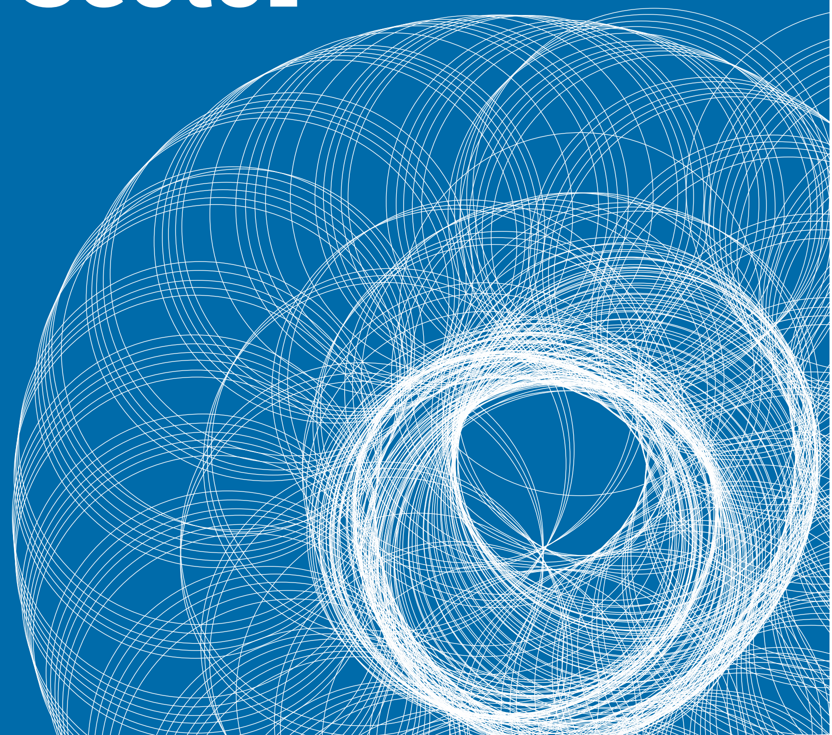
Scotianomics
STRATEGIC | INTELLIGENCE

Discussion Paper

The Resource Governance and Taxation Track Record of the UK Government in the Oil and Gas Sector



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About Scotianomics

In the 21st century data is everywhere but it is the analysis that transforms data into valuable, actionable knowledge that is key to success.

Organisations, both in Scotland's private and public sectors, lack access to useful, reliable data and value-added analysis of the kind that most advanced countries take for granted. This creates a hidden but real disadvantage for Scottish business, limits public policy and disrupts the pursuit of shared prosperity.

Scotianomics aims to spark a knowledge revolution and inform the decision-makers on Scotland's economy. We provide cutting-edge intelligence and strategic planning resources so that stakeholders can gain a wide view of the threats and opportunities in the world through our geopolitical, economic and policy analysis, unique historical datasets, risk and opportunity forecasts, Geographic Information System mapping solutions and strategic planning services.

Gordon MacIntyre-Kemp

Director

Contents

3 Executive Summary

4 Introduction

5 Government revenues from oil and gas in the UK and Norway

6 Why the UK's oil and gas revenues are overshadowed by Norway's

11 UK tax cuts and their impact on jobs and oil company profits

12 Policy impact on scottish government's assigned revenues

14 Conclusion

Executive Summary

- Since 2015, Norway has generated more than £92.2 billion from oil and gas revenues whilst the UK only generated £3.3 billion over the same period. This means government revenues from oil and gas are 95% higher in Norway.
- In 2016 Norway generated around £1,000 million from oil and gas but the UK Government lost £290 million in the same year.
- Norway has generated £386 billion more than the UK Government in tax revenue from oil and gas between 1975-2018— whilst producing 3% less.
- Since 2015, the UK's taxpayers gave Shell £211 million in tax rebates, whilst Shell paid Norway £10 billion.
- UK taxpayers gave BP £468 million in tax rebates between 2015-2017 — making the UK the only country out of the 23 in which BP operates where the company received money rather than paid taxes.
- The UK tax rebates were not specifically linked to any commitment to save jobs, and the UK sector has shed significantly more jobs (183,900 since 2014) than the Norwegian sector (24,800 since 2015).

