SCOTTISH OIL

Bringing Oil Home

May 2006

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Foreword by Alex Salmond MP

Energy and our oil and gas resources will be a central issue for Scotland and Scottish politics over the next twelve months.

With oil prices likely to remain at premium levels and the UK government forecasting record high revenues from the North Sea, Scotland has the prospect of a second oil windfall.

Any modern economic policy requires a pragmatic energy strategy – something that is lacking in Scotland today. This paper, therefore, sets out three important steps we must now take to ensure the benefits of the next thirty years of North Sea oil and gas are felt here in Scotland and contribute fully to a growing, more competitive Scottish economy.

There is a detailed proposal for the creation of a Scottish Oil Fund so that we can invest the record high oil revenues that are now forecast in future success for our country. It must be wasted no longer, paying for illegal wars or saving the British Chancellor from embarrassing spending cuts or tax rises.

We offer a new, stable tax regime for the North Sea which maximises the return at a time of high oil prices but also ensures sufficient and significant incentives for future exploration to guarantee a longer term future for the Scottish sector of the North Sea.

Finally we propose a simple measure to transfer responsibility for North Sea oil and gas and direct the revenues flowing from the Scottish Continental Shelf to the Scottish Parliament. Bringing oil home is an important first step. It will allow Scotland to repair the damage from the British government's recent tax grab and put in place the conditions to ensure our oil and gas windfall benefits us now and for future generations.

And linking these three initiatives is our determination to build on the expertise and infrastructure developed over the past three decades in the energy and offshore sectors to ensure Scotland takes her place as a renewables and clean carbon leader in the 21st century.

Oil and gas - along with a set of pro-Scottish business policies – have the potential to transform Scottish prospects over the next 30 years. They are far too important to be left to London.

It is time to move on so Scotland's precious natural resources can help fuel our nation's future prosperity.

Yours for Scotland

ALEX SALMOND MP

Leader of the Scottish National Party

Summary

Inequality amid plenty

In 1979 fewer than 1 in 5 Scottish children lived in poverty, and yet, despite billions in oil revenues flowing from the Scottish sector of the North Sea, that proportion has increased to nearer 1 in 4.

Secrets and Lies

A series of secret UK government papers have now been uncovered. They show the full extent of British duplicity and deceit over the scale of Scotland's potential oil wealth.

These documents confirm that Scotland would have prospered as an independent nation - despite the claims of Labour and Tory politicians who knew the truth but made the conscious decision to hide it from the Scottish people.

With the "massive surpluses" predicted for Scotland, we would be a very different country today, without the crushing inequalities described.

A tale of two countries

As a nation, our performance over the past thirty years could have more closely matched that of Norway.

In 1974 GDP per person was 6% lower in Norway than in the UK, yet by 2003 it was 24% higher than the UK and 30% higher than Scotland – equivalent to a wealth gap of over $8600 per person.

Economic growth has been lower in Scotland than Norway for 25 of the last 30 years and in all but one year from 1991 to 2004. All this despite 20% more oil being produced in the Scottish sector of the North Sea

And after just 10 years of investment, Norway now has an Oil Fund worth £111 billion – with annual income adding billions to national oil revenues to ensure a fund that will preserve Norway's oil wealth in perpetuity.

Half-way point

But it is not too late for Scotland. Government and industry estimates confirm that half our oil and gas remains – as much as 28 billion barrels, which at current prices is a resource worth £850 billion.

Revenues are once again at a record high and are forecast by Gordon Brown to reach at least £10.2 billion in the year ahead, while offshore operators expect a further £120 billion to flow into the London Treasury in the years to come.

A Scottish Oil Fund

Invested properly this is a resource that could bring long term benefits to the whole of Scotland. With oil revenues held for future generations in a Scottish Oil Fund, after just 10 years we can expect an annual return on our investment of £4.3 billion – more than oil revenues in any year in the 1990s.

The Scottish Oil Fund would be managed by Scotland's financial sector, bringing substantial benefits for this crucial sector of the Scottish economy. The Fund could invest in infrastructure projects through bonds issued by our proposed Scottish Futures Trust.

A tax regime for stability and investment

Alongside this proposal to invest our oil windfall for future generations, an SNP government will reform the oil and gas tax regime to ensure real stability and to promote exploration and investment long term so that we maximise the return from the Scottish sector of the North Sea.

We propose 6 incentives designed to encourage exploration and investment, with a particular focus on the most marginal fields and encouraging new entrants to the Scottish Continental Shelf.

Bringing oil home

To deliver these key improvements for Scotland, the Scottish Parliament needs control. We need the power to legislate for the Scottish sector of the North Sea and responsibility for the revenues from the tax on our oil and gas.

In government the SNP will take every step to bring oil home to the Scottish parliament, and we will seek to build a consensus in Scotland around a Bill to amend the Scotland Act. This Bill (appendix A) will give the Scottish Parliament legislative competence and will require the UK government to transfer oil and gas revenues into the Scottish Consolidated Fund.

Scotland's energy future

Oil and gas was Scotland's first win on the natural lottery, but with our extensive renewable potential, Scotland has won for a second time.

Our proposed incentives for exploration and investment will provide a much needed boost to carbon sequestration and allow more of Scotland's CO2 output to be stored safely in depleted oil reservoirs in the North Sea.

And they will also provide incentives for further expansion into offshore renewable production, so that Scotland can maximise its return from offshore wind, wave and tidal power and increasingly meet our energy needs with carbon and nuclear free energy solutions.

A tale of two futures

Scotland has a choice. We can see our oil resources mismanaged by the UK and the revenues wasted for another thirty years while Scotland slips further behind other similar and often less well endowed European nations.

Or we can take responsibility and see our oil wealth invested for future generations and to ensure a new era of renewable energy opportunity for our nation.

Putting oil in context

Curiously, we have seen some politicians manage to use discussions of Scotland's oil as a negative for the country – implying that Scotland's economy, indeed the case for Scottish independence itself, rests on the price of a barrel of oil.

This is absurd. Oil and gas – an industry in which Scotland has developed world-class expertise – is one sector of the Scottish economy, but there are many others that form the basis for Scotland's economic future. Scotland's economy includes one of the biggest financial centres in Europe, a thriving biotechnology sector, an outstanding tourism industry, thriving exports like whisky and many other sectors that are the basis for Scotland's economic future.

Just as the government considers what is best for the manufacturing or banking industries, so, too, must we ask these questions about the oil and gas industry. That is precisely what this paper sets out to do.

1. Introduction – inequality amid plenty

This paper is about Scotland's oil, but it is also about Scotland's people and Scotland's prospects.

