DET KONGELIGE
FINANSDEPARTEMENT

Royal Ministry of Finance

The National Budget 2014

A summary

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National Budget 2014

1 Introduction

With growth in line with the historical average and low unemployment, the current status of the Norwegian economy differs markedly from that of many of our trading partners. Strong demand from the petroleum industry and higher private consumption underpin growth. The number of people in employment is now about 3 pct. higher than when the business cycle peaked before the financial crisis and unemployment is well below the average for the last 25 years. A substantial inflow of immigrants from the EU has contributed to a large increase in the labour force in the Norwegian economy in recent years, lifting production capacity but also increasing demand for housing and infrastructure.

The oil revenues put Norway in a favourable position when compared to many other countries. Over time, welfare and living conditions in Norway are, nonetheless, primarily determined by developments in the mainland economy. Growth in the mainland economy, i.e. excluding petroleum extraction, pipeline transportation and international shipping, has rebounded after the setback during the financial crisis. If we also exclude electricity generation, which is almost solely based on hydro power and therefore heavily influenced by variations in precipitation, economic growth in the Norwegian mainland economy may be just below the average for the last 40 years this year and just above the said average next year.

The fiscal policy guidelines aim at a gradual phasing-in of oil revenues into the Norwegian economy on par with the expected real rate of return on the Government Pension Fund Global, estimated at 4 pct. The guidelines permit spending more than the expected return in cyclical downturns, whereas spending should be below the expected return when capacity utilisation in the economy is high. This room for manoeuvre was used in 2009 to mitigate the effects of the financial crisis on the economy. Economic growth in recent years has brought the spending of oil revenues well below the four-per cent path. In a period when the Fund capital is growing steeply, as is presently the case, spending of oil revenues in line with the expected return on the Fund (the four-per cent path) would have provided the economy with a strong boost. This would not have been consonant with the objective of stable economic development.

Several years of high wage growth and the gradual appreciation of the Norwegian krone has increased the cost level in Norway. In a situation characterised by weak demand abroad, this makes many export firms vulnerable. We now see a number of examples of Norwegian businesses losing out to foreign competitors, also within petroleum-oriented industries. In the view of the Government this situation calls for caution in expanding oil revenue spending from 2013 to 2014.

The Government's budget proposal for 2014 provides a budget impulse of about ¼ pct. of Mainland Norway trend GDP, as measured by the change in the structural, non-oil deficit. When measured in fixed prices, this represents an increase of NOK 11 billion in oil revenue spending from 2013 to 2014. The estimated impulse is roughly in line with the average phasing-in over the years since the fiscal rule was introduced. The Government's budget proposal for 2014 entails oil revenue spending of NOK 135 billion, which corresponds to 2.9 pct. of the estimated capital of the Government Pension Fund Global. Taking account of the composition of the revenue and expenditure side of the proposed budget, model simulations indicate that it has a more or less neutral effect on production and employment.

2 Economic outlook

Activity in the Norwegian mainland economy rebounded swiftly after the downturn in 2009. Despite weak international development, strong demand from the petroleum industry and higher private consumption have contributed to sustained growth and low unemployment.

Last year, mainland GDP increased by 3.4 pct., cf. Figure 2.2A. However, growth abated towards the end of last year and in the first half of this year. Domestic demand developments have curbed growth over the last three quarters, and also traditional goods exports have developed weakly.

Mainland GDP growth is expected to be 2.2 pct. this year and 2.7 pct. next year, cf. Table 2.1.

Box 2.1 Mainland Norway and the total economy

Mainland Norway is defined as all economic activity in Norway, excluding petroleum activities and ocean transport. From a stabilisation policy point of view this is the most relevant sector definition.

Petroleum activities represent a major part of value added in the Norwegian economy. In 2012, about one fourth of total value added in Norway was accounted for by petroleum activities, while ocean transport accounted for only ½ pct., cf. figure 2.1. Petroleum activities constitute an even larger portion if we look at exports; about three fifths in 2012. The significance of the petroleum industry is less marked in terms of employment. The petroleum industry accounted for just over two pct. of total employment in 2012, whereas ocean transport accounted for just below two pct., mainly foreigners. The combination of substantial value added and rather low employment in the petroleum sector reflects the high level of productivity and the resource rent in this sector. Since production and income fluctuations in the petroleum industry and ocean transport have limited impact on the demand for labour in the Norwegian economy, these sectors are excluded from the analysis of cyclical developments.

