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How to spend it?
A fiscal framework for Norway

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Outline

- Fiscal rule a great success
- Lessons from other countries
- Fiscal rule and public financial saving
- How to spend it?
- Uncertainty in the value of GPFG

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Fiscal rule a great success

- Gradual increase in spending
  - Save for future generations
  - Dampen adverse effects on the economy
  - Spend the money better

- Structural budget balance defines use of oil money
  - Cyclical adjusment of threshold for evaluation facilitates automatic stabilisers
  - Additional stabilization around 4-percent path

- Broad support among politicians, experts and public opinion

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Lessons from other countries

- Fiscal multiplier varies over the cycle
  - Avoid cuts in downturns
  - Moderately countercyclical fiscal policy
    - Automatic and semiautomatic stabilisers
    - Timing of investments, reforms, spending initiatives

- Fiscal framework matters
  - Credible and sensibel fiscal rules
  - Decision making process, transparency, fiscal council

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Fiscal rule – spend expected return on GPFG

- Generational equity – all receive same exp. return
- Neglect value of oil in the ground
  - Uncertainty in future oil income
  - Gradual increase in spending
  - Rising costs related to demographics and pensions
- Implicit baseline of balanced budget without oil
- But also other reasons for non-zero budget balance
  - Counteract demand effects from oil activity
  - Higher social return on public investments due to
    - Population growth
    - Increased expectations due to higher real wages

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How to spend it?

- Strengthen growth potential?
  - Yes, but also important for countries without oil
- Socially efficient spending & gradual changes

- Public budgets likely to be tighter in the future
- => Spend on items that reduce future spending or increase future revenues
  - Public investments now rather than in the future
  - Careful with reforms with high long terms costs
  - Tax system that promotes growth
  - But maintain tax bases, tax types & labour supply

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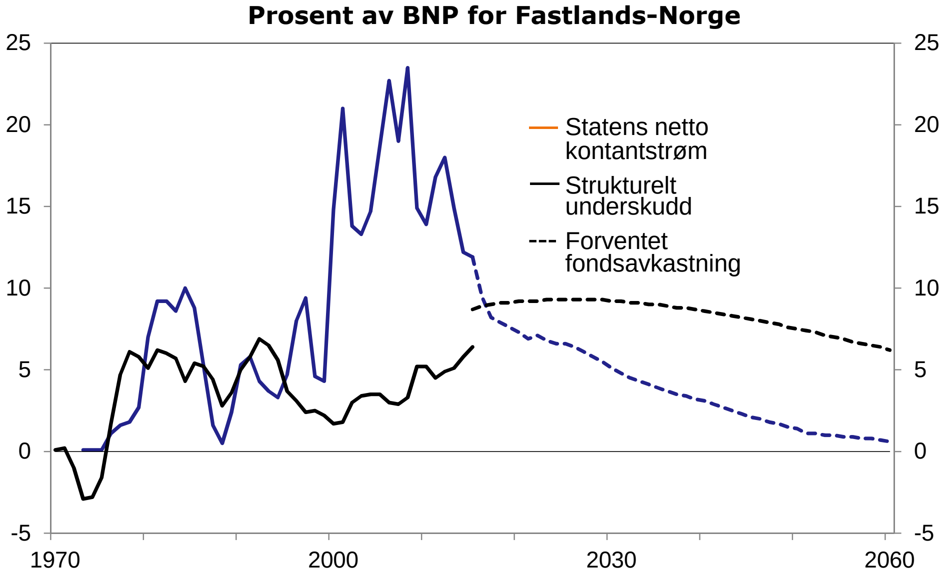
Fluctuating and temporary oil revenues transformed to permanent and stable income



Kilder: Nasjonalbudsjettet 2015

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Large uncertainty in all components

- Value of GPFG
  - Likely to be positively corrrelated with Norw economy
- Oil revenues/inflow to GPFG (NB15: NPV 4000 bn)
  - Strong correlation with economy
  - No direct effect on spending; dampen other risks
- Estimated expected return
  - Unclear correlation with value of GPFG
- Structural budget balance (estimate of spending)

=> Adverse effects on the spending of oil money

  - Fluctuating rather than smooth spending
  - Risk of fiscal contractions in downturns

