



## All that's wrong with 'common wisdom' in one article

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This article from The Telegraph is a wonderful example of pundit cluelessness and or wanton incompetence, and I'm going to rip it to shreds in detail below.

### [Gordon Brown landed North Sea oil in choppy water](#)

*The Treasury is enjoying a windfall as oil soars but taxation policy may have knock-on effects*

The rest of us may have been too busy partying like it was 1999, but on the eve of the millennium Britain was quietly, unwittingly, selling off the family silver on the cheap.

Gordon Brown's choice of that year to start selling off Britain's gold reserves with the precious metal's price close to an unprecedented low is well documented. What is less well known is that 1999 marked the peak for North Sea oil production and - **by an unfortunate twist of fate** - the very nadir of the oil price.

Gordon Brown, who has been lauded for years (and in particular around 1999) as a great Chancellor of the Exchequer is now fair game and everything he has ever done must now be seen in light of his current meltdown. With that in mind, it is not surprising to see articles now popping up to pin blame on him *then* for oil prices now. The biggest story of the day must somehow be his fault too.

But given that oil and energy is a topic that touches upon quite a few ideological traps, he is of course going to be blamed for all the wrong things, in order for the story to fit with the narrative.

The last sentence of the above paragraph is testimony to how far our pundits are from any kind of informed commentary on the subject. Is it really a "unfortunate twist of fate" that oil prices were at their lowest when the highest volumes of oil under our control were extracted, or just a logical consequence of supply and demand rules that they are usually so keen to credit for other favorable economic outcomes?

After the oil shocks of the 70s, the US and the UK were lucky to be able to exploit new oil reserves situated on their territory - in Alaska or the North Sea. These finds, the last major production areas found on the planet to date, flooded the market in the 80s and 90s, duly bringing prices down, and prompting the Economist to write, in [March 1999](#): "*The price of oil has fallen by half in the past two years, to just over \$10 a barrel. It may fall further.*"

Commodities were seen as a relic of the past, as the dotcom age was promising us unprecedented

wealth based on knowledge rather than heavy stuff. Gold was on a 20 year downwards trajectory and all central banks were wondering what to do with their bulky and useless stocks of the metal. Holding it was, then, seeing as silly, and oil was seen as an sideshow - cheap, plentiful and boring.

But hey, let's rewrite history with the benefit of hindsight, and blame Brown for actions which were then lauded as modern and proper.

□ Britain was pumping around 2.8m barrels of oil every day, but the price averaged a mere \$18 and dropped at one stage into single figures. Fast-forward to today, and while the oil price has rocketed up to a record \$135 a barrel, the UK is producing only 1.5m barrels a day.

The Prime Minister cannot be blamed for the fact that Britain's oil production peaked at precisely the wrong time, nor can he really do anything meaningful to the oil price - despite his pledges yesterday. However, the rising price has underlined just how fast the North Sea is declining, and raised questions over whether Mr Brown's policies have served to accelerate its demise.

Well, the Prime Minister *can* actually be blamed for not doing anything about the UK's oil production when he arrived at n°11 back in 1997. It was not fashionable then, and it certainly was not what his predecessors had done, but oil&gas production could have been curtailed and limited in order to last longer. This is what the Dutch did with their gas reserves - limiting by law the production of their giant Groningen gas field so as to husband the resource for longer. It's not as if information on the likely decline of production was not available then, and as if the government did not have the means to direct an immediate stabilisation of production so as to ensure a longer tail.

And even if you accept that it was not a priority topic by 1999, the real issue was not what he did or did not do then, but what he has not done since, as it became obvious that production was declining. The country has lost 1.4mb/d of production capacity in 10 years, has become a major importer of the stuff (in competition with [the rest of Europe](#), which has had somewhat more adapted supply policies for a long time, in the form of long term contracts), and *still has no energy policy* beyond "the markets will provide" or "blame the evil Russians."

And as to "doing nothing about oil prices" - how about focusing on the one side of the supply-demand balance that we can actually do something about: our demand? There's lots that governments can do, from the mundane (fuel efficiency requirements, construction standards), to the all encompassing (fuel taxes, speed limits, public transport investment) to the brutal (rationing, forbidding the sale of cars with low fuel efficiency, closing off highways).