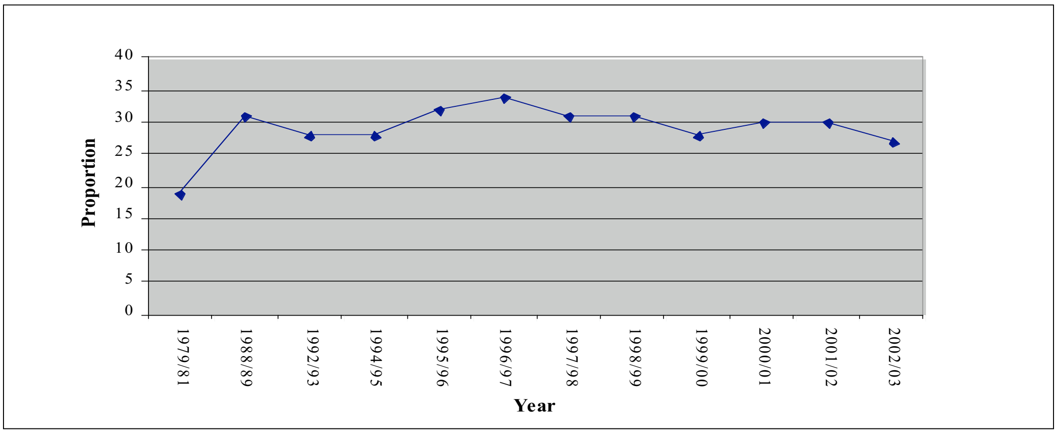
Thirty years ago Scotland had an opportunity to banish inequality and poverty – to join nations like Denmark and Finland where child poverty levels are less than 3% (with Norway and Sweden close behind).

As we look at our record over these thirty years, the lesson is clear. Too little has been achieved; too many Scots have been left on the sidelines. Scotland has not reaped the benefit of its unprecedented oil and gas windfall.

Poverty

In 1979 fewer than 1 in 5 Scottish children lived in poverty, and yet, despite billions in oil revenues flowing from the Scottish sector of the North Sea, that proportion has increased to almost 1 in 4. Today 240,000 children in Scotland live in relative poverty.[1]

Children in relative poverty in Scotland



This year 140,000 Scottish pensioners are in poverty, as are 18% of working age adults (the same level as in 1994/95). In a country as wealthy as Scotland, this is a national scandal and disgrace.

Inequality

A report by the Joseph Rowntree Foundation in December 2004 found that our largest city, Glasgow, had the highest number of council wards in the UK (28) where more than half the children were in families receiving out of work means-tested benefits. This was more than double Liverpool's total of 12.

37% of children in Glasgow live in workless households. The Scottish average is 19%.[2] Glasgow has the largest concentration of poor children anywhere in the UK.

[1] The number of children in relative low incomes households, below 60% of GB Median after housing costs. http://www.scotland.gov.uk/Resource/Doc/95793/0023203.pdf
[2] PQ S2W-13934

But the inequalities and poverty exist in every part of Scotland. The Joseph Rowntree Foundation reported in December 2005 that Glasgow, West Dunbartonshire, Inverclyde and Dundee had the highest unemployment levels in Scotland, but low pay was worst in the Borders, Moray, Dumfries and Galloway and West Dunbartonshire.

27% of the working age population in Inverclyde and 24% each in North Lanarkshire, North and East Ayrshire and West Dunbartonshire live on out-of-work benefits.

Ill Health

Premature deaths are still much higher in Scotland than in England or Wales.

Adults in the poorest fifth of households are twice as likely to be at risk of developing a mental illness as those on average incomes. Almost half of all adults in the poorest fifth of the population aged 45-64 have a limiting long-standing illness or disability, twice the rate for those on average incomes while women on below-average incomes are twice as likely to be obese as women on above-average incomes.[3]

In the poorest parts of Scotland average male life expectancy is only 64.4 years - meaning an eighth of the men in the country can expect to die before the official pension age. This life expectancy is lower than in Bosnia, Lebanon, the Gaza Strip, Iran or North Korea.

Across Scotland there are huge differences in life expectancy between the best and worst postcode areas. In Glasgow it is 26 years, in Edinburgh 22, the difference is 17 years in Paisley, 15 years in Perthshire and nine years in the Highlands.

One-fifth of Glasgow's working age population was on long-term sick leave and the city also has the highest number of babies born with low birth weight.

Thirty years of potential

Scotland has a long way to go to eradicate poverty and remove the glaring inequalities that remain after two decades of Tory rule and nearly a decade of Labour in power.

This paper sets out a future where we use our important national oil and gas resource for the benefit of Scotland.

Driving us is a determination to achieve the best for Scotland. With the right approach and a government that puts the needs of Scotland first, we can achieve a step change for our country.

We have another thirty years of potential and a second chance to wipe out the inequalities of health, income, education, opportunity and outlook that Britain has allowed to develop and left to blight our nation.

[3] JRF Annual Report 2004

2. Secrets and lies

"Possession of the oil revenues would raise Scotland to another league."
Treasury file T13/2928

The past year will be remembered for its high oil revenues, but also as the year the UK government's lies about Scotland and North Sea oil were finally exposed.

Freedom of Information

First, a paper written by senior Scottish economist Dr Gavin McCrone (now Professor McCrone) was uncovered through a Freedom of Information request by an SNP researcher in the Scottish Parliament. Prepared for Conservative ministers in 1974, and resurrected by the Labour government in 1975, the document made clear how much of a difference oil could have made to Scotland – if we had access to the oil revenues.

Dr McCrone wrote: *"An independent Scotland could now expect to have massive surpluses both on its budget and on its balance of payments and with the proper husbanding of resources this situation could last for a very long time into the future."* (p. 16)

"Thus, for the first time since the Act of Union was passed, it can now be credibly argued that Scotland's economic advantage lies in its repeal." (p. 16)

At the time the British government made every effort to rubbish the SNP's economic case for independence, but the secret McCrone papers revealed the truth:

"So far all that Ministers have said is that they expect North Sea oil to be yielding 70–100m tons of oil per annum by 1980 and that on that basis the Government revenue from rent and royalties from the whole of the Continental Shelf ...may be of the order of £100m per annum at that time. The SNP have countered these figures by claiming that North Sea oil should by 1980 be yielding a government revenue of approximately £800m. All that is wrong now with the SNP estimate is that it is far too low." (p. 5)

"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." (p. 8)

Divide and rule

The full extent of Whitehall's duplicity and trickery in its attempts to hide the truth about North Sea oil and to cheat Scotland out of her oil and gas wealth were revealed with the release of additional papers under the thirty year rule.

