Norwegian Oil in Disruptive Times

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London Energy Club
23 July 2020

- *Global economic slowdown, coronavirus disruptions and a volatile oil market challenge Norway's petroleum dependent economy. GDP is expected to fall 3 % in 2020 and bounce back 4 % in 2021. The imperative of dealing with the pandemic along with its economic and societal impact has diverted some political and public attention from the challenges of climate change.*

- *Petroleum activity accounts for one-tenth of Norway's GDP and one-third of total exports. Norway supplies 2 % of global oil demand and 3 % of global demand for natural gas. Norway has on an independent basis committed to* ***reducing oil production*** *in June by 250,000 b/d to 1.6 mb/d and by 134,000 b/d to 1.7 mb/d the rest of the year as a contribution to the endeavours of OPEC and non-OPEC partners to rebalance the oil market.*

- *Parliament has approved temporary measures to* ***lessen the tax burden on oil companies*** *to support oil industry employment and encourage investments that companies might otherwise cancel or delay. The Government is drawing from Norway's trillion-dollar sovereign wealth fund to finance measures to support industry and cushion the economy and society through coronavirus crisis disruptions.*

- *The government is making new acreage available and awarding companies new production licenses* ***envisaging long term petroleum activity*** *on the Norwegian continental shelf, not least in the Arctic, the latter to some domestic political dismay.*

- *While recognizing the importance of the petroleum industry to the economy and employment, the government also aims to* ***reduce carbon emissions*** *by at least 50 % by 2030. It has presented a "****green transition package****" for Norwegian industry, emphasizes the potential for offshore wind and CCS and has launched a* ***strategy for hydrogen*** *technologies, all to drive the transition to a low carbon emission society.*

Petroleum Optimism

The global oil market is being rebalanced much quicker than expected. Brent crude started the year with prices in the USD 60s per barrel before falling below USD 20 per barrel in April. Substantial oversupply had followed the breakdown of production cut cooperation among OPEC and non-OPEC partners (OPEC +) in March, while oil demand fell in the wake of coronavirus lockdowns and travel restrictions. Brent crude climbed past USD 44 per barrel this week, recovering from its April low.

The Joint Ministerial Monitoring Committee (JMMC) of OPEC+ welcomed on 15 July signs of improving oil market conditions as economies around the world were opening up. The Committee also welcomed overall OPEC+ compliance in June of 107 % to production cut targets set in April and recommended to proceed as planned to reduce production by 7.7% from August through the rest of the year with additional. Compensating cuts would be made by those countries that failed to comply with commitments in preceding months. The JMMC will meet next on 18 August for its now monthly review of developments in the oil market.

Optimistic analysts expect the substantial supply surplus in April turning to a supply deficit in July/August with oil prices continuing to climb in third and fourth quarters of the year to USD 50 per barrel, supported by increasing demand as lockdowns are lifted. Prices could continue to rise to pre-coronavirus lockdown levels in the course of 2021. Their forecasts presuppose continued output restraint by OPEC+ countries and decreasing US shale oil production, while high global stock levels are drawn down. Conversely, lack of economic and oil demand recovery, break-down of OPEC+ compliance and increased US shale production would bring prices down again.

The IEA's Oil Market Report for July notes that OPEC+ and other producers, including the USA, Canada and Norway, have cut production by 14 mb/d since April. World oil demand is projected to decline by 7.9 mb/d this year and recover by 5.3 mb/d in 2021.

Too optimistic Too Soon?

While oil market analysts are increasingly optimistic about a further rebound of the oil market, it could be that they are too optimistic too soon. The IMF has signaled that the global recession will be "deeper for longer" than earlier anticipated, global GNP projected down 4.9 % this year. Major uncertainties remain with regard to global economic recovery, spread and second waves of coronavirus pandemic as well as easing and tightening of lockdowns. OPEC+ compliance driven by Saudi Arabia and Russia cannot be taken for granted, in particular should the economic situation worsen in vulnerable OPEC+ countries, exacerbated by coronavirus disruptions that undermine production cut compliance.