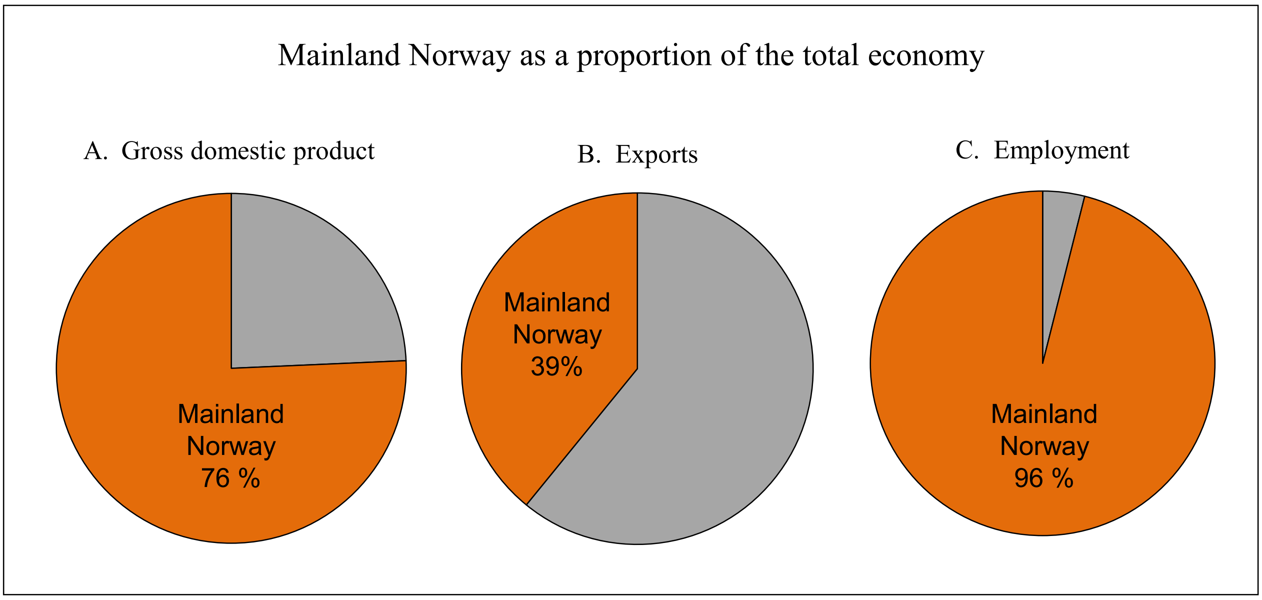

Figure 2.1 Mainland Norway as a proportion of the total economy
Sources: Statistics Norway and Ministry of Finance.

In comparison, average annual mainland GDP growth over the last 40 years was 2.6 pct. A decline in hydropower generation, which represents the main source of electricity in Norway, will dampen mainland GDP growth by an estimated 0.3 percentage point this year.

Following weak performance during the financial crisis, private consumption has over the last three years grown more or less in line with the 3-pct. average for the last 40 years. At the same time, high income growth has paved the way for an increase in savings. When measured as a proportion of disposable income, household savings last year were more than twice the historical average. Much of the savings are mirrored by residential investment, but financial savings have also increased relative to the negative levels before the international financial crisis. Financial savings are presently close to zero.

Developments in the first half of this year may indicate somewhat lower private consumption growth this year than last year. However, prospects for continued low interest rates and high wage incomes suggest that household consumption growth in 2014 will be close to normal.

Housing prices slumped in many countries in the wake of the international financial crisis. In Norway, housing prices contracted moderately from the autumn of 2007 until December 2008, but have thereafter increased steeply and reached record high levels, cf. Figure 2.2B. The price increases have levelled off recently, and the quarterly growth rate was negative in the 3rd quarter of this year. The sustained housing price increase has been accompanied by a significant increase in the level of household debts, cf. Figure 2.2C. The combination of high housing prices and a high level of household debt do increase the risk of a housing market slump, which may have a negative impact on the Norwegian economy.

Housing construction remains high, but growth has abated somewhat since the middle of last year. However, continued high labour immigration contributes to the buoyant demand for housing.

Public sector demand increased significantly in 2009 in order to stabilise economic developments in the wake of the financial crisis. As economic growth has picked up, public sector demand growth has levelled off. The fiscal policy stance in this report implies somewhat stronger growth in public consumption and investment this year and next year, relative to the period 2010-2012.

Following a significant contraction during the financial crisis, mainland business investments increased somewhat in 2011 and 2012. The moderate expansion continued in the first half of this year, but at a somewhat slower pace than last year. This is mirrored by a levelling-off of business indebtedness, measured as a share of mainland GDP. The levelling-off comes in the wake of strong growth in the lead-up to the financial crisis, when both investment and economic activity expanded apace.

Petroleum investment increased by just over 14 pct. last year, following similar growth in 2011, and has been an important driver behind the upturn in the mainland economy in recent years, cf. Figure 2.2D. Survey information suggests that petroleum investment growth will continue this year and next year, although the growth rate is expected to be somewhat more moderate in 2014 than in the preceding years.

After a steep decline in the wake of the international financial crisis, traditional goods exports have fluctuated somewhat over the last three years. The level still remains lower than before the financial crisis. Growth in traditional goods exports is expected to increase as and when growth picks up amongst our trading partners.

Exports of services other than oil and international shipping have outperformed traditional goods exports in recent years and are expected to increase further this year and next year. Exports of services relating to oil activity in other countries are also expected to increase in 2013 and 2014. An expected decline in oil and gas exports this year means that overall exports are nonetheless expected to decline somewhat from 2012 to 2013, followed by an increase in 2014.

Growth in the volume of traditional goods imports has been moderate in recent years, and is expected to pick up gradually in coming years. Nonetheless, the estimates imply that growth in traditional goods imports will remain just below the historical average until the end of 2014.

Higher prices for Norwegian exports since the turn of the millennium have contributed to a significant improvement in Norway's terms of trade, as measured by the ratio between export and import prices, cf. Figure 2.2E. The improvement in the terms of trade has been reinforced by falling prices for imported consumer goods during the period. Strong oil price growth has been by far the most important factor behind these developments, but non-oil price developments were also favourable before the financial crisis. Traditional goods export prices have fluctuated since then. This report is estimating that the terms of trade for both traditional goods and for all goods and services will deteriorate somewhat in the period 2013-2014.

Oil and gas revenues are contributing to a major surplus in Norway's current account balance. Over the last ten years, the current account surplus has fluctuated around a level corresponding to about 13-14 pct. of GDP. The current account surplus is estimated to decrease somewhat from 2012 to 2014, both due to an estimated decline in petroleum production (in value terms) and expectations of lower growth in traditional goods exports than in traditional goods imports.

The oil price has been high in recent months, which most likely has to do with mounting unrest in the Middle East. In early-October, the oil price was about USD 110 per barrel (NOK 650), more or less on par both with the average for last year and the average for 2013 so far. The budget for 2014 assumes an oil price of NOK 635 per barrel (108 USD) this year and NOK 600 per barrel (100 USD) next year, at 2014 prices. NOK 535 per barrel (90 USD measured with the exchange rate at the beginning of October) has been assumed for the subsequent years, in line with long-term price estimates in the 2013 White Paper on long-term perspectives for the Norwegian economy. The gas price follows a similar path.