A confidential memo from Sir Kenneth Berrill, head of the Central Policy Review Staff, dated February 3rd 1975, confirmed, *"on fairly reasonable assumptions about the profits to be made from North Sea oil, Scotland could 'go it alone' quite comfortably".*

The memo admitted that *"the UK government would have to divert a significant amount of resources for Scotland to be as well off as it would be under independence".*

Correspondence from other Whitehall civil servants indicated the extent to which the highest levels of the civil service - including the Constitution Unit and Cabinet Office – were engaged in a campaign to discredit Scotland's claim to its own resources.

On April 15, 1975, one senior civil servant wrote: *"I doubt whether one can prove that an independent Scotland would be a disaster for the Scots – at any rate while the oil lasted. Two points, however, occur to me if one is going in for this sort of speculation."*

And of course Unionist politicians spent a great deal of time trying to rubbish Scotland's case. Two possible tactics were revealed in the correspondence:

"First it might be useful to have an established view as to just how much North Sea oil would, in the event of Scottish independence, be 'Scottish oil'."

In public, assertions were made that Scotland might lose entitlement to much of the central North Sea, but the secret documents presented a different picture:

"The general assumption, which may well be right, seems to be 'most', if not 'all'."

Second, the same correspondence confirms that the British government was even willing to try divide and rule tactics, with the cynical suggestion that efforts could be made to separate Orkney and Shetland from the rest of Scotland as part of a political campaign.

Greater wealth for all

The UK Treasury were also fully aware of the benefits independence would bring to Scotland, contrary to the attacks made by UK government ministers, then and now. An internal memo from the Treasury in fact stated: *"It is conceivable that income per head in Scotland could be 25% or 30% higher than that prevailing in England during the 1980s, given independence."*

Another Treasury official confirmed: *"The Scots have really got us over a barrel here … An independent Scotland can go it alone, provided there is not a disastrous collapse in the world oil price. The prospects for a separate English, Welsh and Ulster economy on the same assumption must look pretty grim."*

Of course, the oil price produced record high revenues in the 1980's, and is doing so again, with the UK government estimating the highest revenues for 20 years next year.

Same Approach

All these years on the UK is still engaged in a smash-and-grab on Scotland's oil. In the 1970's they wanted to grab as much of Scotland's riches as possible for Westminster and smash any claim by Scotland to a share of her own wealth.

Today, London still takes Scotland's oil for granted – Gordon Brown's tax hike in his recent budget is confirmation once again that Britain can't be trusted with the future of Scotland's oil.

3. A tale of two countries

Scotland and Norway are countries of similar size and geography. Both have been blessed by significant oil and gas reserves. Norway is Independent, whereas Scotland's economy and resources are controlled by London for the benefit of the United Kingdom.

Independence and control over oil revenues has been good for Norway. In 1974 GDP per person[4] was 6% lower in Norway than in the UK, yet by 2003 it was 24% higher than the UK and 30% higher than Scotland – equivalent to over $8600 per person.

In 2005, for the fifth year in a row, Norway topped a United Nations ranking as the best country in which to live. The annual list ranks countries by an index combining wealth, education and life expectancy and is published by the United Nations Development Programme. The United Kingdom came fifteenth, behind small nations including Iceland (2nd), Luxembourg (4th), Sweden (6th), Switzerland (7th), Ireland (8th), Finland (13th) and Denmark (14th).

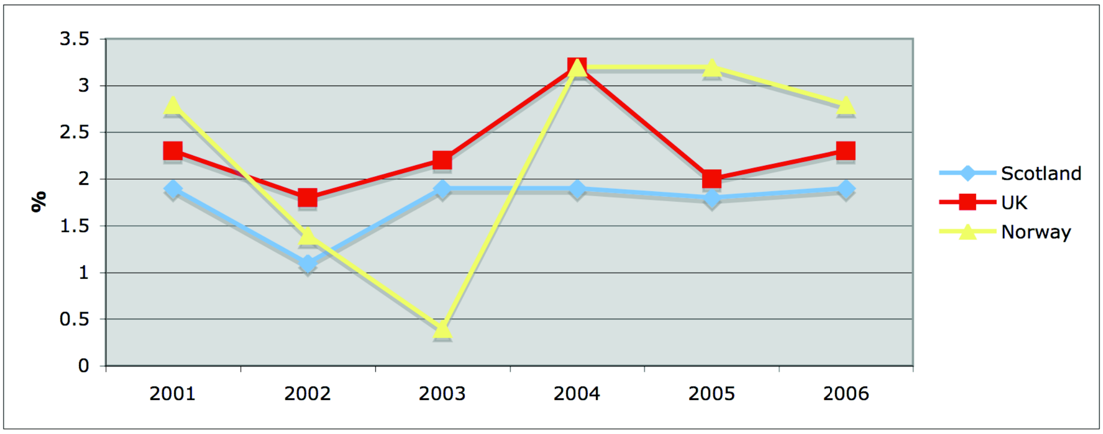
Norway is also judged more competitive than Scotland – coming in at 15th in the IMD's World Competitiveness Scoreboard in 2005, 20 places above Scotland and 7 higher than the UK[5].

This year Norway's economy is set to expand by 3.2%, almost twice the Scottish rate. Interest rates at 2.0% are less than half those in Scotland, annual inflation is 1.1%, again less than half the Scottish rate and unemployment remains low at 3.7%. Unemployment has been lower in Norway than in Scotland in every year since 1974[6].

GDP Growth Rate

Economic growth has been lower in Scotland than Norway for 25 of the last 30 years and in all but one year from 1991 to 2004.

GDP growth rates



Source: OECD, Scottish Executive and Fraser of Allander

[4] Letter from House of Commons Library, 4th February 2004
[5] http://www02.imd.ch/documents/wcc/content/overallgraph.pdf
[6] Letter from House of Commons Library, 4th February 2004

All this despite 20% more oil being produced in the Scottish sector of the North Sea[7].