Additional «known unknowns» impacting the oil market are the pace of energy transition towards renewables as impacted by climate change concern and investor sentiment, along with deglobalization, disrupted international trade and tension-fraught geopolitical developments. A crucial question is whether governments will implement policies for their economies to «bounce forward» to a lower carbon one or «bounce back» to past levels of dependence on fossil fuels. And not least, should India and other emerging markets follow China's path of rapid

industrialisation, global oil demand could accelerate, putting upward pressure on oil prices due to current underinvestment and permanently closed capacity in the global petroleum industry.

Unilateral Oil Production Cut

In the wake of the OPEC+ decision on 12 April to adjust overall crude oil production downwards by a record high 9.7 mb/d in May and June, by 7.7 mb/d through the rest of the year and by 5.8 mb/d from January 2021 through April 2022, the Norwegian government committed on 29 April on a unilateral basis to temporarily reducing oil production on the Norwegian continental shelf (NSC). June production would be **reduced by 250,000 b/d** (from reference level set by the Ministry of Petroleum and Energy (MPE) on the basis of information from companies) to **1.609 mb/d.**

The reduction target would be lowered to 134,000 b/d in July through the rest of the year, thus increasing production on the NSC to **1.725 mb/d**. Taking into account also the delay of production start of some fields until 2021, oil production on the NSC in December 2020 is expected to be 300,000 b/d lower than original plans of companies. Revised production licenses were issued on 11 May fairly distributing the production cuts among oil fields and companies.

Figures subsequently released from the Norwegian Petroleum Directorate show that actual June oil production decreased more than target to **1.543 mb/d** showing a cut of 316,000 b/d compared to the reference production level. For fields that produced less than the revised production permit in June, companies can carry underproduced volumes forward to the second half of the year.

The government has underscored that the Norwegian measures are determined independent of OPEC+ endeavours, albeit in support of these efforts, to rebalance the oil market. The unilateral character of the Norwegian measures has been shown by deviating from OPEC+ timelines and by cutting production at a lower percentage of total production. The measures can be adjusted or discontinued upon independent Norwegian decision as market circumstances evolve.

Norway accounts for around two per cent of global oil production. The Norwegian cut adds little to efforts of other producers to rectify the current imbalance between global oil demand and supply. Having only marginal market impact in itself, the value of the Norwegian cut would seem more psychological and political as a show of producer country solidarity. This is not the first time that Norway contributes on a unilateral basis to efforts of OPEC and other non-OPEC producers to stabilize the oil market. The government's measures enjoy support across political party dividing-lines in Parliament in the current oil market situation.

Norway's new oil-producing giant, the Johan Sverdrup field operated by Equinor, had after start-up in October 2019 already reached by April a production level of 470,000 b/d on its way to plateau production level of 660,000 b/d, which would correspond to one-third of total production on the NCS. A consequence of the Norwegian measures has been to give production at the Johan Sverdrup field an upper limit of 376,000 b/d in June and 416,000 b/d the remainder of the year.

Norway's unilateral oil production cut does not affect production and exports of natural gas. Norway is the world's third-largest exporter of natural gas (exports in 2019 115.2 bcm) and is supplying almost one-fourth of EU/UK demand.

Norwegian Petroleum Relief

As Norway's «**corona lockdown**» imposed in March is gradually being lifted, oil market uncertainties in the wake of global economic downturn create additional uncertainties for the Norwegian economy and financing of the welfare state. The domestic political situation is now more complex after the far-right Progress Party left the majority coalition government in January, making the coalition a minority one and thus moving party policy compromises from within the government coalition to Parliament. Current opinion polls suggest that national elections in September 2021 will bring a «red-green» coalition led by the Social Democratic Party to power replacing the incumbent minority «centre-right» coalition led by the Conservative Party.

As part of the present government's broader efforts to support industry and cushion the Norwegian economy through coronavirus crisis disruptions, Parliament approved on 19 June temporary measures to **lessen the tax burden** on oil and natural gas exploration and production companies. The measures involve same year investment depreciation and raising the level above which the special additional petroleum tax is applicable. They are designed to support oil industry employment by encouraging investments that companies otherwise would have cancelled or put on the back burner. Investments on the NCS are seen to have spill-over effect across the country in terms of employment, technology development and know-how. The Government furthermore acknowledges the importance of the petroleum industry also beyond oil and natural gas in that the industry's know-how can also contribute to the «green transition». It underscores that the temporary taxation changes do not constitute any state subsidy and therefore do not violate the Agreement on the European Economic Area.