Over the last 20 years, productivity growth in our mainland economy has been relatively high compared to that of a number of important trading partners. However, productivity growth declined somewhat from the middle of the previous decade, both in the Norwegian mainland economy and amongst most of our trading partners. This can partly be explained by, inter alia, labour hoarding during the slump in production in a number of countries in the aftermath of the financial crisis. In addition, business investment developments have been weak. The estimates in this report imply that productivity growth strengthen somewhat looking ahead.

A high cost level is squeezing the profitability of many Norwegian exporters, adding to the chal-

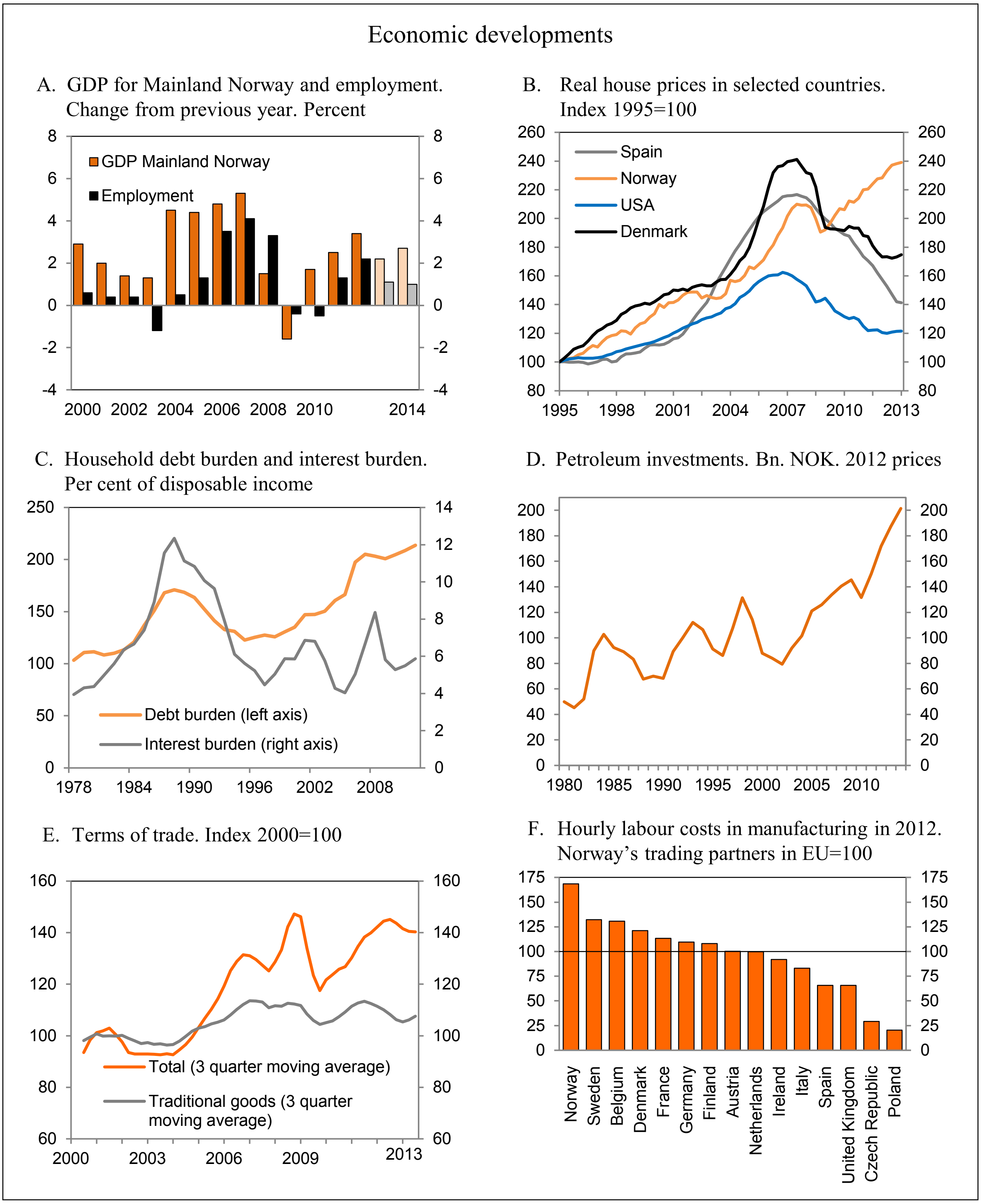

Figure 2.2 Economic developments

Sources: Statistics Norway, the Norwegian Technical Calculation Committee for Wage Settlements, Federal Reserve Bank of Dallas and Ministry of Finance.

Appendix 1

Norway's fiscal framework

Norway's petroleum industry presents particular challenges for fiscal policy in ensuring a stable economic development. The public revenues from petroleum are large, vary considerably from year to year, and will be depleted over time. Many countries have found that temporary large revenues from natural resource exploitation produce relatively short-lived booms that are followed by difficult adjustments as production and revenues diminish. Moreover, income from non-renewable resources like oil and gas should also benefit future generations.

The Government Pension Fund Global and the fiscal rule for the use of oil revenues address these challenges, and are designed to support a stable development of the Norwegian economy in both the short and long term. The Government Pension Fund Act stipulates the transfer of the State's net cash flow from the petroleum industry to the Government Pension Fund Global. The fiscal rule specifies that the transfers from the Fund to the central government budget shall, over time, reflect the expected real return on the Fund, which is estimated at 4 per cent of the Fund's capital at the beginning of the year. This framework delinks the earning and use of petroleum revenues, reducing the costs of future restructuring and the risk of a sharp decline in industries exposed to international competition.

