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Gavin McCrone backs new North Sea oil fund, but warns of perils

Author of a famous civil service paper on oil and Scottish nationalism in 1974, McCrone disputes Denis Healey's conspiracy claims but says declining oil wealth can still be conserved

Gavin McCrone: North Sea oil could 'transform Scotland into a country with a substantial and chronic surplus' Photograph: Getty

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Gavin McCrone, author of a previously-secret civil service paper on the potential value of North Sea oil to Scotland, has again backed calls for oil revenues to be ploughed into an oil fund – with a warning that to do so would carry "extremely difficult" economic challenges.

Then chief economist for the Scottish Office in Edinburgh, the predecessor department to the devolved Scottish government, McCrone wrote a detailed internal paper in early 1974 arguing that future oil revenues could transform Scotland's ailing post-industrial economy.

This was the dawn of the North Sea industry, and McCrone then made a key point: oil revenues would have made an independent Scotland immensely wealthy. Hence his paper's huge cult status for nationalists. Even without independence, investing revenues in an oil fund would have been – in the long run – the shrewdest option.

Speaking a conference on the economy and independence earlier this week, McCrone said:

...that seems to me to be one of the great missed opportunities of the last 30 years or so.

His document, first circulated to a very strictly limited group of senior mandarins in the Scottish Office, and then, in 1975, given to a few senior Cabinet Office figures, asserts that the Department of Trade and Industry, then under Tory control, hadn't properly grasped oil's future value. Its assessments were totally inadequate, he said.

McCrone wrote:

Even after its discovery the full significance of North Sea oil was not immediately apparent and it still remains in large measure disguised from the Scottish public by the DTI's failure to make provision for a proper Government return when the fourth round of licences was issued.

Compared to the DTI's timid estimates, oil would make "a massive contribution" to the UK's balance of payments, by up to £3.5bn a year by 1980. But for an independent Scotland, which then had a GDP 70% the size of the UK's and a probable deficit of £300m, those revenues would likely have an extraordinary impact.

McCrone's analysis was heavily caveated by warnings about the risks that that wealth could present for Scottish monetary policy, inflation, high costs of imports, wages and the jobs market, and assumed a new Scottish currency would need to be established.

But that could be managed, with care and intelligence, and his take-home message to ministers in 1974 was this:

What is quite clear is that the balance of payments gain from North Sea oil would easily swamp the existing deficit whatever its size and transform Scotland into a country with a substantial and chronic surplus...

[The] country would tend to be in chronic surplus to a quite embarrassing degree and its currency would become the hardest in Europe, with the exception perhaps of the Norwegian kroner.

That first point about its under-sold value was resurrected earlier this month when Denis Healey, the former Labour chancellor, claimed in an interview with Holyrood magazine that the Tories deliberately did so, in order to suppress Scotland's burgeoning nationalist movement.

Healey went further than McCrone, by asserting that underselling was a deliberate political decision; McCrone believes it was simply poor analysis by the DTI. Healey said:

I think we did underplay the value of the oil to the country because of the threat of nationalism but that was mainly down to Thatcher.

We didn't actually see the rewards from oil in my period in office because we were investing in the infrastructure rather than getting the returns and really, Thatcher wouldn't have been able to carry out any of her policies without that additional 5 per cent on GDP from oil. Incredible good luck she had from that.

McCrone was asked by the Guardian at the Scotsman conference about Healey's assertion – which is contested by the oil economist and historian Professor Alex Kemp and contradicted by a Parliamentary answer from a Tory energy minister October 1973.

He said:

It was news to me actually, and I was in the government service at the time. It may have been the Treasury attitude, I just don't know. That's, I suppose, what he [Healey] was speaking about. Certainly in the Scottish Office, where I was chief economist then, we didn't attempt to disguise what the revenues might be.

In fact, I wrote that paper which has become rather notorious. It was confidential paper, a briefing for ministers, and has been dug out using freedom of information and I was as surprised as anybody to see that it existed. I had forgotten about it altogether.

But even so McCrone said he stood by his analysis, 40 years on. It remained secret for 30 years, before being finally released under freedom of information legislation in 2005 [two versions of it can be found at oilofscotland.org here].