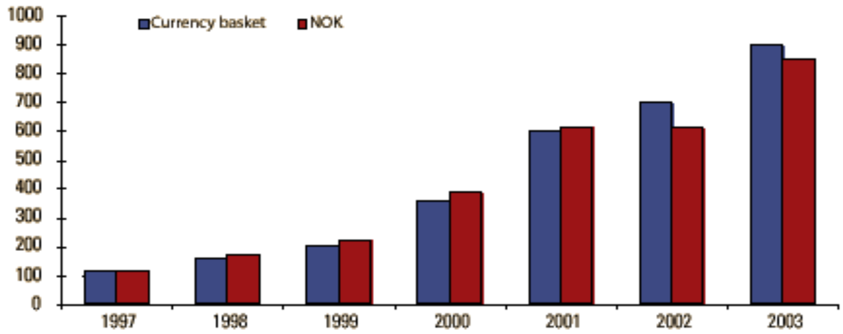
Norwegian Petroleum Fund[8]

Most of Norway's revenue from North Sea oil goes straight into their Petroleum Fund, ensuring that current revenues from their natural lottery win will benefit future generations. According to the latest count, the fund has now reached **1281.1 billion Norwegian kroner (NOK)[9], or £110.9 billion.**

The Petroleum Fund was founded by the Norwegian Parliament, the Storting, in 1990. The first **transfer to the Petroleum Fund** was made for the **1995 fiscal year** and amounted to just **NOK 2 billion (£174 million)**.

Norway's Fund has achieved huge returns on investment – **22.6% in 2003 and 2004** (8.9% for 2004[10] and 8.3% so far in 2005[11]). It also makes significant investment return compared to new oil revenue transfers – for example in early 2004 NOK 22.1 billion (£1.9 billion) in new capital was transferred to the Fund while the return on invested capital amounted to NOK 26.1 billion or £2.3 billion.[12]

More recently, with higher oil prices transfers to the fund have increased – in the first three quarters of 2005 NOK 166 billion was transferred in to the fund compared to NOK 92 billion in investment income[13]. The following graph shows the success of the fund, growing strongly year on year:



[14]

Future Growth – to 2010

The Norwegian National Budget for 2005 has made forecasts for the size of the Petroleum Fund up to 2010. Already in the first three quarters of 2005 the actual fund value has exceeded estimates for the full year.

[7] Figures from UKOOA *2004 Activity Survey* and the Norwegian Minister for Oil and Gas in *The Oil & Gas Review 2004*
[8] All currency conversions on 06/01/06. The Fund is now known as the Government Pensions Fund
[9] http://www.norgesbank.no/front/pressemelding/en/2005/2005-11-29T09-28-42.fgen.html
[10] http://www.norges-bank.no/front/pressemelding/en/2005/2005-03-01T09-42-36.fgen.html
[11] http://www.norgesbank.no/front/pressemelding/en/2005/2005-11-29T09-28-42.fgen.html - 4th quarter 2005 still to be released
[12] http://www.norway.org.uk/policy/news/closetoatrillion.htm
[13] http://www.norgesbank.no/front/pressemelding/en/2005/2005-11-29T09-28-42.fgen.html
[14] http://www.norges-bank.no/english/petroleum_fund/

However even on these forecasts[15] the future looks exceedingly bright, with the Norwegian government estimating the Fund will be worth almost £175 billion by 2010 – more than doubling in just five years.

Forecast Growth in Petroleum Fund

	Billion NOK	£ equivalent
1 January 2005	1 053.1	91.5
1 January 2006	1 244.1	108.1
1 January 2007	1 456.4	126.6
1 January 2008	1 668.9	145
1 January 2009	1 881.8	163.5
1 January 2010	2 102.9	182.8

Source: Norges Bank

Published Fund Strategy

There has been a broad consensus in the Norwegian Storting concerning the Petroleum Fund's investment strategy. The aim is that the Fund is "safely managed based on the objective of high return subject to moderate risk in order to contribute to safeguarding the basis of future welfare, including national pensions"[16].

The Fund acts as a financial investor. The ownership share in individual companies is small, and the Fund is invested in such a way that the return is in line with broad-based equity and bond indices in countries with well-developed corporate, stock market and securities legislation.

Composition of the benchmark portfolio

The Petroleum Fund has a benchmark which is composed of stocks in the FTSE equity indices in 27 countries and of the bonds in the Lehman Global Aggregate bond indices in the currencies of 21 countries. Equities account for 40 per cent of the Petroleum Fund's strategic benchmark portfolio. The equity portion of the benchmark consists of equities listed on European exchanges (50 per cent) and equities listed in the Americas, Africa and Asia/Oceania (50 per cent).

Fixed income instruments account for 60 per cent of the strategic benchmark portfolio. The fixed income portion of the benchmark consists of fixed income instruments issued in European currencies (55 per cent), American currencies (35 per cent) and Asian currencies (10 per cent).

[15] http://www.norges-bank.no/english/petroleum_fund/size_and_return/forecast.html
[16] Norges Bank website

4. Half-way point

Last year saw increased investment and a seven-year high in the number of drilling rigs deployed in the North Sea[17]. The message is clear – there is plenty of potential left in the North Sea and new opportunities opening up for the oil industry to the north and west of Scotland.

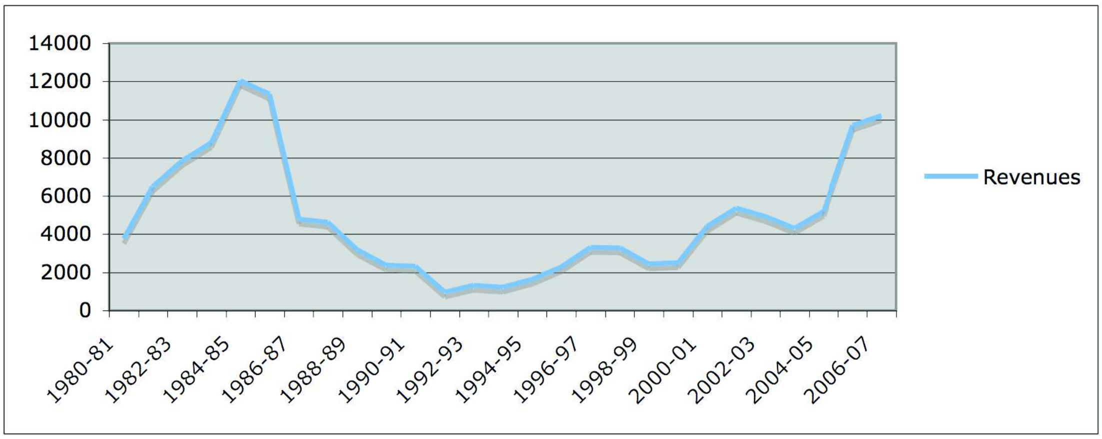
On DTI estimates[18] there are up to **43.8 billion barrels left** in the UK Continental Shelf, whereas a more conservative industry estimate[19] suggests **28 billion barrels** of oil and gas. New technologies have created the potential for more recovery, with the UK government projecting as much as 2 billion barrels of additional oil could be recovered as a result of CO2 injection into depleted reservoirs.