Introduction

In 2015 the UK Government voted to reduce tax on oil and gas (Petroleum Revenues Tax) from 50% to 35% to 0%. This was done under the guise of protecting jobs in the sector but in practice enabled oil and gas giants Shell and BP to pay no tax at all. In fact, the UK is one of the only producer of petroleum to actually give money to these multinationals. This has been done at the expense of jobs in the sector, with 183,900 jobs lost UK wide.

This is illustrative of successive UK government's mismanagement of oil and gas resources. The sector is a very important part of Scotland's economy, employing over 100,000 people and generating a large proportion of Scotland's wealth. As such, decisions taken by governments about this sector affect Scotland more than the rest of the UK. Yet these important decisions about Scotland's economy are not made by the Scottish Government. Meanwhile, the costs of these decisions are borne by Scotland, both in terms of lost revenues and a poorer fiscal position as a result.

Oil prices and their impact on government revenues is a hugely contentious subject in the constitutional debate and one that demands in-depth analysis. This report investigates how Scotland's resources are managed and taxed as part of the UK and how this effects Scotland's fiscal position.

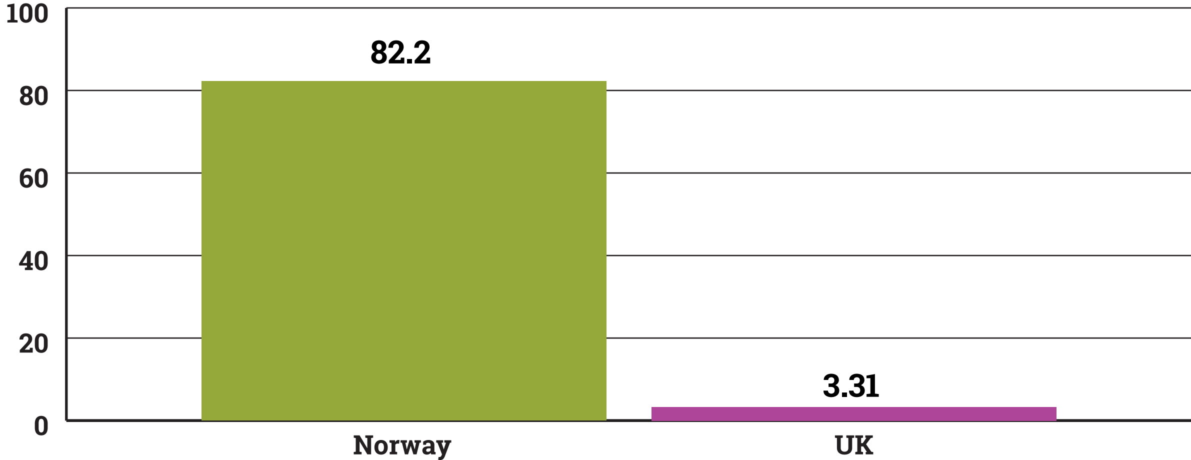
The structure of this report is as follows: Section 1 examines the current and historical revenues the UK government has received since the discovery of oil and gas, comparing this to Norway, a country who has managed their resources in a very different way. Section 2 examines why Norway has generated significantly more revenue from oil and gas (despite having produced slightly less), proposing two reasons: ownership and deliberate policy choices. Section 3 builds upon this by looking at a recent example of UK Government policy which has given rebates to large oil companies and scrutinises the effect this has had on profits and jobs in comparison to other oil producing nations who maintained different policies. The final section the report illustrates how the UK's mismanagement of Scotland's resources affects its fiscal position as this is presented in the Government Expenditure and Revenue Scotland (GERS).

Government revenues from oil and gas in the UK and Norway

This section of the report compares the government revenues received by the UK and Norway from the oil and gas sector. It shows that the Norwegian Government have benefited hugely from oil and gas resources whilst the UK has not, despite the UK having produced slightly more.