The fiscal rule was presented in the White Paper Guidelines for Economic Policy (Report No. 29 (2000–2001) to the Storting), and received the support of a broad parliamentary majority. The White Paper pointed out that the question was not whether more petroleum revenues should be used in public budgets, but rather when and how quickly this should happen. The fiscal rule envisages a gradual increase in the use of this revenue, but also ensures that it will benefit future generations.

The fiscal rule is a long-term guide for the use of the money in the Government Pension Fund Global. It also puts emphasis on evening out economic fluctuations to contribute to good capacity utilisation and low unemployment. Several mechanisms have an effect in this regard.

The fiscal rule allows automatic stabilisers to play out fully. Accordingly, the yearly use of petroleum revenues is measured using the structural, non-oil deficit, not the actual non-oil deficit. The structural, non-oil deficit is corrected for fluctuations in the business cycle and other temporary changes in public expenditure and income. This means that the transfers from the Fund to the budget may be higher than the expected return on the Fund during a downturn and lower during an upturn. The automatic stabilisers in the budget are estimated to be stronger in Norway than in many other countries due to Norway's well-developed welfare systems.

The spending rule also allows budget policy to be used actively to stabilise production and employment. However, experience indicates that fiscal policy has a limited capacity for fine-tuning of the business cycle. Since 2001, monetary policy has been the first line of defence in the policies for economic stabilisation.

Together, the fiscal rule and the Government Pension Fund Global comprise a fiscal framework that insulates the fiscal budget from fluctuations in petroleum revenues, stemming either from volatile oil and gas prices or from changing production in the petroleum sector. Through the Fund, a large proportion of the State's oil and gas income is invested in other countries. Investing foreign exchange earnings abroad protects the

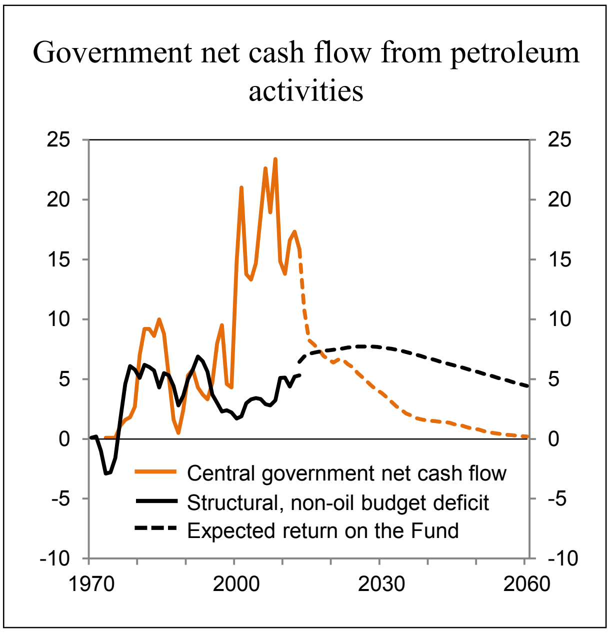

Figure A.1 The State's net cash flow from the petroleum sector, the structural, non-oil deficit and expected real return from the Government Pension Fund Global. Per cent of trend GDP for Mainland Norway

Sources: Ministry of Finance and Statistics Norway.

krone against the large, varying foreign exchange earnings generated by the petroleum industry. The fiscal policy framework thus supports Norway's monetary policy, and lays a foundation for more stable expectations in the currency market.

Following a decline in the second half of the 1990s, the use of petroleum revenues has increased again in the last 10 years, see figure A.1. Nevertheless, measured as a share of trend GDP for Mainland Norway, the level remains lower now than in the 1980s and early 1990s. The figure also shows how the spending rule helps Norway to convert substantial, yet temporary and fluctuating, income from the petroleum industry into more stable spending over public budgets. Norway has managed the most intensive harvesting phase fairly successfully. The contribution of Fund returns to the national budget as a proportion of mainland GDP is expected to increase slightly in the next 15 years, and then peak. The proportion will then fall gradually as flows into the Fund diminish and the mainland economy continue to grow.

Appendix 2

The structural, non-oil budget balance

The overall central government budget deficit may change significantly from year to year without reflecting any fiscal policy changes. In order to form the best possible impression of the underlying fiscal stance, it is appropriate to study developments in the budget balance exclusive of revenues and expenditures associated with petroleum activities, i.e. the non-oil budget balance. In addition, it is appropriate to make corrections for, inter alia, cyclical fluctuations in tax revenues and employment benefits.

Since the National Budget of 1987, the Ministry of Finance has used the change in the structural, non-oil budget balance as an indicator of the fiscal stance. In addition, with the introduction of the fiscal rule in 2001, the level of the structural, non-oil deficit has become a measure of the underlying use of petroleum revenues over the fiscal budget. It is this deficit measure that over time shall equal the expected real return on the Government Pension Fund Global.

Automatic stabilisers are allowed to operate fully when the fiscal stance is measured against the structural, non-oil deficit. This benchmark also helps maintain net public wealth over the business cycle. Structural budget balance indicators also play a key role in the fiscal policy frameworks of a number of other countries, including the EU countries.