Over the past thirty years 34 billion barrels have been extracted from the UK sector of the North Sea, producing a cash windfall for the UK government of **£203 billion**[20]. As much as half of the oil is still to come and, depending on the oil price, there could also be half the revenues to come. Industry estimates suggest revenues of as much as £120 billion remaining.

Record Oil Revenues

In his most recent financial report[21] Gordon Brown forecast twenty-year record high oil revenues for next year and according to the Chancellor, over the next six years we will see £74 billion in oil and gas revenues – equivalent to £14,000 for each person in Scotland. This past year revenues are forecast to be £9.7 billion, while in the coming year they will reach at least £10.2 billion (but as much as £13 billion on current world oil prices), beaten only by the revenues received in 1984-86 – as shown below:

UK Oil Revenues (£millions)



Source: House of Commons library

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[17] The UK government's response to this good news for Scottish jobs was to raise taxes and reduce the incentive for international companies to invest in the North Sea. As a result Shell has cut planned exploration and BP is re-examing its investment plans. There is real concern that unless we restore incentives years could be cut off the lifetime of the Scottish sector of the North Sea.

[18] DTI UK Oil and Gas Reserves - http://www.og.dti.gov.uk/information/bb_updates/chapters/reserves_index.htm

[19] UKOOA *2004 Activity Survey* was published on 27th January 2005 and is available at www.oilandgas.org.uk

[20] Government Revenues from UK Oil and Gas production. Real terms prices for 2003-04 from Commons Library.

[21] http://www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr05/report/prebud_pbr05_repindex.cfm

UK Oil Revenues (£millions)

1980-81	3,743	1989-90	2,368	1998-99	2,452
1981-82	6,492	1990-91	2,312	1999-00	2,510
1982-83	7,822	1991-92	979	2000-01	4,402
1983-84	8,798	1992-93	1,305	2001-02	5,370
1984-85	**12,035**	1993-94	1,223	2002-03	4,905
1985-86	11,348	1994-95	1,642	2003-04	4,295
1986-87	4,783	1995-96	2,289	2004-05	5,200
1987-88	4,618	1996-97	3,303	2005-06	9,700
1988-89	3,168	1997-98	3,277	**2006-07**	**10,200**

Source: House of Commons library

An asset for Scotland's future

North Sea oil and gas represents a huge asset for Scotland. Taking UK government estimates[22] for oil price and reserves, the total current value of North Sea oil is **£850 billion**.

This is equivalent to total government spending in Scotland for 17 years and **is an asset worth £170,000 for every man, woman and child in our country.**

[22] In his pre-budget report (Dec 2005) Gordon Brown forecast oil at $56 a barrel.

5. Scottish Oil Fund

The SNP wants to give the Scottish Parliament responsibility for Scotland's oil and gas resources and the revenues that will flow from them in the decades to come.

Our proposal would see the creation of a North Sea Oil Fund, based on the example of the Norwegian Petroleum Fund. This fund would take and invest Scotland's oil and gas revenues so that the benefits of our ongoing North Sea windfall are felt not only today, but for the benefit of all future generations in Scotland.

The fund would be able to invest in public service capital through our proposals for a **Scottish Futures Trust**. This would allow the Scottish Parliament to deliver better public services, including improvements to our transport infrastructure, new, local health services and improved facilities for our children from early years to secondary school. It would mean a lower cost alternative to the government's wasteful PPP/PFI privatisation.

Our proposal would ensure that the benefits drawn from North Sea revenues are sustained and are felt for decades to come by all future generations living and working in Scotland.

How the Scottish Fund Will Work

Every year a proportion of North Sea Revenues outlined in the annual budget will be passed into the fund for investment. In addition, the annual income generated by the fund will be placed back in the fund.

There will be scope to use the fund to manage fluctuations in revenues, tied to a requirement for balance over the economic cycle. It is expected, however, that a majority of oil and gas revenues would be allocated each year to the fund.

The only resources that can be drawn from the fund will be taken as a share of the annual income after inflation compensation to ensure that the overall size of the fund is protected and reserved in perpetuity.

In the model outlined here the fund can invest a proportion of annual revenues to secure investment in public service capital through bonds issued by the **Scottish Futures Trust.** These capital bonds issued by the Trust would provide a return on the fund's investment. This is to ensure a double benefit is drawn from North Sea revenues through a growing Oil Fund and associated investment in Scotland's national infrastructure.

Management of the Fund

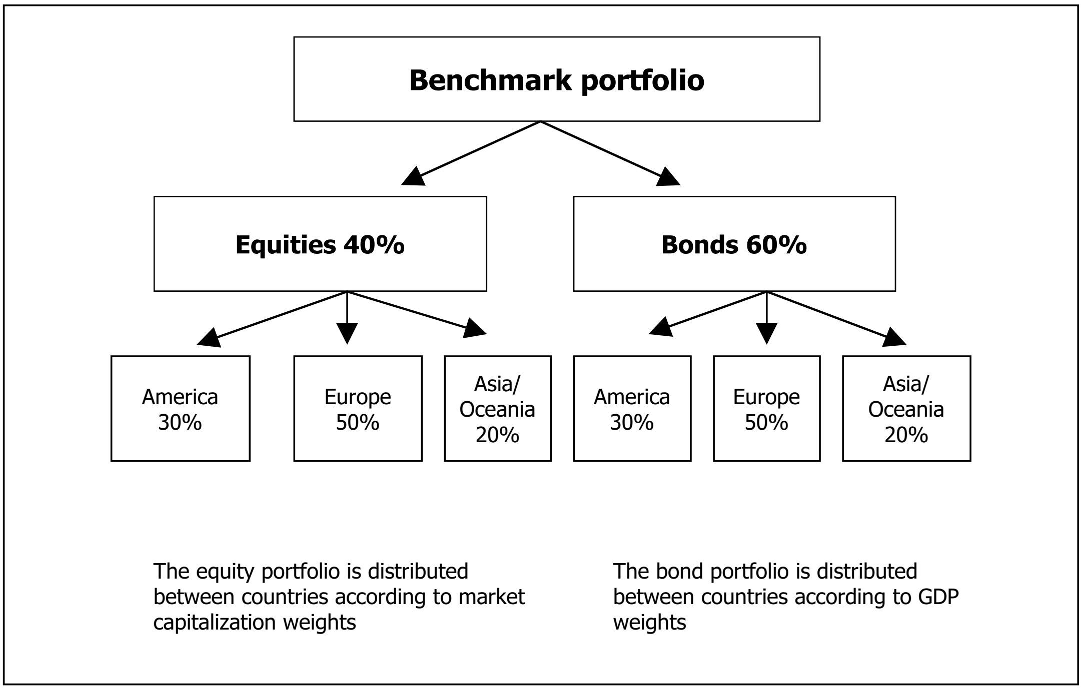
In the Norwegian fund the management of the fund itself is done by Norges Bank, the Norwegian Central Bank. A similar public sector institution could be in charge of the same fund management process in Scotland but our intention would be to offer this business to the Scottish Financial Sector in the anticipation that the expertise is available there to secure the optimal risk balanced performance.

