

**Norway - Resource Curse and Public Spending**  
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# PRODUKTIVITETSKOMMISJONEN

En offentlig kommisjon oppnevnt av Regjeringen for å fremme forslag som kan styrke produktivitet og vekstevne i norsk økonomi.



## Norway – Resource curse and public spending Jørn Rattsø

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# Resource curse/ Paradox of plenty

- Large natural resources (export share of GDP) associated with low GDP-growth (Sachs and Warner 1995 and large literature)
- Dutch disease: Resource sector crowds out traded sectors with scale economies and productivity growth (deindustrialization)
- Rent-seeking: Large potential gains to be captured from non-productive activity ('Grabbing versus production')

# Heterogeneity

- Resources a blessing for countries with good institutions, a curse for countries with bad institutions (Mehlum, Moene, Torvik, EJ, 2006)
- Institutional quality: Rule of law, bureaucratic quality, corruption in government, risk of expropriation, government repudiation of contracts (Knack and Keefer, E&P, 1995)
- Resources may distort institutions, rent seeking and endogenous institutions

# Income and savings

- Resource rents, not standard revenue – resource wealth is converted to money
- Savings rates must be adjusted for reduced resources (Matsen and Torvik, JDE,2005, numbers for 1972-2000)
- Norway 17%, Australia 18%, Malaysia 20%
- Nigeria -22%, Congo -12%, Venezuela -2%

# Empirical evidence, resources and institutions

- Observed corruption increases in areas with oil discovery, West-Africa (Vicente, JDE, 2010)
- Oil windfalls little effect for services, funds are diverted, Brazil municipalities (Caselli and Michaels, AEJ:AE, 2013)
- Commodity price booms raise gov spending, corruption and expropriation risk, 'voracity effect' (Arezki and Bruckner, JIE, 2012)

# Private sector rent seeking

- Entrepreneurs choose between rent-seeking and productive activities
- Resource richness offers more return to rent seeking (Torvik, JDE, 2002)
- More entrepreneurs move to rent seeking, less in productive activities, loss of welfare
- Observations: Public sector contracts attractive, lobbying of politicians, firms seeking government subsidies ('innovation funds' etc)

# Political system under pressure

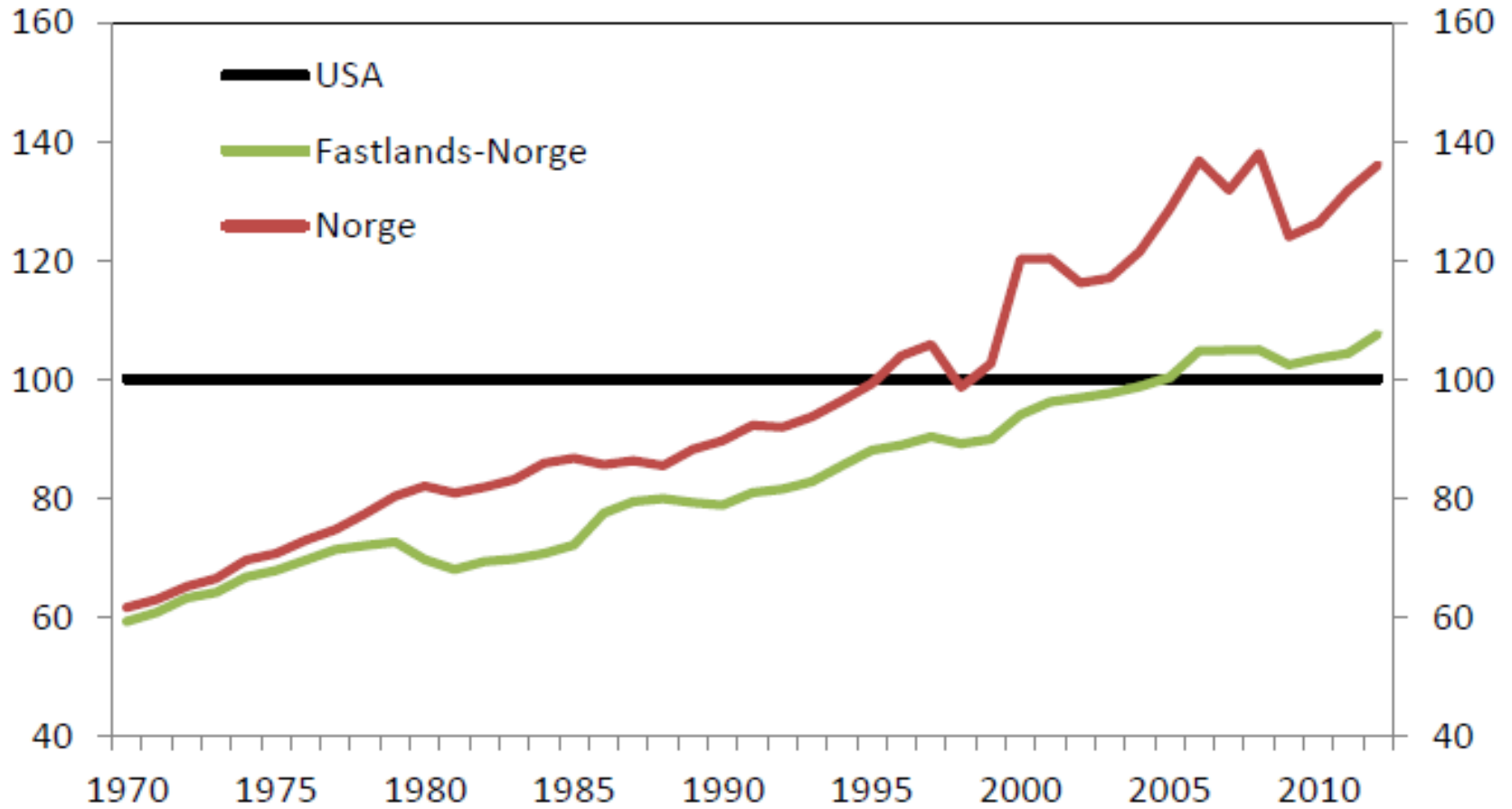
- Does working of political system change with resources?
- Higher demand for spending and harder to defend budget constraint
- Reduced incentive to reform, upfront costs/ resistance stop reform
- Larger opportunities for patronage, spend to favorite interest groups
- Reduced incentive for cost control and service quality