Politically interesting was the Social Democratic Party and Progress Party, both in parliamentary opposition to the government and each other, joining hands in securing for companies a better deal in terms of tax relief than the measures originally proposed by the Government and found insufficient by the petroleum industry itself. Despite broad political

support for these measures in the wake of coronavirus disruptions, critical voices remain arguing that the petroleum industry is part of the problem, not part of the solution in dealing with climate change. They would want government support to go directly to the supply industry for employment reasons and not via the exploration and production companies. They argue that such support should be earmarked to financing «green projects» related to offshore wind, carbon capture and storage, hydrogen and electrification of industry, and this in such a way that would enable Norway to spearhead «green transition» globally.

As an early, profiled result of this tax burden relief, AkerBP (operator) and Pandion Energy submitted a few days later (24 June) their plan for restarting production at the **Hod Field.** Minister of Petroleum and Energy Tina Bru welcomed the decision of the companies to retrieve additional reserves from the field to the benefit particularly of the oil services industry and employment.

Moreover, after the announcement of temporary tax relief, AkerBP and Equinor have agreed on the commercial framework for a coordinated development of fields in the promising **NOAKA area** in the North Sea, where both companies hold operatorships. The tax relief brings forward in time a substantial project of more than USD five billion benefitting employment in the oil services industry and future production.

Oil industry investments are projected to rise by 4 % this year to approximately USD 20 billion, but fall substantially by almost 20 % in 2021.

Financing Coronavirus Relief

Prior to Parliament approving the **revised national budget for 2020** on 19 June, Finance Minister Jan-Tore Sanner had underscored that increased government spending would be necessary to avoid even greater economic downturn and to help viable companies through the coronavirus crisis. The objective was to facilitate job creation and economic growth as society bounces back from the crisis. The Government is in the comfortable position to be able to draw from Norway's trillion-dollar sovereign wealth fund, the Government Pension Fund Global (GPFG), to finance extraordinary measures to alleviate the negative economic impact of the coronavirus on citizens and companies.

The revised budget presupposes **withdrawal of 4.2 % of the value of the GPFG** (as of 1 January) to balance this year's projected state budget deficit of USD 45 billion. This withdrawal from the GPFG exceeds the 3 % indicative average limit stipulated by a special rule that anticipates withdrawal of less than 3 % when times are good, so that more than 3 % can be withdrawn in times of need.

This morning, the value of the GPFG was **USD 1.1 trillion** having recovered the value lost in the 1Q 2020, its worst quarterly performance ever**.** All state revenue from petroleum activity on the NCS is channelled directly into the fund, which in its entirety is invested abroad, so as not to overheat the Norwegian economy by investing at home. The Fund holds on average a 1.5 per cent share of all listed companies in the world. As of 1 January, 70.8% of GPFG investments were held in equity, 26.5 % in fixed-income assets and 2.7 % in unlisted real estate.

As we approach national elections in 2021, increasing political focus can be expected on **environmental and ethical guidelines** for the Fund's investments. With the GPFG already divesting from coal companies, Parliament approved in June 2019 government intention for the GPFG to **divest also from 134 upstream oil and natural gas companies**. The objective was a financial one, to reduce the exposure and vulnerability of the Norwegian economy to a sustained fall in oil prices. The new divestment policy does not affect investments in the larger integrated oil and natural gas companies that in addition to upstream activity are also engaged downstream.

Well-received by political parties and in public opinion, the issue of divesting from this limited number of oil and natural gas companies could, however, be on a «slippery slope» for more to come. Any such further divestment from oil and natural gas companies for financial risk reasons would be marketed by some political parties and celebrated in public opinion also, and mainly, as an additional Norwegian contribution to reducing global carbon emissions.

Making New Acreage Available

Recognizing the continued importance of the petroleum industry for the Norwegian economy, the Government is continuing its policy of making new acreage available for petroleum activity on the NCS in a long-term perspective, despite calls prompted by climate change concern of other stakeholders for down-sizing the industry and moving to a lower carbon economy. On 14 January, the MPE awarded sixty-nine new production and exploration licenses in pre-determined (mature) offshore areas in the North Sea, the Norwegian Sea and the (Arctic) Barents Sea. On 19 June, the MPE invited on companies to apply for thirty-six additional blocks in pre-determined areas in the Norwegian Sea. Allocation of these new exploration and production licenses is expected in January 2021.