The non-oil budget deficit excludes revenues and expenditures linked to petroleum activities. The following adjustments are made to get from the non-oil budget deficit to the structural, non-oil budget deficit:

- The deviations of various tax revenues from trend levels are calculated and corrected for. Moreover, the cyclical component of unemployment benefits is taken into account. The estimated adjustments for 2013 and 2014 in Table 3.4 reflect the fact that tax revenues from the mainland economy are estimated to be close to trend.
- The difference between the actual levels and the estimated normal levels of interest rates and transfers from Norges Bank is adjusted for. As part of the strengthening of the equity of Norges Bank, no capital was transferred from the Bank to the fiscal budget for a period from 2002 onwards. An adjustment for the discontinuation of Folketrygdfondet's mandatory deposits with the State from 2007 onwards has the opposite effect.
- Adjustments are made for accounting changes and for changes to the distribution of functions between central and local government that do not affect the underlying budget balance developments. The adjustments for 2013 and 2014 relate to the introduction of VAT for public roads a corresponding increase in appropriations in 2013 and 2014 to compensate municipalities and counties for the additional VAT expenditure. The adjustment accounts for an estimated accrual discrepancy due to a certain time lag in VAT payments.

The classification of public revenues and expenditure into a cyclical and a structural part cannot be based on direct observations, but needs to be estimated on the basis of analysis of accounting figures, economic statistics and projections for coming years. The distinction between cyclical and structural changes is usually made on the basis of estimated trend levels for the relevant variables. The findings may be influenced by new economic development data, and are subject to revision long after the government's accounts has been finalised.

The calculation of structural tax revenues is based on data on actual revenues recognised in the central government accounts, as well as forecasts for the projection period. The calculations also include taxes on income and wealth that accrue to local government, and essentially cover data from the period 1960-2012 and projections to 2020. The assumptions may be summarised under the following headings:

- *Direct taxes on labour*. This category includes employers' contributions to the National Insurance Scheme and personal taxes, inclusive of wealth tax levied on individuals. The underlying development in the number of man-years employed are an important indicator of developments in employers' contributions to the National Insurance Scheme and in total personal taxes. The projections assume an average annual growth in the number of normal man-years of about 1 pct. from 2014 to 2020. The estimates are based on population projections from Statistics Norway, which assume, inter alia, high immigration from the EEA.
- *Direct taxes on capital*. This category includes taxes paid in arrears by corporations and other non-individual taxpayers outside the petroleum sector. It also includes withholding tax and inheritance tax. It has been assumed that taxes from enterprises outside the petroleum sector will remain approximately unchanged as a portion of Mainland Norway GDP after 2014. This corresponds to an average nominal growth rate of just below 5½ pct. per year. As far as inheritance tax is concerned, the assumption is an

average nominal increase of about 8 pct. per year until 2020.

- *Indirect taxes*. This category includes value added tax, motor vehicle excise duties and other indirect taxes, including stamp duty and miscellaneous sectoral duties. It also includes the investment tax until its abolition in 2002. Private consumption developments are an important influence on indirect taxes, and it has been assumed that the average consumption growth will be 3¼ pct. per year from 2014 to 2020.

The adjustment on the expenditure side of the budget relates to unemployment benefit expenditure. The cyclical correction of unemployment benefit expenditure is based on estimated trend deviations for the number of unemployment benefit claimants.

Developments in the non-oil and the structural, non-oil fiscal budget balance are shown in table A.1. With the exception of the years 1987-1988, 2001 and 2007, all of which came at the end of lengthy and robust cyclical upturns, the fiscal budget after 1975 has generally registered a significant actual deficit when excluding revenues and expenditure relating to petroleum activities, although with major variations over this period. This has to do with the spending of petroleum revenues being expanded rapidly during the 1970s. Since then, both the non-oil and the structural, non-oil deficit have fluctuated around a level corresponding to about 4 pct. of Mainland Norway GDP.

The fluctuations in the structural, non-oil deficit have to do with the budget having at times been used actively to stabilise production and employment developments. Figure A.2 shows that the fluctuations in the non-oil deficit are considerably larger than the fluctuations in the structural, non-oil deficit. This is because one has sought to prevent cyclical fluctuations in mainland economy tax revenues from triggering fluctuations on the expenditure side of the budget. The estimated activity adjustments are shown in Figure A.3.

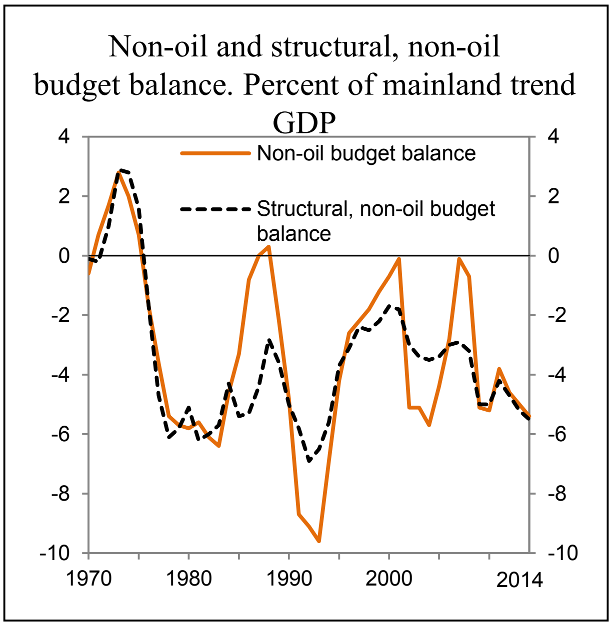

Figure A.2 Non-oil and structural, non-oil budget balance. Percent of trend GDP Mainland Norway

Sources: Statistics Norway and Ministry of Finance.

Table A.1 The structural, non-oil budget deficit. Bn. NOK

	2011	2012	2013	2014
Non-oil budget deficit	79 399	100 898	116 475	133 092
+ Net interest payments and transfers from Norges Bank. Deviations from estimated trend level	3 492	1 634	789	1 374
+ Accounting technicalities	3 480	0	-400	400
+ Taxes and unemployment benefits. Deviations from trend	2 697	-577	3 660	266
= Structual non-oil budget deficit	89 068	103 109	120 523	135 132
Measured in pct. of Mainland Norway trend GDP	4,2	4,7	5,2	5,5
Change from previous year in percentage points[1]	-0,8	0,4	0,5	0,3

1 The change in the structural, non-oil budget deficit as a percentage of the trend GDP for Mainland Norway is used as a rough indicator of the budget's impact on the economy. Positive figures indicate that the budget has an expansionary impact.

