

Oil and gas revenues more than 6 times that estimated put Scotland's finances in the black

Key findings

- Office for Budget Responsibility (OBR) forecast of £57 billion of oil and gas revenues by 2040, well below industry forecasts
- If the recommendations from the Review of North Sea activity by Sir Ian Wood (Wood Review) and by N-56 are implemented, oil and gas revenues as high as £365 billion by 2040 (more than 6 times the OBR figure of £57 billion)
- OBR forecasting production of less than 10 billion barrels of oil and gas, industry experts such as Oil and Gas UK put recoverable oil and gas reserves at somewhere between 15 and 24 billion barrels
- Instead of public sector deficits Scotland's public finances could be comfortably in surplus by as much as 7% of GDP by 2020 (more than £12 billion per annum) with surpluses of £9 billion to £11 billion per year in the 2020s and £5 billion per year in the 2030s
- While Scotland would have a surplus, UK will have a public sector deficit in the 2020s and 2030s
- Potential to establish an oil fund – at a modest 3.2% real interest rate if all surpluses were invested in such a fund it could grow to more than £300 billion (in today's prices) by the end of the 2030s

Scotland's oil and gas revenues are estimated to be more than 6 times those forecast by UK economic watchdog, the Office for Budget Responsibility (OBR), over the next 30 years, according to an independent report by apolitical business organisation, N-56.

Along with the establishment of an oil fund these are some of the key findings contained in Part 2 of N-56's latest Scotland Means Business report entitled "Oil and Gas – A Pivotal Moment" out today (18th August), part of a series of reports which aims to propel Scotland to become one of the top five wealthiest countries in the world.

The report was prepared for N-56 by economics consultancy BiGGAR Economics and energy consultancy Tulloch Energy.

The report highlights the woefully pessimistic forecasts on barrel price and oil and gas reserves left put forward by the OBR, established in 2010 to provide "independent and authoritative analysis of the UK public finances" and on whose figures the state of Scotland's

future public finances are often based. Historically forecasts from the OBR have proven to be woefully inaccurate (see Notes to Editors).

The OBR indicates that between 2014 and 2040 oil and gas revenues will amount to a mere £57 billion.

However, based on expert forecasts for barrel price and production forecasts from the likes of industry body Oil and Gas UK and oil economist Professor Alex Kemp, if the recommendations put forward by N-56 and the Review headed by Sir Ian Wood (Wood Review) to maximise recovery of oil and gas are implemented, this figure could be as high as £365 billion. This is more than 6 times that of the OBR (with Scotland's share of UK offshore tax revenues agreed to be around 90% on average).

Recommendations put forward by the Wood Review and N-56 include:

- Government policy and decision makers responsible for oil and gas taxation and regulation to be moved from London to Aberdeen, whether Scotland is independent or not.
- A more competitive tax regime for the North Sea established through a thorough review of the taxation system.
- The creation of a Hydrocarbon Investment Bank to boost investment in the sector,
- A long-term oil and gas industrial development plan to foster economic growth.
- Revitalising exploration to ensure recoverable oil and gas resources in the UK are fully explored and exploited, including taxation incentives to boost production.
- Ensuring oil operators maximise economy recovery from the fields they hold licences for.
- Developing resources on a regional basis, rather than by individual field, to maximise their value.
- Investing in prolonging the life of the existing infrastructure to process oil and gas resources.
- Exploiting the use of existing technologies to maximise recovery of oil and gas.

So, instead of public sector deficits Scotland's public finances could be comfortably in surplus by as much as 7% of GDP by 2020 (more than £12 billion per annum) with surpluses of £9bn-£11bn per year in the 2020s and £5 billion per year in the 2030s, providing an opportunity to build up an oil fund, as almost every other oil producing country has done.

As a contrast, in the 2020s and 2030s the OBR is forecasting that the UK public finances will return to deficit, even if the current UK Government's target of eliminating the current deficit by 2018-19 is met

While the OBR, for example, is forecasting a Scottish public sector deficit of 4% of GDP in 2026-27, the high oil revenue scenario would generate a Scottish public sector surplus of 2.2% of GDP.

Oil Fund

The UK or Scottish Government (whether independent or given devolution of responsibility for oil revenues) could choose to use the Scottish public sector finance surpluses that would be associated with higher oil taxation revenues to increase public spending above current planned levels or to reduce taxation. However, the surplus would provide an opportunity for the UK or Scotland to establish an oil fund so that future generations could also benefit from this natural resource endowment.

Almost every other oil producing country, apart from the UK, has established a fund, in order to ensure fiscal stability – with savings in years when income is high used to offset any deficits when income is lower - and to share the windfall with future generations. This includes Norway's Government Pension Fund with an asset value of \$878 billion (£522 billion), as well as most of the Middle Eastern Countries, Alaska and Alabama in the US, Russia, Algeria, Alberta in Canada and Timor Leste.

Even at a modest 3.2% real interest rate if all surpluses were invested in such a fund it could grow to more than £300 billion (in today's prices) by the end of the 2030s under a high oil production scenario. This is more than double the annual economic output for Scotland¹.