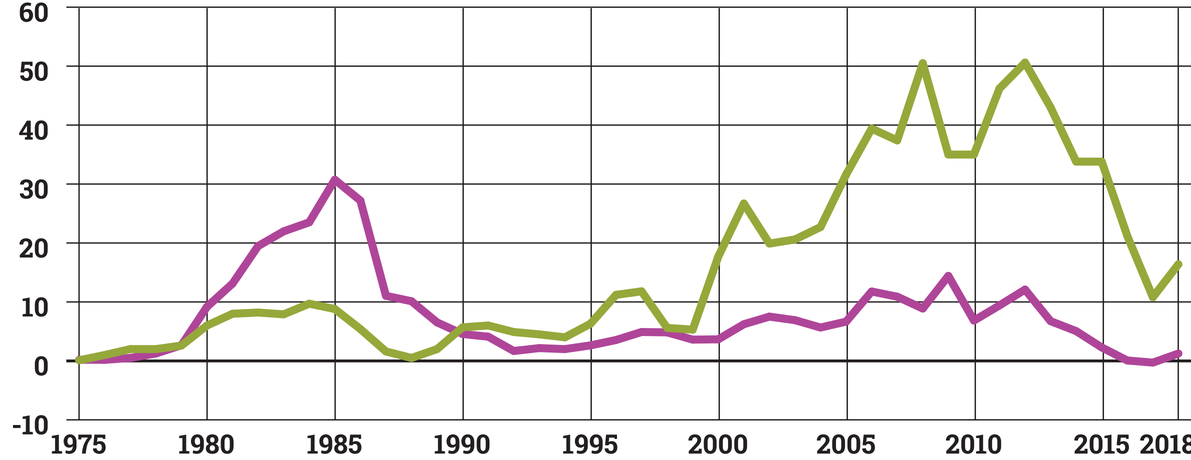
Since the major drop in the price of oil in 2015, the Norwegian government has generated more than £82.2bn from oil and gas revenues whilst the UK government only generated £3.3bn over the same period. This means government revenues from oil and gas are 95% higher in Norway.

Figure 1. Total revenue from oil and gas 2015-18 (£bn)



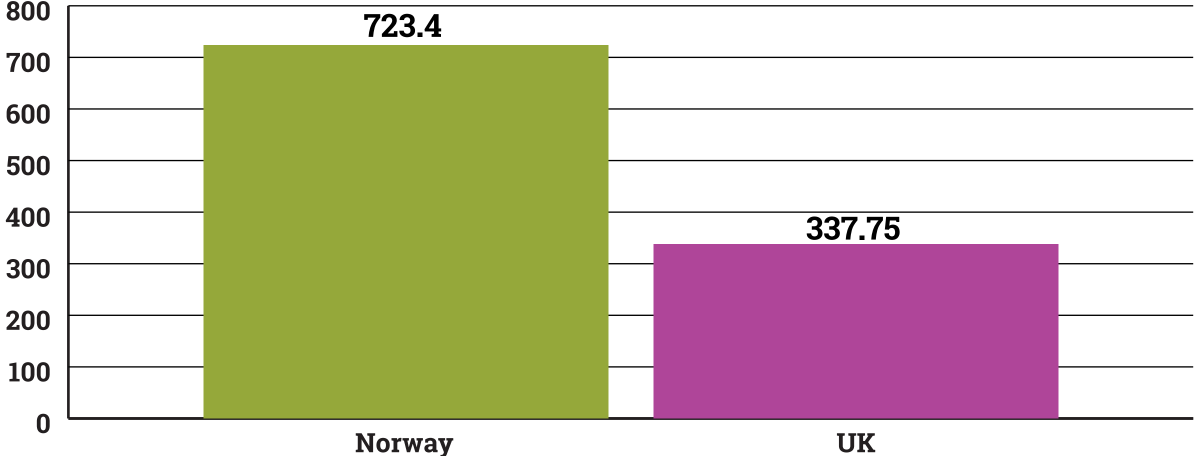
The disparity in government revenues is even more apparent if one considers that in 2016 in particular Norway generated around £11,000 million from oil and gas but the UK Government lost £290 million in the same year.