In short Ted Heath's government had got its sums wrong – a point McCrone reminded his colleagues that had been picked by the House of Commons public accounts committee. His paper stated that the Scottish National party's analysis about future receipts was far more accurate. It might even, he suggested, be an underestimate.

McCrone said this week:

Having reread it, there's actually nothing I would disagree with. I mean, the trouble was in the early 1970s the Conservative government debated long and hard about how they were going to put a proper tax regime in place to get the oil revenues.

And they hadn't reached a decision by the election of early [1974]. And the Scottish secretary of state of the day was told to say that oil revenues from rent and royalties might be £100m in 1980. Well that was ridiculous. In fact, they were in the order of £3,000m in 1980.

And the paper I wrote was simply saying to ministers 'look, you can't go on saying this, you've got to admit to the fact that oil revenues are going to be fairly large and will affect the political debate but there are also great opportunities there.' That was all I was saying about it.

Professor David Bell, an economist at Stirling university had earlier told the Scotsman conference, held at the National Galleries of Scotland, that from the historic perspective that period was – economically at least – the best moment for Scotland to strike out as an independent state.

With oil revenues about to flow in abundance, had Scotland become independent in 1979, Bell said, the positive impact North Sea incomes would have made on an independent Scotland's GDP and future prosperity have never since been equalled:

If a new nation state needed to establish financial credibility by demonstrating an ability to control its public finances, there never was a better time for Scotland to have sought independence. Whereas the state of UK finances was parlous throughout the 1970s, it was rescued by North Sea oil during the 1980s.

McCrone said oil remains of huge economic significance to Scotland, but it is, he cautioned of more limited and diminishing value.

And today, an independent Scotland would still need to make hard choices about its spending priorities, tax regime and investment strategy – with or without a policy to plough North Sea receipts into an oil fund.

One of the reasons Scotland is wealthier by GVA (gross value added) than any other of the regions of the UK apart from London and the south east is because of the employment and income from oil. North east Scotland actually has a GVA per head 144% of the UK average which means it's the wealthiest region of the UK apart from inner London.

While public expenditure in Scotland is 10% above the UK average, tax revenues are more or less the same as the UK's – excluded North Sea receipts.

That means that without North Sea oil there would be a very large fiscal deficit, about 14.6% of GDP in the latest year. If you add North Sea oil in it adds 21% to GDP and it reduces the budget deficit to about 5% - which is better than the UK figures. But it should be said that's still unsustainable, it's still too high; it would still have to be brought down.

McCrone repeated the regular warnings that North Sea oil revenues are now in steady decline, often very volatile, and also now face a new challenge: that of the huge (but unproven) predicted gas and oil reserves in England from fracking – using "hydraulic fracturing" to release gas and oil trapped in rock.

With firms predicting between 500m and 1 trillion cubic feet of gas from fracking, that could transform the UK's energy map, and – crucially for Scottish offshore revenues - depress oil and gas prices.

Even so, an oil fund would still be the prudent route to conserve today's income for the longer term:

Plainly, as David Bell said, if money from oil revenues had been put into an oil fund in the early 1980s, when they should've been in my view, then the whole country would be in a much stronger financial position.

And that seems to me to be one of the great missed opportunities of the last 30 years or so.

I've advocated an oil fund for quite a long time. Only the Shetland islands and Orkney islands had the sense to actually set one up. The Shetland charitable trust, because of its oil revenues, now has in excess of £210m and an income of about £11m a year. Norway, on the other hand, the state pension fund now has about £330bn in its oil fund which dwarfs its debt and is about 70% more than the output of the Norwegian economy in one year.

[But] could Scotland do it at this particular point? Well, what's been happening is we've been running down a capital resource to finance current expenditure and that in my view is not a good thing to do and ought really to be stopped. Therefore, it would be much better to set up an oil fund.

During the question and answer session, he added:

If you're faced with a financial position where you're in quite serious financial deficit, which is the case even with oil, then it's a bit difficult to start putting a substantial chunk of your oil revenue into a separate fund. That's the problem. I still think it would be a good thing to do.

"...you have to accept that it would impose tighter fiscal autonomy on Scotland for an oil fund, then that would result in higher unemployment and more general economic difficulties for Scotland