Sources: Statistics Norway and Ministry of Finance.

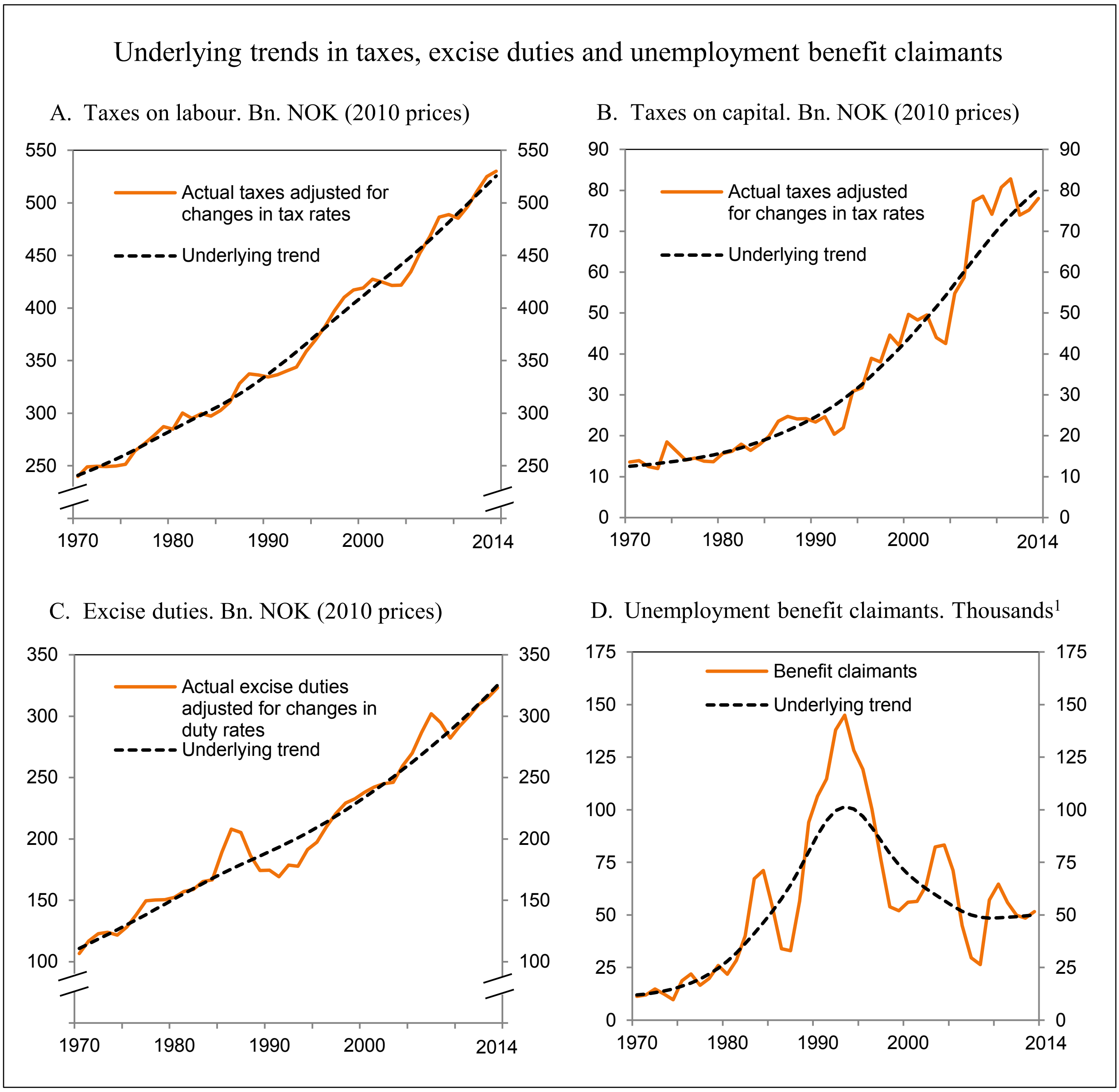

Figure A.3 Underlying trends in taxes, excise duties and unemployment benefit claimants

1 Correction is made for unemployment benefit recipients who may be partly unemployed by converting the number of recipients into full-time equivalents.

Source: Ministry of Finance.

Appendix 3

Capital transactions and the government's balance sheet

Government capital transactions are not included in Central Government budget deficit. Such transactions are funded by government borrowing, and represent a reallocation of government financial assets, and not expenditure funded by government revenues. Capital transactions may nonetheless influence activity in the economy, e.g. if the financial system is not performing its regular function.

Capital transactions influence the composition of government assets as recorded in the central government's balance sheet. Government equity accounted for 21 pct. of Mainland Norway trend GDP at the end of 2012, when excluding the Government Pension Fund, cf. figure A.4A. This portion has remained reasonably stable in recent years, suggesting that the savings accumulated in the Government Pension Fund have not been countered by a reduction in other equity. Government debt has trended downwards since the early 1990s, but increased temporarily after 2008 due to the measures to deal with the financial crisis.

