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PRIME MINISTER

To glance
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Treasury Chambers, Parliament Street, SW1P 3AG
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3rd January 1980

Dear Michael,

ECONOMIC BENEFITS OF NORTH SEA OIL AND GAS

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The Chancellor has asked me to let you have the attached briefing note on this subject which he has had prepared here. It is intended as material on which FCO Ministers and other colleagues can draw in countering arguments that their overseas counterparts may put in particular contexts about the benefits of the North Sea.

I let you have it now so that the Lord Privy Seal may have it by him in Rome on 7 January at the first of his series of talks on the EEC Budget.

I am sending copies of this letter and of the enclosure to the Private Secretaries to the Prime Minister and other Cabinet Ministers, and to Sir Robert Armstrong.

Yours ever,

A.M.W. BATTISHILL
(Principal Private Secretary)

M. J. Richardson Esq.



THE "BENEFITS" OF NORTH SEA OIL AND GAS

1. Introduction

North Sea oil and gas represent an addition to the nation's real income which comes through mainly in the form of oil company profits and Government tax revenues, with little direct effect on income from employment. It also has an important impact on the balance of payments. Welcome though these benefits are, their importance should be kept in perspective, both in scale and duration. We may be self sufficient in energy for no longer than the periods of office of two successive Governments.

2. Effect on national output

i. The effect on GNP is not large. Production in 1979 probably added about 2 per cent to the level of GNP. Even in the mid-1980s - the years of peak production - less than 5 per cent of GNP is likely to be due to the North Sea. The rate of growth of GNP is increased only when production is building up.

ii. This gain to the nation's annual real income will, even at the peak of production, probably represent less than two years of the kind of economic growth rates achieved in the 1950s and 1960s.

3. Impact of higher world oil prices

i. Although in volume terms Britain will in 1980 be self-sufficient in oil we are not immune from the effects of increased oil prices. For example, the OECD has forecast that the increase in world oil prices following the December 1979 meeting of OPEC will bring overall economic growth in 1980 to a standstill in the OECD countries. A slowdown in world activity will harm the UK economy as growth in our export markets slows down.



ii. In addition if investors shift into sterling, perceiving the UK economy to be better insulated than some others from some of the direct effects of oil price increases, the exchange rate will strengthen and for a time at least make it more difficult for UK industry to compete internationally.

iii. It is not true [as the Germans have attempted to argue] that with UK oil production of, say, 560 million barrels in 1979 each \$1 increase in the price of oil benefits us by \$560 million. The UK is not yet a net exporter of oil and so an increase in the price brings no net benefit. Rather it brings a transfer of resources between UK consumers and producers, with UK manufacturers, for example, facing increases in their energy costs just as their overseas competitors do. Even to the extent that Britain does become a net oil exporter very little net benefit may arise from higher oil prices, not only because of the effect on markets for our exports ((i) above) and on our competitiveness ((ii) above) but also because a large part of North Sea oil revenues accrues to foreign oil companies.

4. The effect on tax revenues

i. Government revenues from royalties, petroleum revenue tax and corporation tax are expected to be about £2.1 billion in 1979-80. This is equivalent to about 9 per cent of the yield from income tax. But receipts will not build up their peak until the mid-1980s and will obviously begin to tail off thereafter.

ii. By the mid 1980s North Sea revenues might be equivalent to $7\frac{1}{2}$ per cent of total general government tax receipts. But slow growth in the rest of the economy could mean little growth in total tax revenues in real terms.



5. The balance of payments

i. North Sea benefits appear initially as foreign exchange savings. In 1979 the contribution to the visible account, net of debits such as repatriation of profits by oil companies, was estimated at about £5 billion, equivalent to about 9 per cent of exports of goods and services.

ii. But even with this useful contribution the current account for 1979 is expected to be in deficit by £2½ billion, reflecting a high level of imports from the Community and elsewhere, our poor export performance and large contributions to the EEC Budget.

iii. The contribution to the balance of payments can be realised through the accumulation of larger foreign exchange reserves or other overseas assets; through a higher level of demand at a given exchange rate; or through a higher exchange rate and hence lower inflation. But there are drawbacks in all of these: building up foreign exchange reserves threatens control of the money supply; supply-side constraints severely limit the possibility of expanding domestic output and a higher exchange rate makes it harder for our exporters to compete on world markets.

