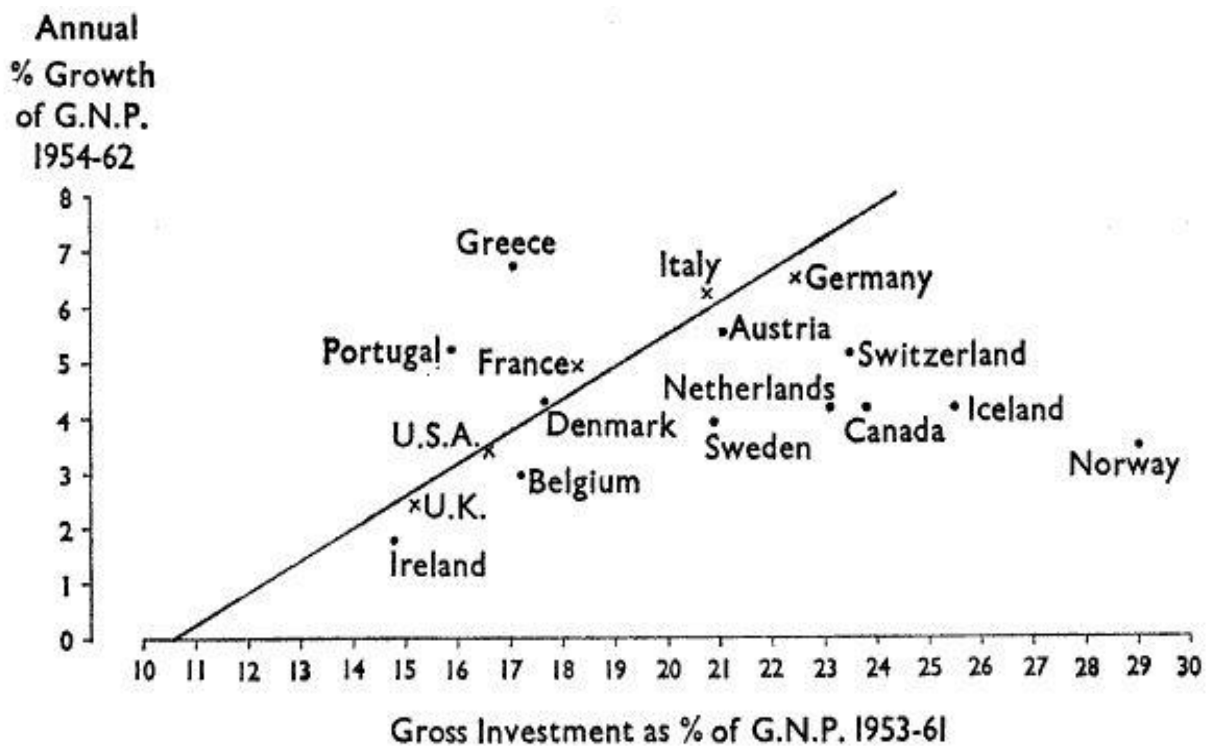


Fig. 1



T.P. Hill 1964, 'Growth and investments according to international comparisons', ***The Economic Journal*** **1964 (facsimile)**

