Grasping the thistle
Adding energy to the debate
Grasping the thistle: taking the temperature of the independence debate in the Scottish business community

As the discussion on Scotland’s fiscal and constitutional future intensifies ahead of the 2014 referendum, EY is committed to facilitating an open, frank and informed public debate focused on the key issues that matter. With this aim in mind, in 2012 we launched a series of thought leadership reports under the title ‘Grasping the thistle’, based on specially-commissioned primary research canvassing the views, hopes and concerns of the business community in Scotland.

Our first ‘Grasping the thistle’ paper, released in September 2012, looked at the implications of Scottish Government gaining control over corporate taxation. This was followed in mid-2013 by our second report in the series, examining the implications of the Land and Building Transactions Tax (LBTT) for Scotland’s economic prosperity and competitiveness.

This third ‘Grasping the thistle’ paper – ‘Adding energy to the debate’ – examines the views of oil & gas companies with operations in Scotland on the implications and anticipated impacts of a ‘yes’ or ‘no’ vote. At the same time, we are using a similar approach to develop a parallel thought leadership report examining the current views amongst leaders of Scotland’s financial services industry.

A survey of senior leaders in Scotland’s oil & gas industry, conducted by EY in association with Aberdeen & Grampian Chamber of Commerce.
Adding energy to the debate

Foreword

Oil & gas: a major battleground in the independence debate

With the referendum on Scottish independence now less than a year away, it is already clear that Scotland's oil & gas industry will be one of the main elements in the debate. As the countdown continues, the implications for this key sector will remain at the forefront of the national and international discussion, as questions are raised around several key issues.

For example, does the oil & gas business community have the information it needs to prepare fully for the referendum? What are their key causes of uncertainty as we approach the vote? What impact has the prospect of the referendum had to date on investment in the UK Continental Shelf (UKCS)? And how does the industry view the potential establishment of a Scottish Sovereign Wealth Fund post-independence — or indeed in the event of a 'no' vote?

To help answer such questions, we have set out in this research report — in association with Aberdeen & Grampian Chamber of Commerce — to take the temperature of opinion in Scotland's oil & gas community. Our questionnaire covered all the issues mentioned above, whilst also delving into other important questions, such as the degree to which the industry believes regulation and taxation would differ in an independent Scotland from one that remains part of the UK.

In introducing the findings of this study, I would like to thank the 137 senior leaders and decision-makers who participated in the research for their time, assistance, cooperation and frankness. Alongside the statistical data we have highlighted several of their verbatim comments, which we feel really bring to life the debate now under way across and beyond the industry.

We trust you will find this report interesting and informative, as a unique snapshot of pre-referendum opinion in what is arguably Scotland's most important industrial sector. In publishing these findings, we are seeking to contribute to the constructive, informed and lively public discussion that we believe is vital to Scotland's continued future economic wellbeing and vitality whatever the changes through which the country's businesses have to navigate their way in the next few years.

Colin Pearson, Tax Partner
EY Scotland

Research sample and methodology

The data for this research report was collected in October 2013 through an online survey of 137 senior leaders and decision-makers in oil & gas-related companies, including many that are members of Aberdeen & Grampian Chamber of Commerce.

The individuals surveyed were all in senior management positions with companies operating in the oil & gas sector in Scotland, in subsectors including oilfield services, exploration & production, legal services, and finance. Half of the respondents have board level roles such as CEO, CFO or Chairman, with the rest split mainly between finance, operations and legal.

Just over two-thirds of the companies surveyed are headquartered in Scotland, with the remainder divided roughly equally between being headquartered elsewhere in the UK or headquartered overseas.

The survey attracted responses from a broad range of companies by size, with 34% turning over less than £10m a year, 25% between £10m and £100m, and the remaining 41% more than £100m.

Survey participants by sector
More information required ...

As the referendum draws nearer, Scotland-based firms in all regions and sectors are starting to assess how independence might impact their business. Oil & gas businesses are clearly no exception. Asked whether they have enough information on which to form a view on this key issue, over half of the industry leaders we interviewed – 55% – say they have some information, but that more is still required (see Chart 1).

Chart 1: Do you have enough information to form a view of how Scottish independence might impact your business?

In contrast, just 10% say they already have the right amount of information to reach a view, whilst 35% say they still require significantly more information to form a view. Whilst these findings point to the continued existence of a significant information gap less than a year ahead of the vote, there is plenty of time for this gap to be closed during the campaign.