This is not an opportunity afforded the Norwegian financial sector at present and could provide a great advert for Scottish fund managers, taking the benefits of the fund beyond the public sector.

In this model the government would set the investment strategy and benchmark performance while actual portfolio management would be managed on a day-to-day basis by the fund managers. The reporting structures and lines would ensure that the Government and Parliament received regular reporting on the fund's performance.

Investment Management

The anticipated investment management strategy is outlined in the chart below together with the anticipated initial spread of investments.



This broad structure could be altered by the Government in the light of changing market circumstances although the key performance indicator in all investments would be the performance against the annual benchmark, which would be set by the Government. This would be set on the basis of defined market indices.

The Government would also set the maximum limit for risk assumptions and investments within this structure.

The anticipated guidelines are as follows:

> Investments shall be made only in companies listed on large and recognised stock exchanges, in countries with sound company, stock exchange and securities legislation.

The fund will not be invested as a surrogate enterprise development measure and the rate of return will be the only performance indicator.

The fund will act exclusively as an investor with small ownership shares in any one company. The fund will not control the nature of activities of companies in which the fund is invested.

Equity investments shall provide a return in line with broadly diversified equity portfolios on different international stock exchanges.

Potential Fund Growth and Performance

The growth and performance of the fund is clearly dependent on the amount of resources that are devoted to it on an annual basis and the performance of the investment portfolio.

On our illustration and assuming the same annual growth rate as achieved by the Norwegian Petroleum Fund since 1997, it would take 10 years for the return on our investment to exceed oil revenues, with the fund producing a continuing annual income of **£4.3 billion**.

What Scotland has lost

If Scotland had invested our share of North Sea Oil revenues between 1997 and 2004 in an Oil Fund, and if we assume a similar rate of return to Norway, then Scotland:

- would have made a **real rate return of £1.23 billion per year or £9.87 billion in total.**
- would have made a nominal **rate (including inflation) of return of £1.72 billion per year or £13.78 billion in total.**

Other Oil Funds[23]

Name	Country	Inception Date
General Reserve fund	Kuwait	1960
General Stabilization Fund	Papua New Guinea	1974
Alaska Permanent Reserve Fund	USA	1976
Alberta Heritage Saving Trust Fund	Canada	1976
State General Reserve Fund	Oman	1980
Coper Stabilization Fund	Chile	1985
Government Petroleum Fund	Norway	1990
Nunavut Trust	Government of Nunavut (Canada)	1990
State oil Fund	Azerbaijan	1999
Revenue Management Plan	Chad	1999
Investment Fund for Macroeconomic Stabilization	Venezuela	1999
Foreign Exchange Reserve Account	Iran	1999
National Fund	Kazakhstan	2000

[23] The Center for Strategic and International Studies (CSIS). http://www.csis.org

6. A tax regime for stability and investment

In response to the Chancellor of the Exchequer's 2005 pre-budget report, industry warned of the possible long-term impact of the government's proposed changes to the tax regime. With many investment opportunities involving riskier, marginal discoveries, it is critical that we act responsibly to secure the long-term future of the North Sea.

Because of the nature of long-term decision-making in the energy industry, there is a lag between government policy and the consequent benefits or problems it creates. As Mike Tholen, the economics and commercial director of UKOOA said: "Today's buoyant activity is founded in investment decisions taken before the announcement of the tax increase on UK oil and gas companies… experience shows that across industry, and not just in the oil and gas sector, higher taxation today will ultimately lead to a decline in investment."[24]

According to a report commissioned by Scottish Enterprise Grampian, the Chancellor's tax rise could reduce Scottish economic output by between £150M - £800M over the next four years. Even if our only concern were the Treasury coffers, then this alone is reason to change the current tax environment as a GDP reduction of this magnitude translates to tax loss of £60-£320M. But a loss in GDP is far more serious than Treasury receipts as it means a loss of jobs both in the oil and gas industry and in the communities where oil and gas workers live.

So while 28 billion barrels remain, we need the right policy mix to ensure that the maximum benefit accrues to both public finance and the industry. The McCrone papers have shown that the UK government has not shepherded the resources of the North Sea responsibly – opting in the 1970s for a short-term revenue policy rather than one that would yield the results most in line with the public's long-term interests.

Companies need a stable fiscal environment in which to make investment decisions which is precisely why the Chancellor's recent 10% tax hike was so ill-advised. This increase in the supplementary charge raised the rates of tax to 50% and 75% on North Sea activities and will have a negative effect on investment, particularly if oil and gas prices decrease. This warning was born out in the Scottish Enterprise report, which predicted that the with the Chancellor's tax hike in place, investment could be 17.5% lower between 2006-2010 than it would be otherwise. It is therefore critical that we act now to put targeted incentives in place.

The way forward

The following incentives would carry modest costs that would be more than offset by the benefits of securing the jobs and revenue from a vibrant oil and gas industry:

1) removing the supplementary charge from tariff contracts will encourage the development of the many small fields, which rely on existing infrastructure to make them economically viable. One of the perhaps unintended consequences of the increase in rates was to increase the tax payable on tariff receipts, which was inconsistent with the need to reduce tariffs to promote competitive levels for the encouragement of small

[24] "Rise in oil tax could reduce Scots economic output." *The Herald*. 22 February 2006.

fields, which was recognized in 2003 when PRT was removed from new tariff contracts.

2) leveling the playing field for new entrants by increasing the extent to which unrelieved allowances are reimbursed will ensure that new entrants have a stronger incentive to enter into exploration in the North Sea. While it is current UK policy to encourage the entry of new players, those in a non-tax-paying position are penalised in comparison to existing players because they cannot obtain immediate tax relief for all exploration and development costs. Currently new entrants can carry forward unrelieved allowances at 6% interest. This could either be increased to reflect the cost of capital for new players (very little cost) or to reflect the marginal tax rate (a bolder incentive offered in Norway).

3) extending the R&D tax credit to North Sea activities will encourage further efforts to introduce tertiary recovery techniques in the North Sea. Such credits are widely employed onshore in North America and the credit would encourage their use in North Sea fields. Encouraging R&D in areas like carbon capture includes both environmental benefits (safe storage of CO2) and economic benefits (enhanced oil recovery).