Figure 2. Historical government revenues from oil and gas 1975-2017 Norway UK



2016 is not an exception to the rule, instead it is a fact that Norway has been able to generate more, and at times considerably more, revenues from oil and gas than the UK since the 1980s. In addition, since 1975, the Norwegian government has been able to generate 53%[1] more revenues from oil and gas despite having produced 3% less.[2] This is equal to £386 billion more revenues for the Norwegian government.

Figure 3. Total Government Revenues from Oil and Gas 1975-2018 (£bn)



Why the UK's oil and gas revenues are overshadowed by Norway's

The key reason for this is that Norway's oil and gas industry is state owned, whilst the UK's is privatised. Norway views petroleum resources as belonging to the people of Norway as a whole, with the Norwegian state securing a large share of the value creation through taxation and the system known as the State's Direct Financial Interest (SDFI) in the petroleum industry. This means that the main principle for managing petroleum is that it must result in maximum value creation for society as opposed to the company.

Therefore a significant proportion of its oil and gas revenues are used to invest in the economy and boost welfare provision. Government revenues from oil and gas are transferred into the Government Pension Fund Global, which at the end of 2018 had holdings with a total value equivalent to £761 billion.[3] Under the fiscal rule, transfers can be made to the fiscal budget from the Fund to finance important public goods. This ensures that the revenues are managed with a long-term goal by making sure Norway's future generations will benefit from the revenues as well.

1 Based upon Norsk Petroleum total £723.4bn and UK O&GA total £338.8bn.
2 BP Statistical Review of World Energy (2018), UK total 6109 mtone, Norway total 5950 mtone.
3 Based upon NOK 8256bn, annual average exchange rate 10.85:1 GBP.

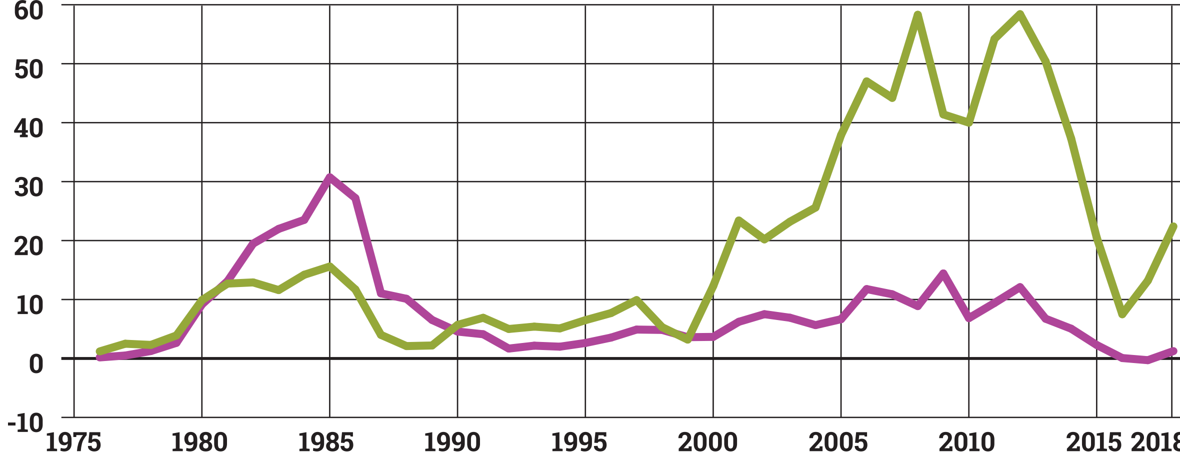
Ingrid Rasmussen, Deputy Director General of the Norwegian Royal Ministry of Finance explains:

> "Norwegian petroleum policy aims at ensuring a reasonable public share of the resource rent accruing from petroleum production, and at the same time extract profitable resources.
>
> Whilst Norway's oil and gas sector is state owned, the UK's is privatised. This means that society only benefits from the oil and gas revenues through taxation. Whilst the UK is recorded to have one of the lowest corporation taxes in the world, the UK Government decreased the tax rate for oil and gas companies when the price of oil fell."[4]

In other words, there is a massive difference in the contribution of the petroleum sector to government revenues. However, mainly due to the fact that UK governments have decided to pursue low corporate tax rates policies, the UK has generated 94% less in taxes than Norway[5]; this is excluding Norway's revenues from publicly owned oil fields and through the SDFI.