Commenting on the report Graeme Blackett from BiGGAR Economics said:

“Since 1970 over £1 trillion in oil and gas revenues have been produced by the North Sea and at least as much value remains to be produced as already has been, presenting a tremendous opportunity for the sector and for Scotland's public finances.

“Scotland is a net contributor to the UK public finances, in part due to our geographic share of oil and gas revenues, and this ensures that our finances are typically healthier than the UK public finances as whole.

“The OBR puts forward incredibly pessimistic forecasts on both barrel price and reserves, largely discredited by industry experts. What is clear is these natural resources can be maximised through implementing the recommendations put forward both by ourselves and the Wood Review, delivering considerable surpluses that we would recommend are used to invest in an oil fund to benefit future generations.”

¹ A 3.2% real return is what the Norwegian oil fund has achieved in recent years. This is over and above inflation, so if inflation was 2.5%, that would mean a nominal return of 5.7%, in order to achieve the 3.2% real return.

Notes to Editors

OBR forecasts well below industry standards

- Established in 2010 to provide “independent and authoritative analysis of the UK public finances”, the OBR has not been in existence long enough to assess its performance in making long-term forecasts. However, the revenue forecasts by both it and HM Treasury have proved generally been inaccurate with large errors, not making it sensible to rely on their long-term projections. For example, in June 2010 the OBR forecast for oil and gas industry expenditure (from which estimates of tax revenues are made) for 2012-13 was £15.1 billion and the actual figure was £22.1 billion, almost 50% higher than forecast.

- The OBR oil price projections – based on a decline in oil prices over the next few years to less than \$100 per barrel and then gradually increasing - are based on much lower oil prices than the UK Government's own projections, which would see oil prices rise to \$120 per barrel by 2020 and further to \$135 by 2030(1). Historic trends indicate oil prices will continue to rise reaching \$150 in the 2020s and \$200 around 2040. Indeed, the OECD has recently projected for oil prices to reach \$190 by 2020(2).

- In addition, while the OBR is forecasting production of less than 10 billion barrels of oil and gas (9.8 billion), this is a third less than the projections by oil economist Professor Alex Kemp of the University of Aberdeen (whose model has been validated by the industry) of 14 billion barrels(3), as well as Oil and Gas UK which put recoverable oil and gas reserves at somewhere between 15 and 24 billion barrels(4). The OBR forecast also takes no account of the Wood Review recommendations to maximise output, at the low end amounting to an additional 3 to 4 billion barrels of oil and gas, worth approximately £200 billion to the UK economy at today's prices(5).

- The OBR is also assuming that the costs of production (around £40 per barrel) will be much higher than the industry is projecting (around £30 per barrel). This is important since for any given level of production, higher costs mean lower profits, which in turn means lower tax revenues.

1 Department of Energy and Climate Change (July 2013), DECC Fossil Fuel Price Projections.

2 Jean-Marc Fournier, Isabelle Koske, Isabelle Wanner, Vera Zipperer (8th March 2013), OECD Economics Department Working Paper 1031, The Price of Oil – Will it Start Rising Again?

3 http://www.scottish.parliament.uk/ResearchBriefingsAndFactsheets/S4/SB_14-28.pdf.

4 Oil and Gas UK Economic Report 2013

5 UKCS maximising economic recovery review: final report, Sir Ian Wood, Feb 2014

About N-56

- Full copies of the reports are available at www.N-56.org.

- N-56 is an apolitical business-led initiative that seeks to examine and promote the fundamentals of Scotland's economic investment case. While Scotland is already a wealthy country with a strong economy, N-56 advocates the introduction of a new economic strategy that will lead, over time, to Scotland becoming one of the top five wealthiest countries in the world, economically and socially, through stronger and more sustainable economic growth.

- Founded by Dan Macdonald, N-56 aims to provide a new locus for Scotland's business community, working with government and others throughout the country to plan a more prosperous future for the whole of Scottish society.

- N-56 signifies Scotland's geographical location in a global context. (The World Atlas Latitude & Longitude coordinates of Scotland are 56.49067119999999 N, 4.2026458000000275 W).

- The name illustrates what the initiative is setting out to achieve: a detailed and fresh analysis of the current direction of the Scottish economy within an international context, and the production and promotion of a new economic strategy that will allow it to compete more strongly with the most economically and socially successful countries in the world. That entails looking ambitiously outward at the very best international models for growth that can

be adapted to Scotland's needs in the years ahead, and then mapping out how we can take a place as one of the world's leading economic success stories.

- To kick off the discussions as to what form that new economic strategy should take, N-56 is launching a series of reports entitled Scotland Means Business. These will independently examine different aspects of Scotland's economy and start to identify what needs to happen to build on Scotland's strong economy in the years ahead. The reports have been commissioned from renowned experts in their respective fields from around the world.

- See more at: <http://www.n-56.org/updates/oil-and-gas-revenues-more-6-times-estimated-put-scotland-s-finances-black#sthash.q27ucJXi.DbUv9l9P.dpuf>

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