The main government assets, apart from the Government Pension Fund, are in the form of lending, primarily to households and private enterprises, cf. figure A.4B. Government lending via, inter alia, the state banks (the Norwegian State Housing Bank, the Norwegian State Educational Loan Fund and Innovation Norway), as well as Export Credit Norway and the residential mortgage scheme of the Norwegian Public Service Pension Fund (NPSPF), account for the majority of overall capital transactions in the fiscal budget in recent years. Such lending declined gradually after peaking in the early 1990s, but has increased again somewhat in recent years. This increase is inter alia linked to the establishment of Export Credit Norway and the steep growth in the NPSPF residential mortgage scheme. For 2013 and 2014, it is estimated that annual new net lending from the NPSPF corresponds to about 1 pct. of mainland GDP. At the end of 2012, lending from the state banks, Export Credit Norway and the NPSPF residential mortgage scheme accounted for close to 9 pct. of the aggregate gross debt of households and non-financial enterprises in Mainland Norway. This share is almost halved since the mid-1990s.

The state also has significant assets in government enterprises and ownership shares in other companies. This is primarily financial capital, which is normally recognised in the balance sheet at its acquisition cost on the transaction date. Such capital corresponded to about 8 pct. of mainland GDP in 2012, and has remained fairly stable since the late 1990s. However, book values

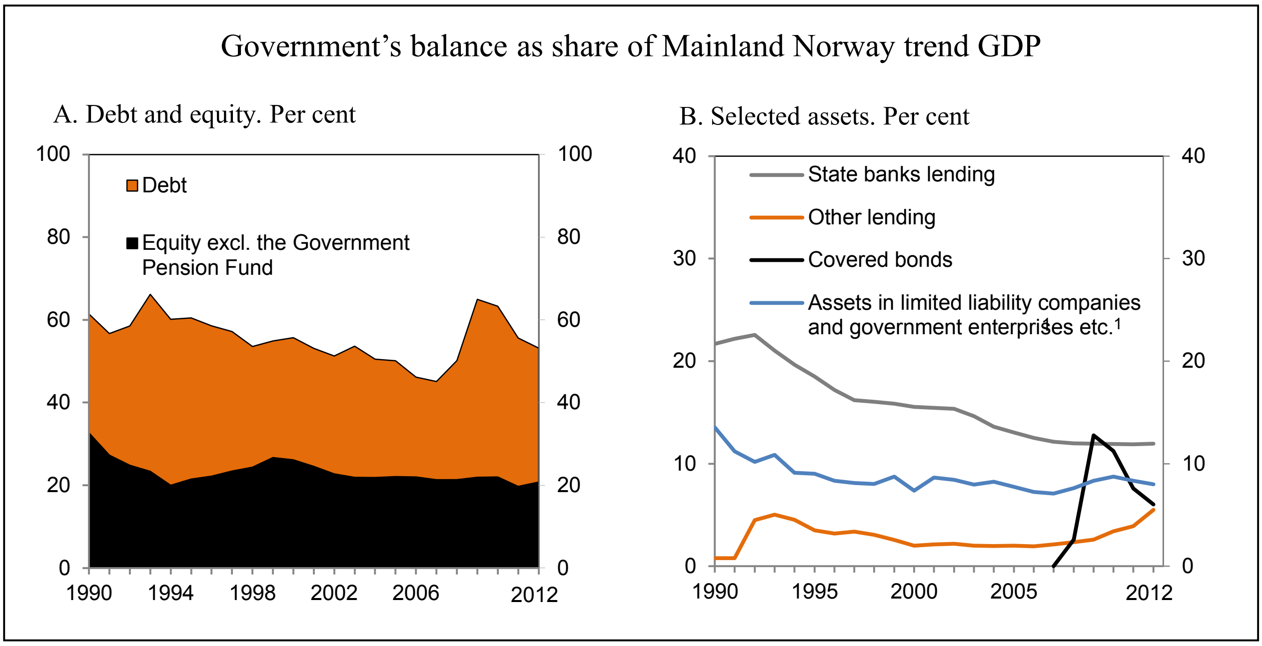

Figure A.4 Government's balance as share of Mainland Norway trend GDP
1 Excluding the State's Direct Financial Interest (SDØE)
Sources: Statistics Norway and Ministry of Finance.

may deviate considerably from actual values. At the end of 2012, the market value of direct government holdings on the Oslo Stock Exchange was about NOK 430 billion higher than the book value. This corresponds to 19 pct. of mainland trend GDP and is additional to the equity recognised in the central government accounts.

The effects on economic activity of lending via the state banks or the operations of government-owned enterprises depend, inter alia, on the situation in the economy. If lending by the state mainly replaces loans from private providers, as one would expect when the financial markets work as intended, the impact on economic activity will be less than if such loans are additional to other funding. The transfer of loans from private to government lenders may, for example, take place if the state offers more favourable loan terms than do private lenders, as has been the case with the NPSPF in recent years. All government capital transactions are also included in government funding needs, and financed by corresponding government borrowing. Hence, the state does not add to the net capital available in the economy through such capital transactions. This cushions their impact on economic activity.

When the financial markets do not work as intended, as exemplified by the financial crisis, the demand effects of government lending will be greater. The objective of the swap arrangement, which was introduced in the autumn of 2008, was indeed to contribute to keeping the normal channels for credit to households and enterprises open. The arrangement enabled banks to swap covered bonds (OMF) for government securities. In 2009, the OMF holdings of the state corresponded to almost 13 pct. of Mainland Norway trend GDP. These holdings have been gradually reduced since then, and the last swap agreements will mature in the course of 2014. The swap arrangement is visible on both sides of the government balance sheet.

At the end of 2012, the State had furnished explicit state guarantees in the total amount of NOK 144 billion, which corresponds to about 6 pct. of mainland trend GDP. Guarantees administered by the Norwegian Guarantee Institute for Export Credits (GIEK), as well as guarantees for certain multilateral development banks, account for the predominant part of this amount. Such guarantees are not included on the government balance sheet, but are described in the central government accounts.