This has not always been the case. Between 1976-1989 the UK generated more tax from oil revenues than Norway indicating that it was indeed predominantly a policy choice by successive UK government's that has reduced public revenue from natural resources.[6]

Figure 4. Historical revenues from oil and gas taxation (£bn) Norway UK



4 Author's personal correspondence with Ingrid Rasmussen.

5 Norsk Petroleum total £22.4bn; UK O&GA £1.25bn

6 Norsk Petroleum total £804.9bn; UK O&GA £337.6bn.

Figure 5. Government revenue from petroleum tax (£m)

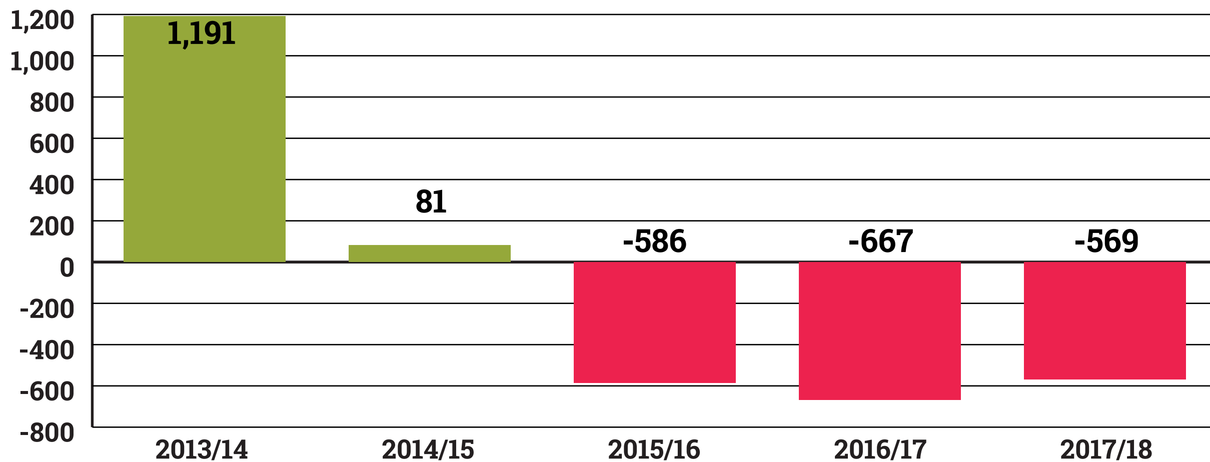
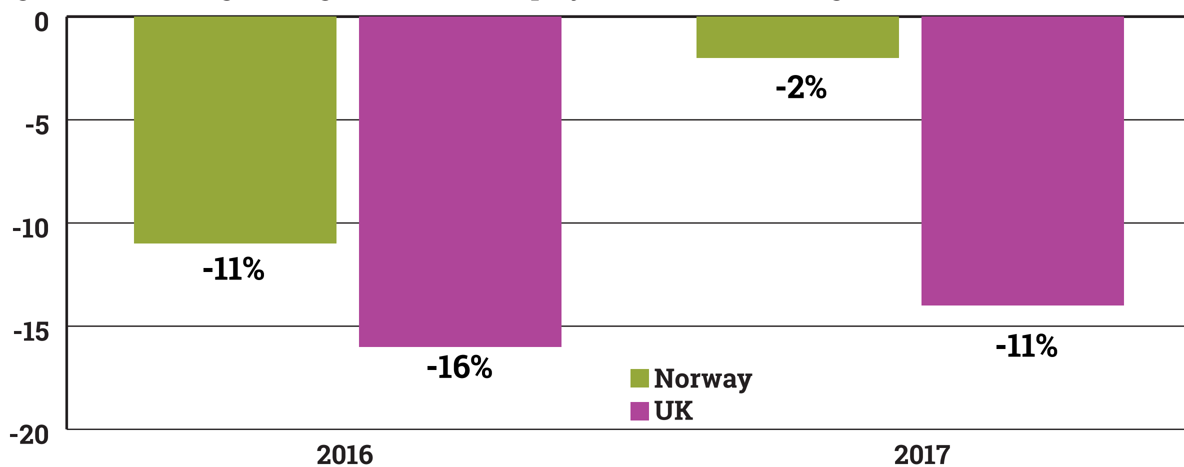