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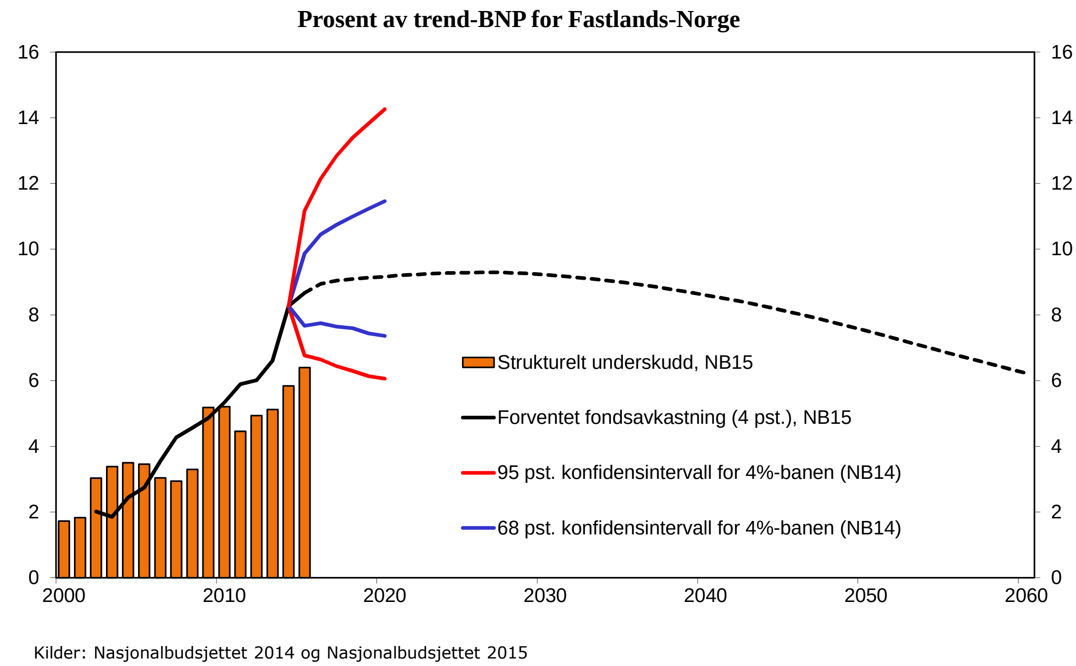
Effect of estimated uncertainty in GPFG (from NB13)



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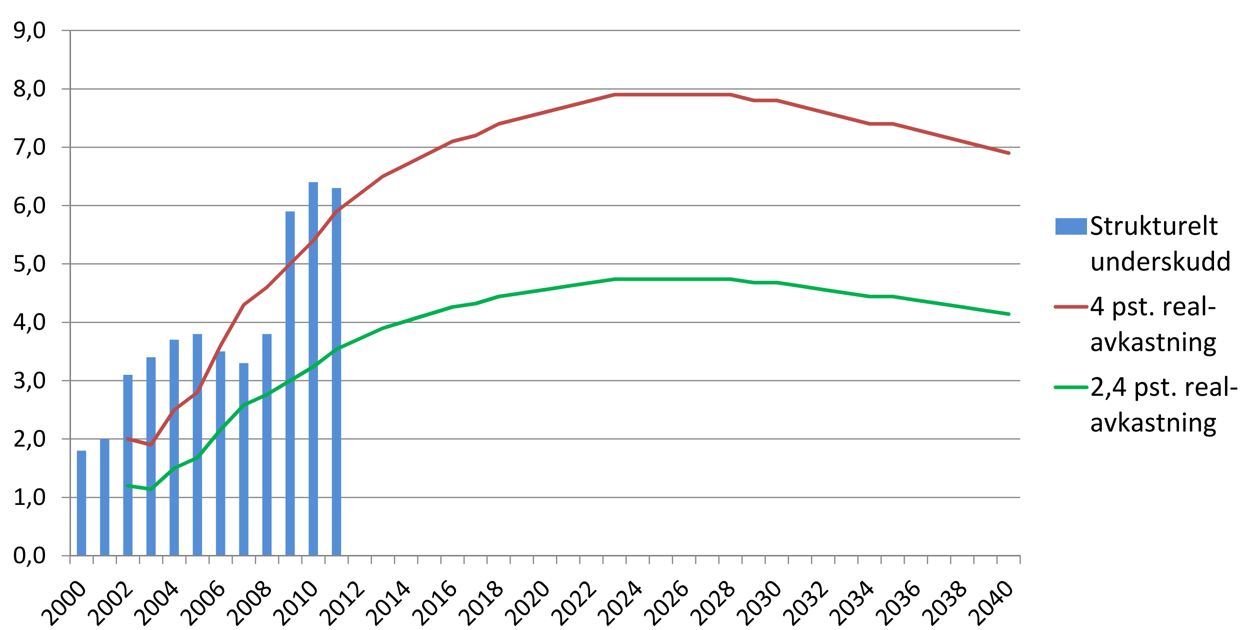
Effect of lower expected return
Fall 2010; Holden (Samfunnsøkonomen, 2011)