“I would like to understand if the Scottish branch of my business will need to operate as a separate business entity under Scottish law in an independent Scotland with its own P&L and taxation.”

“We need clarity on whether a ‘yes’ vote ties Scotland to the EU or not. The answer to this could change several of my responses.”

“Now is not the time to be dissecting policy. No-one knows if the SNP will get voted in at the general election, as in essence they will have achieved their goal already.”

Verbatim comments made by our respondents indicate that their need for more information centres on a handful of specific jurisdictional and legal issues that have yet to be resolved. For example, a significant number highlight the uncertainty over Scotland’s future membership of the EU, given the combination of the Scottish referendum on independence and the UK’s proposed referendum on EU membership. Furthermore, it was pointed out that, in the event of a ‘yes’ vote, much would depend on the outcome of the first Scottish general election after independence – meaning the fact that Scotland is independent will not determine the policies that are applied.
... but little impact to date

Whatever the potential effects of Scottish independence, oil & gas-related businesses say that, to date, the planned referendum has had relatively little impact on any important aspect of their business. As Chart 2 shows, asked about its effects across a range of key areas and activities, most respondents of all sizes and across all subsectors say it has had no impact at all.

The area where the lowest proportion of respondents cite ‘no impact’ is in investment in UKCS, where 64% say there has been no impact and 24% register a slight or significant negative impact. This appears to reflect the wider uncertainty created by the referendum in areas such as taxation – a factor looked at in more detail later in this report.

Chart 2: What effect, if any, has the planned referendum on Scottish independence had on your business to date with regards to each of following?

“‐It’s not possible to plan in any detail for the unlikely outcome of a ‘yes’ vote.‘“
Aberdeen & Grampian Chamber of Commerce Viewpoint

In June this year, 68% of AGCC members told us independence would impact their businesses. However, at that point 60% didn’t know enough to take a view on what that impact would be. In July we published a paper stating that taxation, EU status, currency and regulation were the ‘big ticket’ items in the debate – and, usefully, this EY study confirms those findings.

There are still ten months until the voting date, and therefore sufficient time for detail to be provided. Providing clearer information will help change views of businesses, but just 20% of our members expect to get the answers they want from politicians or each of the campaigns.

Businesses want to hear the compelling narrative informing them why the UK is ‘better together’. They also want to know the details of how and why an independent Scotland will be more successful than one that remains in the UK.

Current positions can be seen as simple rhetoric – and it is fascinating that the results show an expectation of an increase to the tax and regulatory burden in an independent Scotland, although the campaigning would say otherwise. Whilst we are starting to see some firmer positions being taken on issues such as currency union, more clarity is needed.

The data shows we have not seen major changes in behaviour from companies. In economic terms this is good news. However, we hope that the vacuum in the political debate does not impact on this ‘business as usual’ attitude.

We will continue to press for answers from each campaign and fill the gaps for businesses, not least because whether we see a ‘yes’ or a ‘no’ vote there will be new debate that will start on 19th September 2014. That debate or negotiation could arguably be more important than the vote itself.

Our views are published at http://www.agcc.co.uk/policy1/#scotland-s-future

James Bream
Research and Policy Director, AGCC
A central theme of the debate over independence has been the proposal from the ‘Yes’ campaign that if Scotland becomes independent, it should follow the approach of oil-rich countries ranging from Qatar to Norway by setting up a Sovereign Wealth Fund for the benefit of future generations.

The fund would aim to enable the country to spread the wealth generated by oil & gas across the generations so the beneficial impact is transformational to the economy in many decades’ time. However, opponents have countered that its creation could require tax increases and/or cuts to public expenditure.

With the recent high profile pronouncements on using oil & gas revenues to create a fund it seemed of particular interest to gauge support for the proposition from industry executives. As Chart 3 shows, when respondents were asked whether they would support the creation of a Sovereign Wealth Fund after independence, 39% give an outright ‘no’.

Chart 3: Would you support the creation of a Sovereign Wealth Fund by the Scottish Government post-independence?

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<table>
<thead>
<tr>
<th>Option</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Sovereign Wealth Fund for the UK should be created regardless of the referendum</td>
<td>25%</td>
</tr>
<tr>
<td>A Sovereign Wealth Fund for Scotland should be created regardless of the referendum</td>
<td>17%</td>
</tr>
<tr>
<td>No</td>
<td>39%</td>
</tr>
<tr>
<td>Yes</td>
<td>19%</td>
</tr>
</tbody>
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Analysis of the results by size of company reveals further important insights. The biggest companies turning over more than £100m are generally less positive about the creation of a Sovereign Wealth Fund post-independence, with 45% rejecting the idea outright, and only 14% saying they would like to see an independent Scotland set one up. In contrast, only 27% of businesses turning over less than £10m give an unqualified ‘no’ to the idea, whilst 25% would support the creation of such a fund after independence.