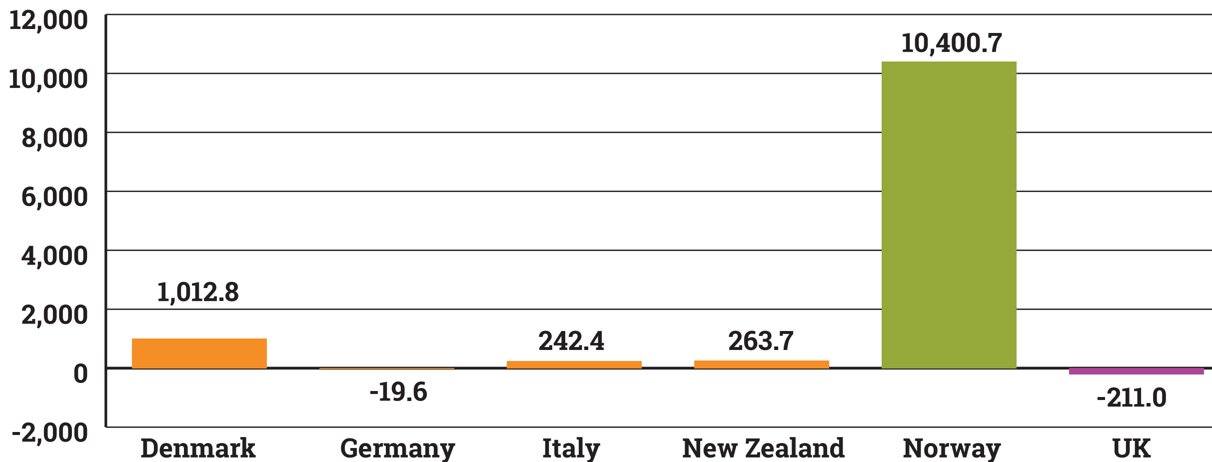
Figure 6. Percentage change in indirect employment in the oil and gas sector



To further illustrate the difference, the policy responses to the oil price reduction have been vastly different in the UK and Norway. This has opened the disparity in government revenues from the natural resource sector. Successive UK governments have made resource management decisions that effectively wipe out tax revenues from oil and gas. Rather than taxing large oil conglomerates, the UK provides huge rebates for these companies to extract oil. In response to falling oil prices, the UK Government decided to cut Petroleum Revenues Tax (PRT) in 2015 from 50% to 35%, and in 2016 it was further reduced to 0%. The supplementary charge was also cut from 62% to 50% to 10% during the same time.