Moreover, on 24 June, Minister Bru announced the MPE's proposal to award new production and exploration licenses in the **25th regular round of concessions.** She invited companies to submit by 28 August any new information and comment they may have regarding a total of **136 blocks** in nine areas (125 blocks in the Barents Sea and eleven blocks further south in the Norwegian Sea) identified for the round. After consideration of company input, the MPE will subsequently invite companies to apply for specific blocks with a view to allocating the new

licenses in the second half of 2021. Minister Bru remarked that the main objective of Norwegian petroleum policy is to facilitate profitable production of oil and natural gas on the NCS in a long-term perspective. The Minister underscored that «**we need new discoveries** to maintain employment and value creation in the years ahead».

The designated acreage on offer in the 25th Round is located within the overall framework area for petroleum activity re-confirmed by Parliament on 18 June in connection with its approval of the Government's White Paper on **«Integrated Management Plans for Norwegian Maritime Areas»** on 18 June. Parliament's approval of the White Paper also involves the politically controversial determination of new «**ice edge**» in the Barents Sea, the line above which petroleum activity is not allowed.

The Minister's announcement of new blocks on offer in the Arctic was **met head on by environmentalists** and some members of Parliament, who had wanted the «ice edge» drawn further south. Their proposed «ice edge» would have excluded five of the new blocks in the Barents Sea now on offer. It goes without saying that the 25th round of concessions will be subject to heated political debate in the run up to parliamentary elections in September 2021.

The New "Ice-Edge"

Petroleum activity in the Arctic, where climate change has resulted in a long-term trend of rising sea temperatures, shrinking ice cover and large-scale ecological changes, is centre-stage in the polarized domestic debate in Norway on the future of the industry. Political party youth organisations and some Members of Parliament as well as environmental NGOs are calling for petroleum activity in the Barents Sea to be downsized, if not put to an end, in the belief that petroleum activity in the Arctic is destined to leave «stranded assets» in the transition to «green economy».

The new **«ice edge»** is basically a minority coalition government compromise between the Conservative Party, originally wanting the line further north, and the Liberal Party, originally wanting it even further south. Internal government discussions were facilitated after the Progress Party had left the coalition in January, that Party wanting the new "ice edge" drawn not only further north than even the Conservative Party, but also allowing petroleum activity moving ever northwards as global warming reduces the Arctic ice sheet. The issue was seen as a potentially explosive one for the government, even providing the pretext for the Liberal Party, whose opinion poll support had plummeted since joining the Conservative Party-led government, leaving the coalition.

The new "ice-edge" is drawn just above the northern most acreage opened and awarded to companies. Sources see, in any case, lack of company interest in ice-prone acreage for

exploration and production north of the new, compromise "ice-edge". The Social Democratic Party, the main opposition party, supported the government proposal, while the smaller opposition parties, the Socialist Left Party, the Greens and the Reds (communist) wanted the "ice-edge" drawn further south.

Beyond Petroleum

The political imperative of cushioning the economy and securing employment through coronavirus disruptions, economic downturn and volatile oil market, has brought increased recognition of the importance of continued and long-term petroleum activity to the Norwegian economy and welfare state. This more immediate concern has to a certain degree overshadowed the pronounced pre-coronavirus echo-chamber gap in Norway's **polarized energy/climate debate** on the petroleum industry's future.

While providing tax relief for oil and natural gas companies and recognizing the importance of the industry for the economy, the government has also reconfirmed its commitment to the Paris Climate Accord. Earlier this year, it submitted an enhanced national target of reducing carbon emissions by at least 50 % by 2030. The government has since presented a "**green transition package"** for Norwegian industry. Moreover, in addition to emphasis on the potential for offshore wind and carbon capture and storage, the government presented on 3 June a **strategy for hydrogen,** setting the course for efforts to stimulate development of hydrogen-related technologies that can be an important contributor in the transition to a low emission society, particularly as regards transport and industry. The government has made clear that the temporary tax relief measures are also designed to give oil and gas companies some breathing space to better prepare for, and contribution to, the green energy transition.

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