This distinction appears to suggest that larger companies are more wary of the idea, since they think they might end up making the biggest contribution to the costs.
... but not if it raises taxes or cuts state spending

Significantly, the overall figure of 61% in favour of a Sovereign Wealth Fund in all its forms falls dramatically once the issue of its wider potential fiscal impacts is introduced. As Chart 4 shows, only 27% of respondents support the creation of a fund – with or without independence – if it means higher taxes in the oil & gas sector and/or reduced public spending in the short term. 35% oppose the idea and the biggest share – 38% – are undecided.

Chart 4: If you currently support a Sovereign Wealth Fund with or without independence, would you continue to do so if this meant higher taxes in the oil & gas sector and/or reduced public spending in the short term?

- Yes: 27%
- No: 35%
- Does not currently support the creation of a Sovereign Wealth Fund (as per previous question): 38%

A breakdown of the responses by size of company throws up some significant divergences. Amongst larger companies (turning over £100m-plus), only 23% say they would continue to support a Sovereign Wealth Fund if it meant higher taxes on oil & gas companies and/or reduced public spending. Amongst companies turning over less than £10m, the level of support in these circumstances remains much more solid, at 35%. This may indicate that larger companies believe any resulting rise in the tax burden might fall disproportionately on them.

“Regulation and Tax: increases expected following a ‘yes’ vote

Turning to anticipated changes in the weight of regulation and taxation borne by the UKCS oil & gas sector post-referendum, there is a widespread expectation amongst our interviewees that both of these burdens would rise following a ‘yes’ vote – whilst a ‘no’ vote would see them remain relatively unchanged.

Chart 5: What is your expectation of change to the weight of regulation imposed on the UKCS oil & gas sector in the event of a ‘yes’ or ‘no’ vote?

- In the event of a yes vote:
  - Increase a lot: 10%
  - Increase a little: 20%
  - No change: 30%
  - Reduce a little: 40%
  - Reduce a lot: 50%

- In the event of a no vote:
  - Increase a lot: 10%
  - Increase a little: 20%
  - No change: 30%
  - Reduce a little: 40%
  - Reduce a lot: 50%

“The main issue is the uncertainty a ‘yes’ vote would introduce until a new Scottish government was in place and all the regulations were updated.”

That said, the fact that over a quarter of respondents overall still support the creation of a Sovereign Wealth Fund even if it drives taxes upwards and/or public spending downwards, does underline the strength of support for the concept in the oil & gas industry, whatever the outcome of the referendum.

“I may have been supportive of the fund with a guarantee that it did not involve any tax increases and was from surplus revenue.”

“I would support a Sovereign Wealth fund if it meant a reduction in public spending, but not if it meant an increase in taxation.”

Grasping the thistle
As chart 5 illustrates, the figures paint a clear picture. In the event of a ‘yes’ vote, a total of 62% of respondents think the UKCS oil & gas sector will be more heavily regulated – with almost half of these saying they expect regulation to increase ‘a lot’. Only 10% expect regulation to reduce following a ‘yes’ vote. Conversely, only 5% expected an increase in the regulatory burden in the event of a ‘no’ vote, whilst an overwhelming 90% expect no change to the status quo if independence is rejected. 

Whilst the Scottish Government’s consistent message has been that the likely overall direction of taxes after independence would be downwards, these findings suggest that the oil & gas industry either does not believe this, or thinks that this does not apply to it. Executives appear to expect that an independent Scotland would be unable to avoid increasing the burden on the sector, whatever might happen with general corporation tax rates.

That said, there is an apparent contradiction between the industry’s strong expectation that independence would be followed by heavier industry regulation and taxation, and the finding shown in Chart 2 that the referendum is having little impact on key areas of the business. If companies really were expecting taxes and regulation to increase in a year’s time, then their behaviour in areas like UKCS investment would be changing now. The fact that the referendum is having little effect so far may suggest that most respondents continue to believe that independence is unlikely to come about.