4) extending the current Renewables Obligation (RO) to award ROCs for output from low and carbon-neutral electricity generation. These Carbon Reduction Certificates (CRCs) would give the same level of support to carbon free generation that is already available for renewables, and a lower level of support for other low carbon generation.

5) encouraging investment in heavy oil extraction through a heavy oil tax incentive would make this area of North Sea activity more attractive. Heavy oil sells for ~$10 less/barrel than other oil, so presently decisions to invest in heavy oil fields often stack up as less financially favourable.

6) introducing a floor of $30 a barrel below which the supplementary charges will not apply will allay fears about the tax regime at prices lower than current levels and make industry more confident about future investment. $30 a barrel is a crucial level for many marginal fields and the supplementary charge unquestionably affects investment where there are smaller accumulations. There should be a mechanism for phasing out the charge if the oil price heads towards $30 a barrel and a commitment that it will be removed below this level.

In addition to these six incentives, we will also explore the introduction of a decommissioning fund. Allowing tax-deductible payments to accumulate in a fund to meet the costs of decommissioning will extend the life of mature fields. Other countries have similar funds with the twin goals of protecting new players and removing the risk of default.

The above measures would cost no more than 10% of the supplementary charge's £2bn in additional Treasury receipts. With a resource worth £850 billion still lying off our shores, we must be sure to put the right policies in place to secure Scotland's oil and gas industry long into the future.

7. Bringing oil home

It is now over thirty years since the first oil was pumped from the Scottish sector of the North Sea.

In that time more than 34 billion barrels of black gold have come ashore, bringing a revenue windfall for the United Kingdom of £203 billion.

It was the prospect of Scottish oil that enabled Britain to secure the IMF loan in the 1970's that saved the United Kingdom from bankruptcy.

It was the huge revenues from Scotland's oil in the 1980's (many times more than UK spending on health or education or economic growth in Scotland) that bailed out the Thatcher government. It was Scotland's oil and gas that paid for the millions thrown into unemployment by the Tory government's recessions.

And today, with oil revenues once again at the record high levels of the 1980's, Scotland's wealth is now filling the black hole in the British budget. The UK Chancellor has cynically used Scotland's oil to save his own Prime Ministerial ambition – avoiding the embarrassment of spending cuts and tax rises.

As we have seen we are now at the half-way point for Scotland's oil and gas production. Scotland will remain a net export of oil and gas for many years to come. We have the opportunity to deliver a stable tax regime, exploration incentives and a Scottish Oil Fund – measures that will ensure the benefit of our win on the natural lottery is felt for longer and delivers a secure financial future for our country.

As we have seen from the UK's decision to penalise investment in the North Sea, Britain cannot be trusted with the future of our precious oil and gas resource.

The Scottish Parliament needs the power to protect the long term future of the Scottish sector of the North Sea, so we can put in place the right measures to protect jobs and revenues and invest our oil wealth for future generations.

Independence will bring home control of Scotland's oil and gas – but the Scottish Parliament needs the power now.

The SNP will be seeking cross-party support for a Bill to give responsibility for oil and gas to the Scottish Parliament and to transfer all revenues from the Scottish sector of the UK Continental Shelf to the Scottish Consolidated Fund (see Appendix A).

We must ensure that the second half of our oil windfall brings benefits to everyone living in Scotland so we can tackle the inequality that blights our society. The last thirty years of oil are gone and largely wasted.

Let us make sure the next thirty see the transformation that Scotland deserves.

8. Scotland’s energy future

If the 20th century’s lottery win was oil and gas, the 21st century win may well be wind and water. Scotland not only has 62% of the EU’s proven oil reserves, it also has 25% of the EU’s potential wind and tidal energy and 10% of the EU’s wave potential. In fact, a 2001 report commissioned by the Scottish Executive found that Scotland’s renewables potential could meet six times current electricity capacity. Offshore wind alone could meet Scotland’s needs two and a half times over.

However, with the mix of hydrocarbon and renewable technologies in which Scotland either has a comparative or natural advantage we need not fear any kind of energy gap if the right policy mix is in place.

While the Scottish Labour party just recommitted itself to continued reliance on dangerous and expensive nuclear power, the SNP stands with people in Scotland and around the UK calling for a new era of energy policy.

What we need is not more platitudes in favour of responsible energy, but specific policies that will secure our energy supply. We need:

- devolution of energy policy to the Scottish Parliament so that Scotland can have security of supply that fits its own needs and values

- removal of unfair anti-Scottish transmission charges which financially handicap Scottish power stations by as much as £20M a year in comparison with a power station sited near London – leading to a disincentive for renewables investment. The limited 10-year transitional arrangements for the smallest renewable producers are simply not sufficient to remove the generation barrier created by these discriminatory transmission charges.

- investments in new low and zero carbon technologies, such as clean burn coal (which could be pioneered at Longannet) and carbon capture and storage (set to be used at the world’s first hydrogen power station in Peterhead that will capture carbon and inject it back into the North Sea, allowing for both safe storage of CO_2 and aiding in oil recovery).

- diversification of renewable technologies that will allow Scotland to harness its vast potential in wave, tidal and offshore wind

- a phasing out of nuclear power in Scotland, which is expensive, dangerous and unnecessary to meet our local needs and global responsibilities.

The choices we make today will have implications for generations to come. Rather than rely on short-term fixes that carry long-term problems, it is time to seize the moment with ideas and policies that are as imaginative and inventive as they are responsible.

We have advantages in our offshore infrastructure, skills base and geology, which must form the basis for a successful development of Scotland’s renewable and low-carbon potential.

The oil and gas industry has left a legacy for Scotland, which an SNP government is determined to build on to ensure a successful second wave of Scotland's energy revolution.

We wait for the UK government's decision on the treatment of offshore renewable generation in the transmission charging regime, but will not tolerate any measures that place at a commercial disadvantage schemes such as the internationally important Beatrice offshore wind project in the Moray Firth.

Beatrice has the potential to provide as much capacity as a nuclear power station. Hunterston nuclear power station is a 1190mW station but on completion, the Beatrice offshore wind-farm will be only just less than that at 1000mW – however the transmission charging regime is the biggest barrier to this project. The concern must be that the 10-year moratorium for renewables does not have a long enough time horizon to sufficiently assist major capital intensive projects that are operating on a longer time scale.

According to Talisman UK, the company developing the field, they will consider the construction of a full-scale offshore wind farm including building up to 200 turbines linked to the Beatrice platform. A commercial venture could generate almost 20% of Scotland's current electricity demand (enough energy to power a million average UK homes) while extending the life of our Beatrice facility. The project is the largest renewable energy development in Scotland and could become the world's largest wind farm.[25]

In government, therefore we will act to ensure a level playing field for this and other offshore wind, wave and tidal schemes.