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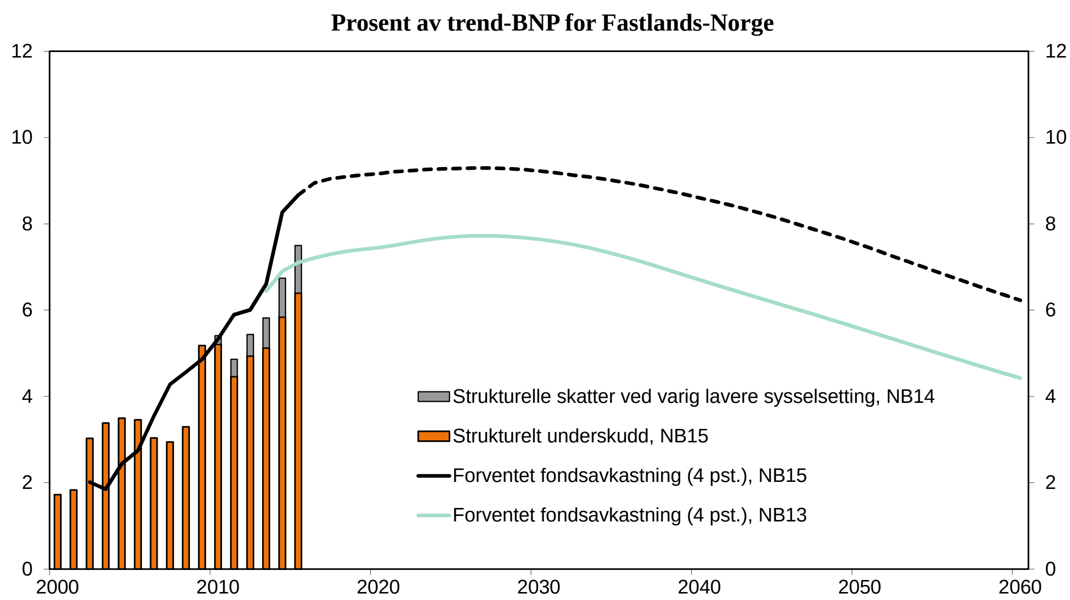
Lower structural taxes due to lower employment & lower GPFG



Kilder: Nasjonalbudsjettet for 2013, 2014 og 2015.

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What to do when the value of the exp. return from GPFG falls

- Avoid/minimize cut in downturn
- Safety margin prior to fall
  - Based on oil in the ground, but decreases over time
  - Excessive saving compared to case with no uncertainty
  - May stretch political feasibility
- Smoothen/gradual reduction in spending after fall
  - Delay cut will magnify long term reduction in GPFG
  - Downturns may be long-lasting
  - Credibility among investors, voters, foreign govts’
- Other types of flexibility in public budgets

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Safety margin

- Must sooner or later change fiscal rule to ensure a sufficient safety margin
- But when? Difficult to change something that works

Possible analysis:

- Uncertainty band for the future value of the GPFG/the return from the GPFG
- Identify the, say, 30% path (30% risk lower value)
- Smooth transition towards this path

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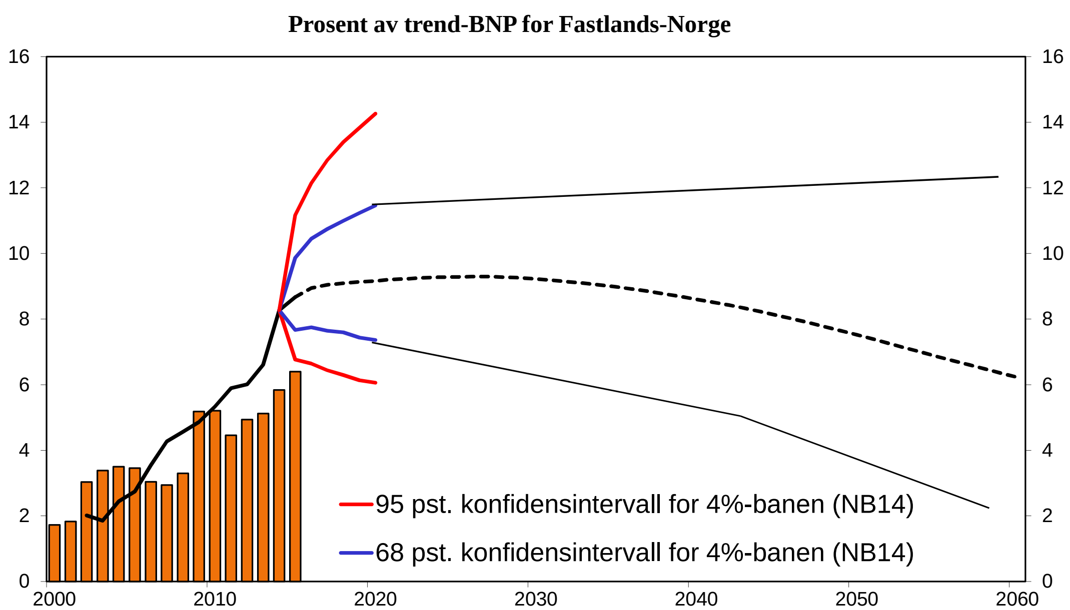
Safety margin gives limited room for future rise in spending?



Kilder: Nasjonalbudsjettet 2014 og Nasjonalbudsjettet 2015; Extended lines for illustrative purposes

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Also prepare for smoothing of spending in a downturn

- Smoothing when the GPFG increases (symmetry argument)
- Broad understanding and consensus prior to fall
- Public plans and sound analysis
- Institutional framework (fiscal council?, govt commission?)

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Conclusions

- Large uncertainty in the future expected return from the GPFG
- Aim for gradual changes in the spending, and avoid cuts in downturns
- Future oil revenues has provided an ample safety margin, but this is about to change
- Must sooner or later change fiscal rule
- Possible analysis: Uncertainty band for the future value of the GPFG/the return from the GPFG
- Smooth transition towards the 30% (?) path
- Room for countercyclical policy around path