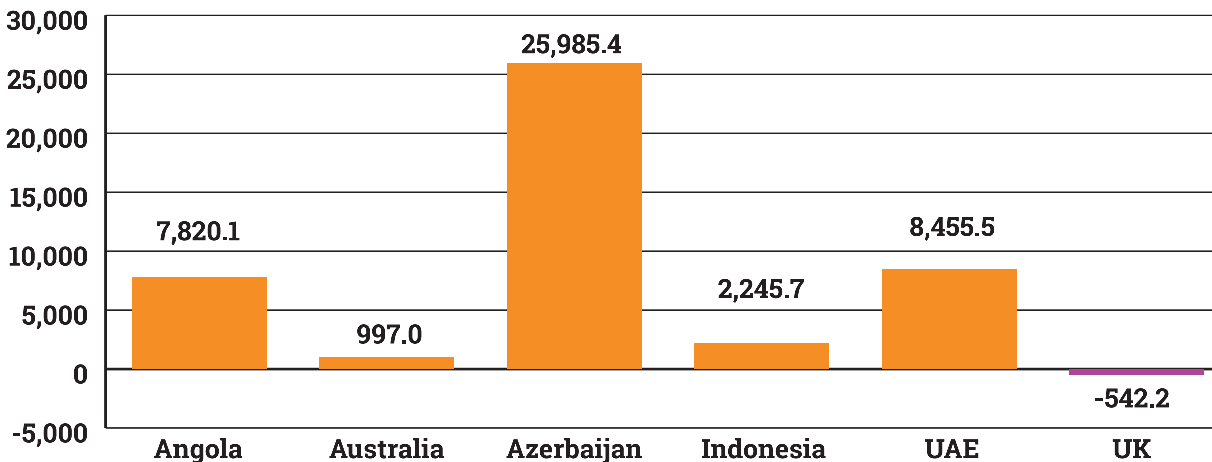
The impact this has had on UK tax revenues is striking. Since the reduction of PRT, inflation-adjusted government revenues have fallen by £1,822m.

Figure 7. Shell's payments to governments 2015-18 (£m)



It is not only that Westminster completely cut petroleum taxes, but also that it decided to give tax rebates to large oil companies to decommission rigs and to explore for new oil fields. By comparison, the Norwegian Government maintained taxation levels on oil and gas at 78% and were able to draw upon the oil revenue-driven sovereign wealth fund to assist workers who lost their jobs. To put it blatantly, the actual difference between Norway and the UK's effective taxation rate is 78%.

Figure 8. BP's payments to governments 2015-2018 (£m)



Commenting on this, Ingrid Rasmussen said:

> "The Norwegian petroleum policy aims at ensuring a reasonable public share of the resource rent accruing from petroleum production, and at the same time extract profitable resources. Stable and predictable framework conditions for the companies is an important consideration in policy design
>
> Norway did not increase the tax rate when the oil price increased. Correspondingly, the petroleum tax was not reduced when prices fell. The Norwegian fiscal rule specifies that the transfers back to the state budget shall, over time, reflect the expected real return on the Fund. Thus, the Pension Fund Global shields the budget from oil price fluctuations. A decline in the price of oil therefore has no immediate impact on the fiscal stance".[7]

It would be fair to say that the Norwegian Government's approach to oil and gas resource governance has been at least more competent. They have avoided the need to cut Government spending in the face of falling oil prices, having protected their budget from oil price volatility through investing their sovereign wealth fund, and they are focused on channeling oil revenues to the benefit of the public good rather than offering substantial tax breaks to large oil companies.

7 Author's personal correspondence with Ingrid Rasmussen

UK tax cuts and their impact on jobs and oil company profits

The policy rationale behind the UK Government's PRT cuts and rebates was that it would enable the oil industry to remain competitive and protect jobs.

UK tax cuts were made under the guise of protecting jobs, yet rebates were not specifically linked to any commitment to save jobs. Consequently, the UK sector has declined at a faster rate than that experienced by comparable nations such as Norway. For instance, between 2014-2017 183,900 jobs were lost in the UK's oil and gas sector. Of this, around 71,700 were in Scotland.

This represents a decline of around 16% in 2016 and 14% in 2017. By comparison, in Norway (which shed 24,800 jobs between 2015-2017) experienced a lesser decline of 11% in 2016 and 2% in 2017.

As well as looking at Norway, it is worthwhile examining how other oil producing countries have been treating global oil companies.

Both Shell and BP release annual *Payments to Government's* reports where they detail the taxation policy of countries where they are operating. In the 24 countries where Shell extracts oil and gas, except the UK and Germany, Shell payed taxes between 2015-2018. In that period the UK gave Shell £211m in tax rebates whilst Shell paid Norway £10bn.