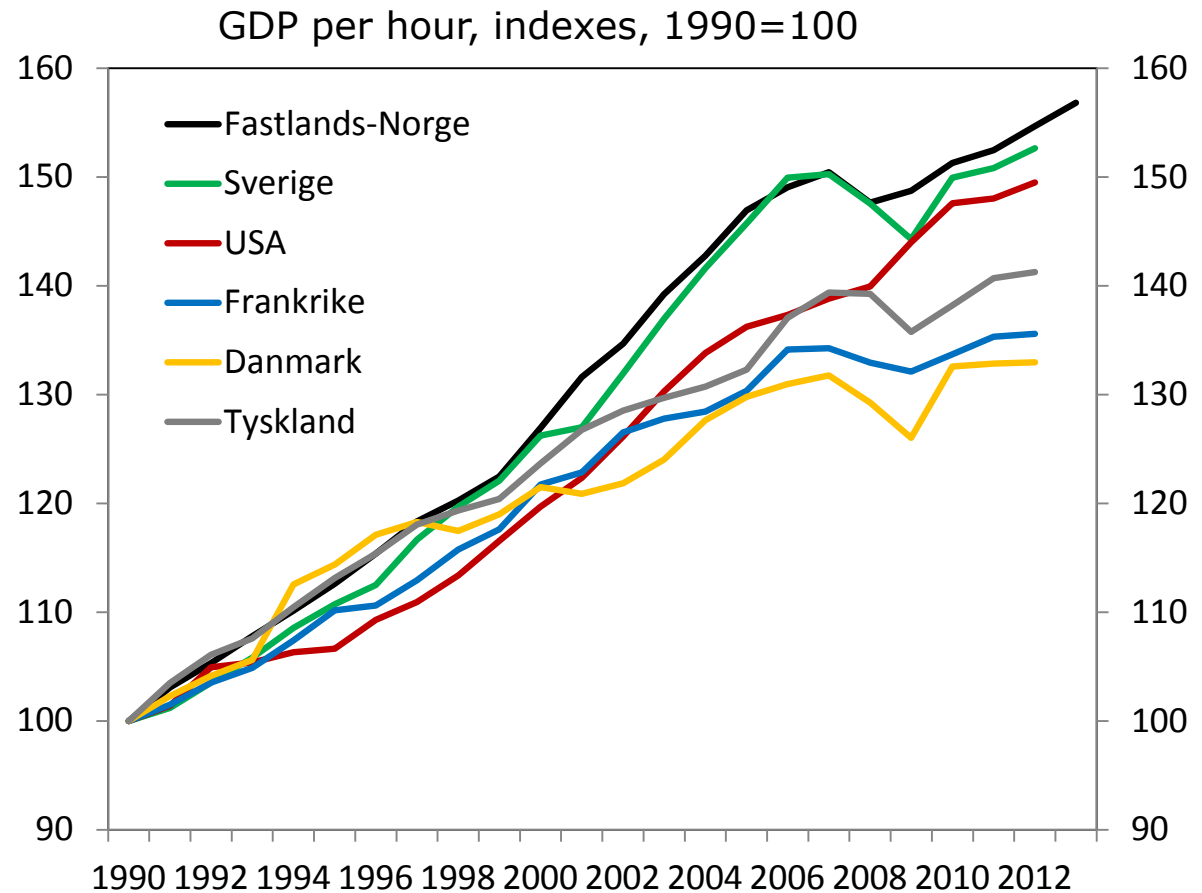
# Relevance for Norway

- Good institutions established before oil
- Learned a lesson on Dutch Disease with overheating in the mid 80s and following unemployment, all three major commercial banks went bankrupt
- Paved the way for:
  - A number of structural reforms in the 90s lifting productivity growth; tax system, market reforms (telecom, el power) and new public management
  - A prudent framework for handling petroleum revenues (fund and fiscal rule)
- Is this sustainable 25 years after the Norwegian eye-opening crisis?
  - No structural reforms over the last decade – among the worst performers among the OECD countries

# Productivity ahead of frontier (USA)



# Productivity slowdown common problem

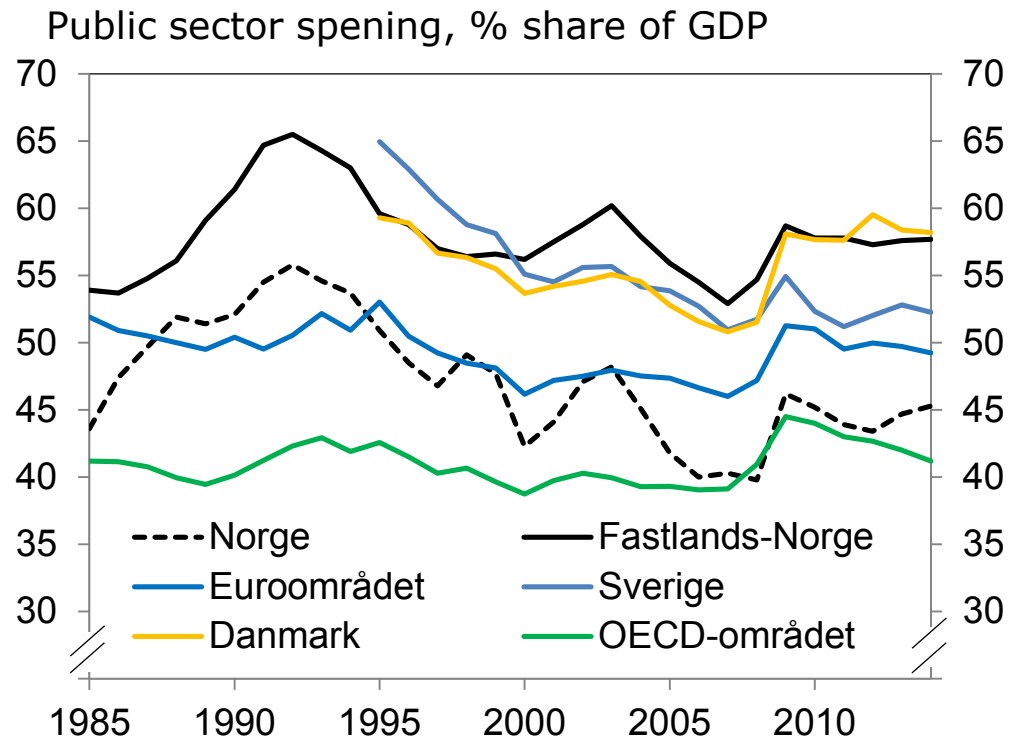


Kilde: OECD

# Micro-macro paradox?

- Macro: High GDP per capita and GDP per worker, ahead of world technology frontier (USA)
- Micro-observations: Schooling on oecd average, no top international university, limited 'break-through' research, limited innovation, weak transport infrastructure, police inefficiency, dysfunctional organization of local governments
- Has the growth of oil activity and associated industries masked an underlying productivity problem?

# Expanding public sector



# Economic implications

- Old government structures survive, many local governments, hospitals, colleges, police districts etc
- More pork barrel politics, more colleges, airports, tunnels,..
- Urbanization is held back and cities are badly organized
- More service production in government institutions, less privatization and competition
- More government enterprises and ownership, limited competition

# Norwegian challenges

- Norway after oil, like Finland after NOKIA
- Capacity to reallocate resources and innovate
- Strengthening higher education (competition, quality evaluation), research organization, innovation system
- Increase competition at domestic service markets and internationalization
- Raise productivity and quality of public sector
- Politics with too much money