Fig. 2 State Bank Growth in Norway

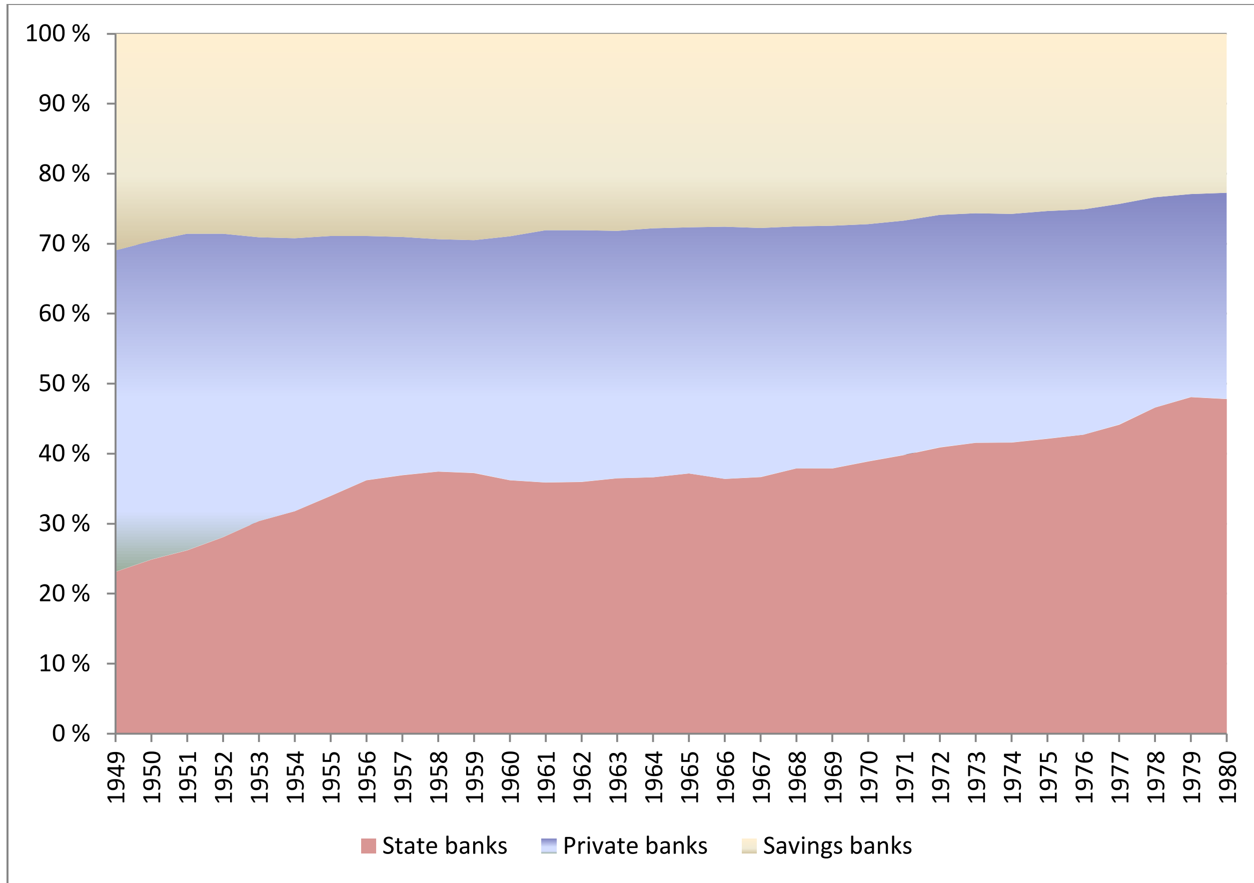


Fig. 3: Interest rates (bond yield) in selected countries

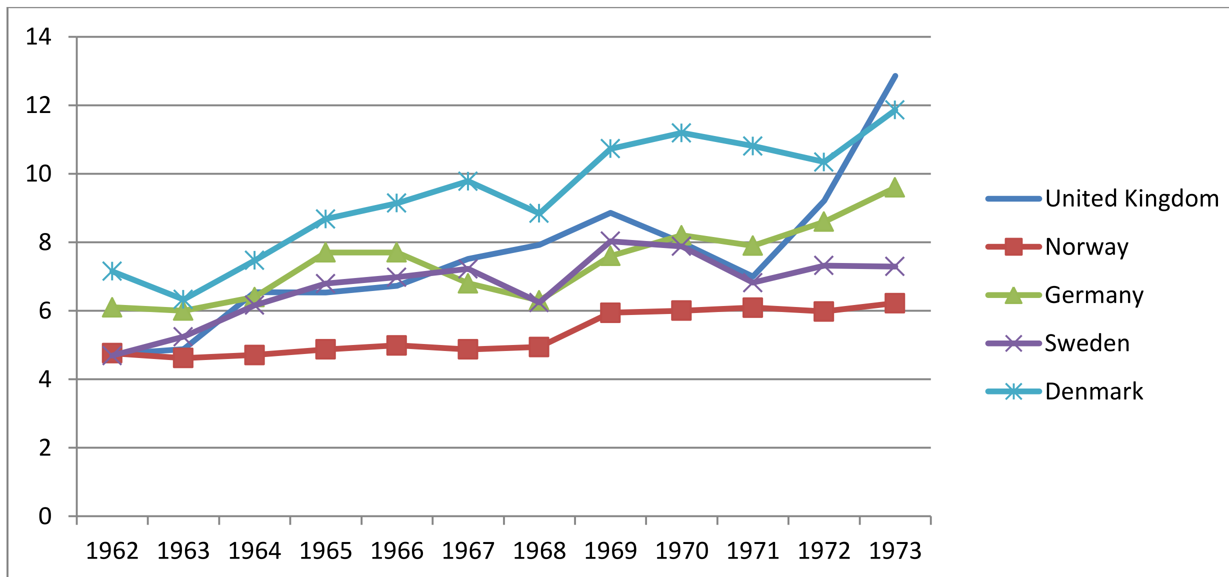


Fig. 4