The SNP is currently engaged in an extensive review of energy policy for Scotland, led by Professor Stephen Salter. We wait the outcome of that report before finalising our proposals to support the development of carbon capture, sequestration and enhanced oil recovery schemes in Scotland.

However, there is no doubt Scotland has huge potential in this area. We have an extensive pipeline network and a series of mature North Sea oil fields, allowing the pumping and storage of CO2 and accessing otherwise irrecoverable oil reserves.

The British Geological Survey's estimate of potential CO2 storage in the UK sector of the North Sea as a whole is 755 billion tonnes of CO2. This compares to an annual CO2 output from Scotland of 50 million tonnes.

The DTI has estimated that 2 billion barrels of oil could be recovered as a result of CO2 storage in depleted oil reservoirs in the North Sea. At today's oil prices, this is a resource worth $120 billion.

Clearly Scotland is among the countries best placed in the world to fully exploit the clean carbon potential of carbon capture schemes. However, there is a need to extend the current renewables obligation to include a clean carbon element, up to the value of £50 million.

[25] http://www.talisman-energy.com/cr_online/2004/23_sustainable_value.html

9. Conclusion

Scotland has been blessed with a range of natural resources and, for the foreseeable future, we can benefit from the great wealth of oil, gas, infrastructure and expertise that exists in the Scottish sector of the North Sea.

The numbers are huge – in terms of remaining resource, future revenues, and contribution towards GDP, employment and wages. With the right husbanding it can be an asset for our whole nation with the power, alongside other sensible, pro-Scottish economic policies, to transform lives and futures and deliver a better standard of living for all.

The lesson of the first half of Scotland's oil and gas is that only a Scottish government will give top priority to the interests of our people and our nation. Only a Scottish government will put the long-term future of this resource at the heart of public policy.

We need the right approach to guarantee the maximum return from Scotland's offshore energy wealth, and that is why the SNP proposes incentives to encourage new investment and further exploration and why we will create a Scottish Oil Fund to invest in Scotland's infrastructure today while preserving the revenues from the North Sea for the benefit of our nation.

It is why we believe Scotland's Parliament should become the custodian of this precious resource, with full responsibility for the growth and development of the offshore energy sector.

And of course, as we face the shared challenge of climate change, we must ensure our oil and gas contribute to the creation of a low emissions energy policy. Carbon-free generation through carbon capture and storage and the full utilisation of our offshore infrastructure and expertise for the development of wind and tidal generation must be an integral part of that energy future.

Taken together, the measures proposed in this paper provide the most comprehensive strategy for the development of Scotland's existing and potential energy resources.

It shows that with the right approach we can open the door to a better future for our nation.

Appendix A - draft Repatriation Bill

Scotland (Oil and Gas Repatriation) Bill 2006

An Act to provide for the transfer to the Scottish Parliament of legislative authority over Scotland's oil and gas resources; to provide for revenues from the Scottish sector of the UK Continental Shelf to be paid into the Scottish Consolidated Fund; and for connected purposes.

BE IT ENACTED by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:-

PART I

Transfer of legislative authority

Amendments to the Scotland Act 1998

1. – (1) The Scottish Parliament shall have legislative authority over Scotland's oil and gas resources.

(2) Matters within the devolved competence of the Scottish Parliament will include:-

a) the ownership of, exploration for and exploitation of deposits of oil and natural gas,

(b) the subject-matter of section 1 of the Mineral Exploration and Investment Grants Act 1972 (contributions in connection with mineral exploration) so far as relating to exploration for oil and gas,

(c) offshore installations and pipelines,

(d) the subject-matter of the Pipe-lines Act 1962 (including section 5 (deemed planning permission)) so far as relating to pipelines within the meaning of section 65 of that Act,

(e) the application of Scots law and the jurisdiction of the Scottish courts in relation to offshore activities,

(f) pollution relating to oil and gas exploration and exploitation, but only outside controlled waters (within the meaning of section 30A(1) of the Control of Pollution Act 1974),

(g) the subject-matter of Part II of the Food and Environment Protection Act 1985 so far as relating to oil and gas exploration and exploitation, but only in relation to activities outside such controlled waters,

(h) restrictions on navigation, fishing and other activities in connection with offshore activities,

(i) liquefaction of natural gas, and

(j) the conveyance, shipping and supply of gas through pipes.

(3) The enactments mentioned in Schedule 1 are repealed to the extent specified in that Schedule.

PART II

Payment of oil and gas revenues into the Scottish Consolidated Fund

Treatment of revenues from Scottish sector of the UK Continental Shelf

2. - (1) Revenues accruing from the Scottish sector of the UK Continental Shelf shall be paid into the Scottish Consolidated Fund.

(2) The Treasury shall designate by order that all receipts from taxes or royalties in the Scottish sector of the UK Continental Shelf including taxes on profits from oil and gas extraction are payable into the Fund.

3. - The Scottish Ministers may reimburse any Minister of the Crown or government department for administrative expenses incurred by virtue of this Part at any time after the passing of this Act by the Minister or department.

Amendments to the Scotland Act 1998

4. – (1) Matters within the devolved competence of the Scottish Parliament will include taxes, allowances and royalties paid in relation to the Scottish sector of the UK Continental Shelf.

(2) The enactments mentioned in Schedule 2 are amended to the extent specified in that Schedule.

PART III

Supplementary

Interpretation

5. – (1) In this Act-

“Scottish sector of the UK continental shelf” means the area of Scottish waters defined by the co-ordinates set out for the boundary in the Continental Shelf Jurisdiction Order (S.I./1968, 891).

Transitional Provisions

6. - Subordinate legislation may make such provision as the person making the legislation considers necessary or expedient for transitory or transitional purposes in connection with the coming into force of any provision of this Act.

Commencement

7. – This Act shall come into force on the date of Royal Assent

8. – This Act may be cited as the Scotland (Oil and Gas Repatriation) Act 2006

S C H E D U L E S

SCHEDULE 1

REPEALS

Chapter	Short title	Extent of repeal
1998 c. 46.	Scotland Act 1998.	In Schedule 5, Part II, delete Section D2. Oil and gas

SCHEDULE 2

MODIFICATIONS OF ENACTMENTS

Scotland Act 1998 (c.46)

1. In Schedule 5, Part II, Section A1. of the Scotland Act 1998 (reservations), in exceptions add “Any taxes, allowances or royalties paid in relation to the Scottish sector of the UK Continental Shelf including Petroleum Revenue Tax and Corporation tax and the supplementary levy on taxable profits from oil and gas extraction”.

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