Likewise, UK taxpayers gave BP £542m in tax rebates between 2015-2018. In fact, of the 25 nations where BP operates, the UK was the only country in 2017 where BP received money rather than paid taxes. In contrast, the oil producing country of Azerbaijan received over £16m in taxes and fees during the same period.

Whether the tax cut that reduced North Sea revenues to below zero was required to save the oil companies is seriously questionable. In 2016, Shell, having benefited from tax rebates from the UK Government and having made many thousands of workers redundant, went on to declare the world's largest shareholder profit dividend that year. In 2018, Shell declared a four year profit high of $21.4 billion. Without the extraction-related taxes of the UK, it has undoubtedly been easier for the company to generate more profit.

Policy impact on scottish government's assigned revenues

From this, it can be concluded that the UK has mismanaged Scotland's resources historically by not investing tax revenues in projects for public benefit, and in the past five years by giving tax breaks to large corporations whilst providing no guarantees that jobs in the sector will be protected. This section of the report will examine the effects of this mismanagement on Scotland's fiscal position, particularly how revenues are assigned to Scotland in GERS.

Scotland has the majority of the UK's oil fields, this means that government economic policy in this area disproportionately affects Scotland's economy. For instance, the policy of reducing tax on oil companies has had a significant impact on Scotland's national accounts, leading them to show a larger fiscal deficit than the rest of the UK. Since 2015, £1822m has been lost from PRT alone. However this loss of tax income has not been replaced by other sources.

This support to large oil companies (whether necessary, advisable or otherwise) was managed through tax rebates which have effectively wiped out Scotland's North Sea revenues. Around 60% of the cost of the PRT cut is deducted from Scotland's accounts in GERS.

In the case of oil and gas revenues, this means that Scotland effectively paid and is still paying for the UK's policy of decommissioning. In other words, Scotland has no say in the decommissioning and the tax rebates out of which it receives little benefit. Most importantly, these UK government policies can turn GERS revenues negative. To make this clearer, when the UK Government lowers a revenue which is almost completely attributed to Scotland as a region of the UK, there is a major reduction in tax revenues assigned to GERS. On the other hand, if the UK Government had maintained tax levels but then offered grants from the treasury retrospectively for decommissioning and exploration, then only a population percentage (8.4%) of the costs of that grant support would have been deducted.

To illustrate further, a cost can be allocated to GERS on an economic impact basis. For instance, a precedent with GERS can be seen in high-speed railway project (HS2) and the London Olympics. Once it was confirmed that HS2 would not go north of the border to Scotland, the GERS compilers refused to take a share of the costs onto Scotland's accounts. They also refused the Treasury request to take a population percentage share of the costs of the London Olympics because an equivalent economic benefit was not coming to Scotland.

As discussed above, this is not the case with oil and gas revenues. As a result, UK government policy has removed one of Scotland's key revenue streams. The impact this has on GERS figures is that they show Scotland as part of the UK running a bigger deficit that the rest of the UK.

This report argues that it must now be a matter of urgency to consider if the tax rebates and reductions can be phased out given that it will reduce Scotland's revenues whilst the oil companies make larger profits than before the oil price crash.

Nonetheless, on the positive side, GERS also shows that despite this and the lower oil price, Scotland's economy still have grown year on year, thus proving that Scotland's economy is remarkably resilient and resistant to oil price fluctuations.

Conclusion

The evidence presented and discussed in this research briefing and that previously undertaken by Scotianomics demonstrates a long-term mismanagement of Scotland's oil and gas sector directly as a result of UK government policy. UK government policies — specifically the lack of taxation, rebates and a lack of public ownership — have protected the profits of corporations and their shareholders' dividends whilst failing to adequately protect North Sea workers who have lost their jobs.

Without this resource mismanagement, Scotland would likely have healthier public finances such as those experienced by similar oil producing regions such as Norway. Furthermore, continued privatisation of Scotland's oil fields will only benefit corporations and their shareholders as opposed to Scottish society. Norway's sovereign wealth fund provides an interesting example of how profits from the oil and gas sector can be used more effectively, and be channelled into projects that benefit those who live there.