“A similar sense of uncertainty is evident when our interviewees are asked about the future direction of fiscal policy in the UKCS. As Chart 6 shows, an overwhelming 79% of respondents think the tax take from the industry will increase in the event of a ‘yes’ vote, split roughly evenly between those expecting a ‘big’ or ‘small’ increase. A ‘no’ vote is seen as maintaining the status quo, with 80% expecting no change in the industry tax take if independence is rejected.

Chart 6: What expectation do you have on the direction of fiscal policy in the UKCS in the event of a ‘yes’ or ‘no vote?“Currently I believe that the UKCS and oil & gas industry does not receive the attention that it deserves. In the event of a ‘yes’ vote, I believe that the UKCS would be better recognised and more focus applied to the issues within the industry.”
Current uncertainties: talent is the biggest headache ...

Our final area of questioning is around the biggest uncertainties that companies are currently facing in their UKCS operations. As Chart 7 shows, ‘supply of skilled employees’ emerges as the most pressing area of uncertainty by a wide margin, cited by over 50% of respondents in their top two. However, more than a quarter rank the skills supply as not being a concern, ranking it 5 or 6.

Chart 7: What is currently the biggest uncertainty your company faces in your UKCS operations? [Options ranked 1-6 in order of level of uncertainty]

Response Summary

Other areas of uncertainty highlighted by significant numbers of respondents include their companies’ cost base, cited by 36%. Almost a third rate taxation levels as an uncertainty, perhaps reflecting the concerns voiced above about a potential rise in the industry tax take post-independence. Funding is cited by 22% and regulation by 21%.

... but opinions are divided on the referendum

On what might have been expected to be the single biggest uncertainty for the industry – the imminent referendum – opinions are sharply divided. Whilst 37% rate this as a significant cause of uncertainty in their UKCS operations, an even higher proportion – 41% – rank this as their fourth, fifth or sixth most important source of uncertainty.

This even balance may seem counter-intuitive but perhaps provides a message that, whatever happens politically, there will still be oil & gas under the North Sea that needs to be extracted. It appears that rather than speculating or worrying about what might happen after the referendum, the oil & gas industry is simply focused on the task at hand: running their businesses and generate wealth and employment for the UK and Scottish economies.

“It’s not just the referendum – it’s whether or not Scotland and/or the UK remains in the EU.”

“With a ‘yes’ vote the main uncertainty is, “What type of government will the people of Scotland elect?” I’m concerned there is no pro-business Scottish party. Will the Scottish vote for a Socialist government with a nationalisation agenda in the event of independence?”
Tax rate and Sovereign Wealth Fund

EY viewpoint

The Scottish Government has consistently stated that, should Scotland become independent, it would use its tax-setting powers to promote the economic prosperity of Scotland by reducing the tax rate, either generally or in some targeted fashion. The results of this survey suggest that it has a long way to go in convincing oil & gas executives that this will be the case.

The respondents overwhelmingly expect taxes to increase should there be a ‘yes’ vote. In stark contrast, almost the same percentage believe there would be no change in fiscal policy should there be a ‘no’ vote on the referendum. Clearly, the well-publicised dialogue between the oil & gas industry and the UK Government has bred confidence in the current fiscal position, and the respondents are confident in the current fiscal compact being sustained.

However, there appears to be little confidence in the pronouncements of the Scottish Government. Whether these views reflect the broader uncertainty over the business landscape post-independence, or are a reflection on the economic credibility of an independent Scotland, remains unclear.

In contrast, on the proposal to establish a Sovereign Wealth Fund or ‘Oil Fund’ – another cornerstone policy of the Scottish Government – the survey is very supportive. Interestingly, the largest block of support within those who answered ‘yes’ to the creation of a fund came from those who wanted a fund to be set up for the UK, regardless of the outcome of the referendum.

The nuances here are intriguing: namely, it appears that the Scottish Government is winning the argument on the merits of a fund, but this may not be actually persuading people of the case for independence; they consider a fund to be a good idea outright and not necessarily limited in application to an independent Scotland. Strong support remains even where the proposed fund cannot simply be created from surplus cash.

So there is a mixed bag here for both sides of the debate. The survey sends a clear message to the Scottish Government on the need for it to build more credibility with the oil & gas community on economic forecasting in the event of independence. By contrast, the debate on setting up a Sovereign Wealth Fund has struck a chord with business leaders, and there is strong support for this proposition. But this does not obviously translate into support for independence, as there is a strong block of support for a UK fund – something the UK Government may wish to take into account when considering its approach in the coming months.

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