6. Conclusions

i. The North Sea is an undoubted benefit to the UK economy. Compared with what would otherwise have happened, the oil and gas increase our real income, help with the balance of payments, and reduce the rate of inflation and the burden of taxation.

ii. But the deep-seated problems of the UK economy mean that the benefits of the North Sea go nowhere near solving the problems we still face.

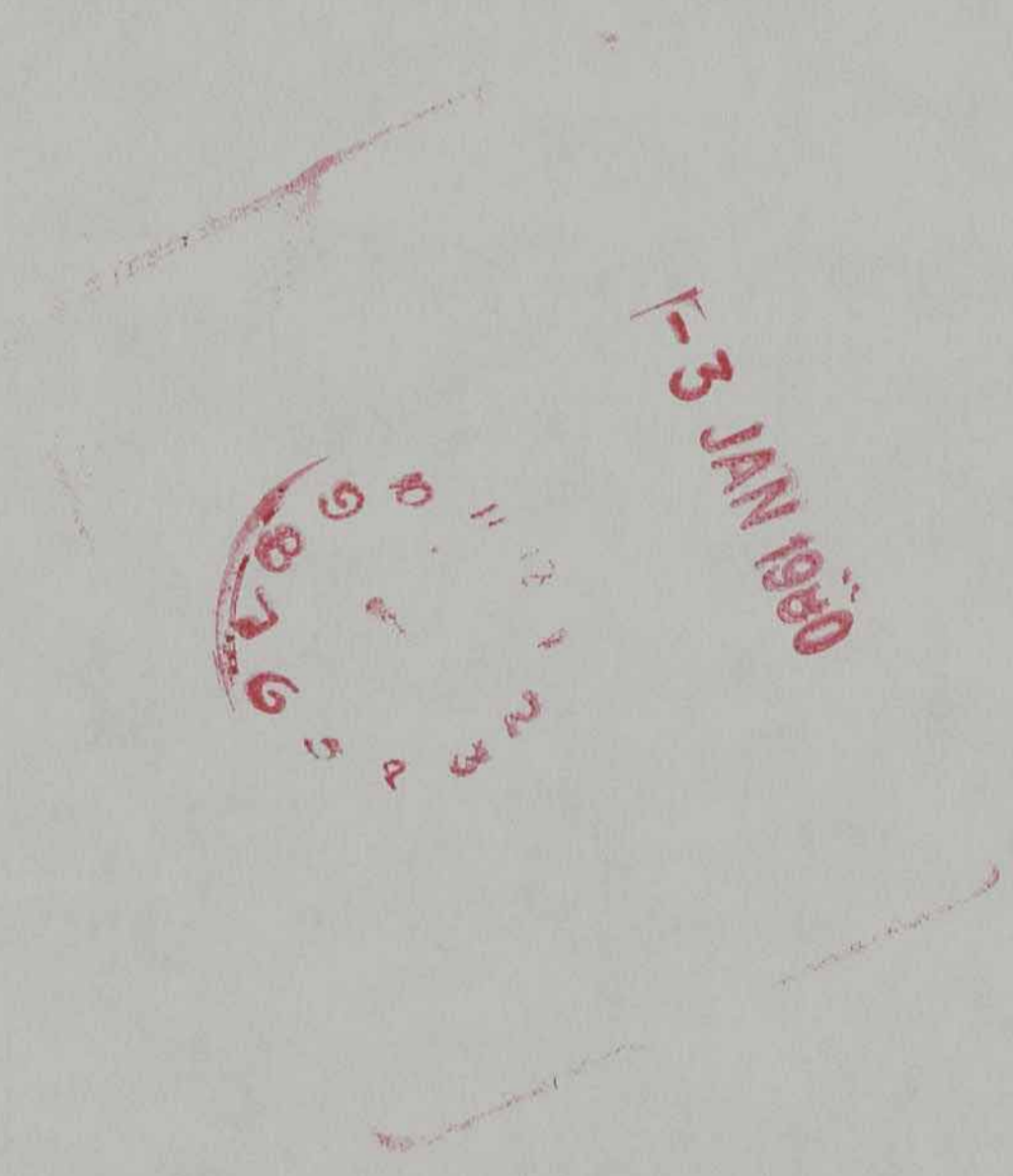


iii. The benefits are not large when compared with the size of the economy; nor are they long-lived.

iv. There are some positive disadvantages, in particular sterling has been pushed to levels which reduce our competitiveness and create problems for our industrial base.

v. Our prospective self-sufficiency in oil does not insulate us from the effects of OPEC price increases.

HM Treasury
2nd January 1980



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