Appendix 4

The role of the petroleum sector in the Norwegian economy

The petroleum sector generates large, but fluctuating, revenues for Norway. From 1970 until the present day, an industry has been developed whose production value has only in the last decade varied between 25 and 40 pct. of mainland GDP. The petroleum industry contributes, through its demand for goods and services, to considerable activity and to a range of jobs in the remainder of the Norwegian economy as well. The tax system and the State's Direct Financial Interest (SDØE) ensure that most of the extraction revenues accrue to the State. Such revenues make a major contribution to the funding of the welfare state and the strengthening of public finances. The State's net cash flow from petroleum activities has represented about 30 pct. of the State's total income since 2000. How the petroleum revenues are handled in fiscal policy is discussed in Appendix 1. This appendix covers the more direct effects of the oil and gas activity.

Direct mainland economy demand from the petroleum sector may be grouped into two elements:

- investments
- intermediate inputs, which include all mainland deliveries to petroleum sector operations, from repairs and maintenance to catering

Growth in aggregate demand from the petroleum sector was particularly steep from the mid-1970s to the mid-1980s, cf. Figure A.5A. Subsequently, demand from the sector fluctuated around a fairly stable level as a percentage of mainland GDP, before picking up significantly again over the period 2005-2010.

Investments corresponded to just below 8 pct. of mainland economy value added in 2012. Surveys indicate that these will increase further this year and next year. Whereas investments in the beginning of the Norwegian oil and gas era were principally devoted to the development of new production fields, investments in fields that are already in operation have become more dominant over time, cf. Figure A.5B.

Intermediate inputs have increased gradually. This partly reflects the fact that offshore production has increased over time relative to mainland economy production, and partly that it becomes more difficult to extract oil and gas from the fields as these mature.

High productivity in the extraction of oil and gas results in the sector generating large profits without having to employ a lot of people. Direct petroleum industry employment accounts for

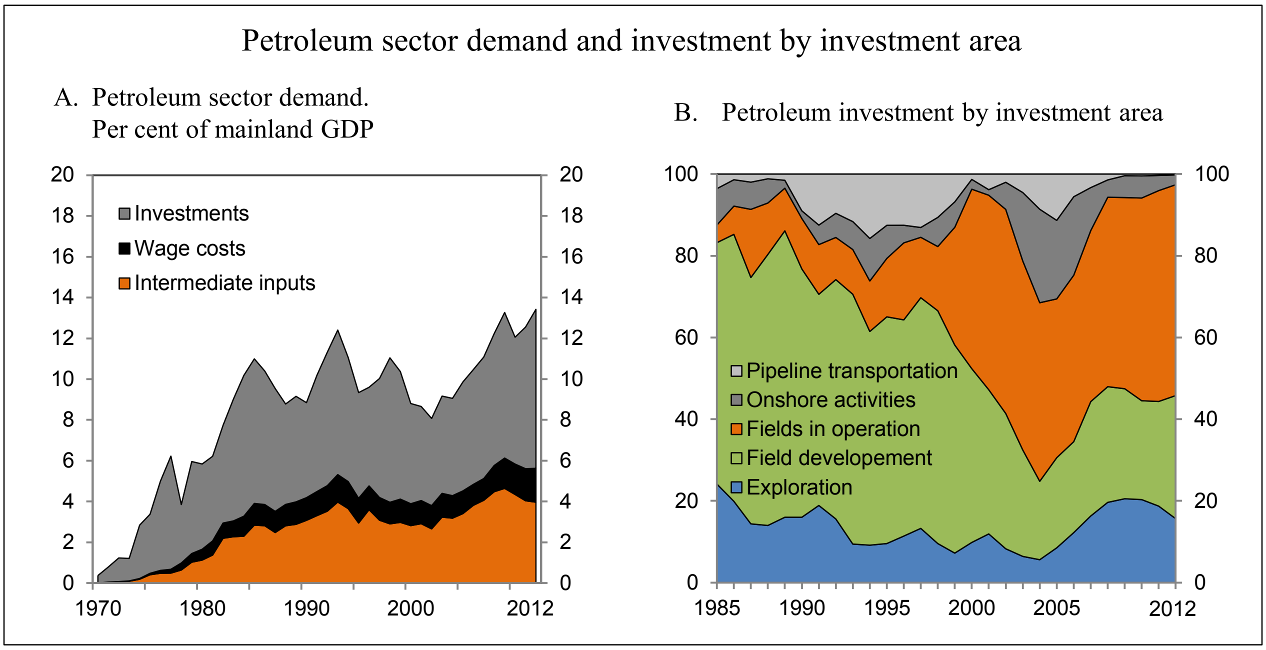

Figure A.5 Petroleum sector demand and investment by investment area
Sources: Statistics Norway and Ministry of Finance.

about 2 pct. of overall employment in Norway. Consequently, wage costs are low relative to the costs associated with investments and intermediate inputs. Yet the wage level is distinctly higher than the average level within the mainland economy.

Development of the petroleum activities has given rise to a large Norwegian supply industry. Calculations made by Statistics Norway researchers indicate that in 2009 the sector accounted, directly and indirectly, for about 8 pct. of employment in the Norwegian economy. The highest concentration of such employment is likely to be found in coastal areas, but supply enterprises are found in large parts of the country. Moreover, petroleum revenue spending via the fiscal budget results in a higher level of public sector employment.

Thus far, petroleum industry demand has largely correlated with the mainland economy business cycle. This tendency is especially notable in investments, which are significantly more volatile than intermediate inputs. Nonetheless, certain periods have deviated from this pattern. Investments have, for example, grown also in the wake of the financial crisis, which has resulted in favourable mainland economy developments despite weak export market performance. A larger Norwegian supply industry means that mainland economy activity is more sensitive to offshore demand fluctuations than was previously the case. A reduction in the proportion of petroleum sector supplies accounted for by imports has the same effect. Imports account, directly and indirectly, for about 40 pct. of petroleum sector investments on average. The import content of intermediate inputs is somewhat lower than this.