But no, the common wisdom does not focus on that, it focuses on this:

However, the Government is culpable for its management of the tax regime. Some years ago Mr Brown switched the system to a more modern scheme, charging oil companies a supplement to corporation tax for their North Sea profits, but allowing them to offset the investment they poured in.

It was a sensible change, designed to encourage companies to spend more on finding

new fields. However, in 2005, the Treasury suddenly and unexpectedly raised this supplementary tax rate.

Ah. Tax increases. **That's** the real problem. Of course. It is, as we know, the root of all evil.

All businesses are reluctant to invest in a region if they fear its tax policies will change suddenly and without warning - none more so than oil companies, which make their investment decisions on a 20 to 30-year horizon.

Tax instability (which happens only when taxes go up, not down, of course) is the cause of the production decline. No matter that the tax was increased only in 2005, ie 6 years after production started declining, and that it was increased by a few % at a time when oil prices had already climbed up from \$15 to \$50 - it Just. Has. To. Be. The. Reason. Oil. Production. Declined. As we are reminded again:

Even so, the speed of the North Sea's decline has taken almost all experts by surprise. According to Kevin Norrish, commodities analyst at Barclays Capital, since the turn of the millennium production has consistently disappointed expectations. "With no major new projects on the horizon to make up for the accelerating decline rates in the UK's mature fields, the prospect of significantly arresting the established decline in output looks poor," he said. Likewise, the amount of investment injected into the region has been consistently lower than many had forecast.

"Experts" were surprised. Presumably the very same experts that were "surprised" when Iraqis did not welcome US and UK soldiers with flowers, or when oil prices went above \$50, and above \$60, and above \$80, and above \$100, etc... The same experts that are still listened to today, and quoted widely. But it all makes sense for them:

This is hardly surprising. Over the past decades the North Sea has become one of the Government's biggest corporate tax cows, generating more than £230bn in revenue since 1968. The Treasury is expecting to make around £10bn this year from oil revenues, though experts at Grant Thornton think this could rise as high as £16bn due to higher oil prices.

However, this windfall has come at a price. If, as thought, it is responsible for depressing production in recent years, it has helped make the UK a net oil importer two years earlier than expected.

It's government fault that production is declining, and more precisely, it's Gordon Brown's fault for increasing taxes at the wrong moment. The man cannot keep his hands of our hard earned

Not only does this have serious implications for energy policy, it has pushed the current account deficit sharply higher and contributed to a weaker pound. It has meant that whereas a few years ago Britain was well positioned to benefit from a high oil price, the implications today are far more damaging for the economy.

We hit the jackpot! Brown's tax increases not only explain the oil crisis itself (killing incentives, *despite today's prices*, to invest in more North Sea production), but it also explains Britain's huge trade deficit (see, nothing to do with the financial sector's growth slowly killing the manufacturing sector, à la [Anglo Disease](#)) AND it suggests that there is a simple, successful energy policy round the corner (lower taxes on energy companies).

The Conservative and Labour governments since Thatcher have benefited immeasurably from the North Sea's constant stream of revenues in the past decades. Only now are the full implications of its decline sinking in.

Lady Thatcher, in her infinite wisdom, bestowed future governments with a golden goose, and now that damn evil, incompetent, (shall we dare say it - *socialist*) Brown has spoiled it all. Damn him.

Sigh...

While the last sentence touches one profound truth (British governments over the past 20 years have had it easy thanks to the North Sea bonanza), it also points that the real issues are not even on the radar yet. Oil production decline (in the case of the UK, but the logic is the same as regards global stagnation of production) is only caused by pesky governments interfering with private sector investment, and there is no problem that cannot be resolved by lower taxes or less regulation. Peak oil is not even on the radar screen, Demand-side policies are inexistent (beyond, occasionally, a token, throwaway mention) and, of course, irrelevant.

As usual, all that matters are supply-side policies. Maybe it's time to call it, as properly suggested long time ago by George Bush Sr for their economic cousins, **voodoo energy policies** - it's all the more appropriate as it appears to mostly include the hope that production will somehow, magically, increase - or that an alternative solution will just as magically emerge painlessly.



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