
Economic Perspective 2

THE OFFSHORE SUPPLIES INDUSTRY: CAN SCOTLAND WIN THE NINTH ROUND?

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Later this spring the Government will announce the results of the ninth round of licencing 'blocks' of the UK Continental Shelf (UKCS) for the purposes of exploration and development of new oil and gas reserves. The blocks on offer are an intriguing mixture of unexplored 'mature' areas in the North Sea and 'frontier' acreage in places such as West Hebrides and West Shetland. In terms of attracting bids the latest round is already clearly a success: 147 applications have been received and over half the 195 blocks on offer have attracted attention. Since the Government only expected to license some 80 blocks, it has every reason to be satisfied with this response.

It is not generally realised that the allocation of blocks to particular applicants does not usually depend entirely on the financial value of their bids (for example, only thirteen blocks have been sold by auction in the ninth round); rather, to be successful, applicants must convince the Government of their ability to satisfy other designated criteria. In the past, the most important criterion has been a 'proven' (usually on the basis of previous track record) willingness to explore and exploit licensed territory. The priority given to this criterion clearly demonstrates the importance successive Governments have placed on finding and producing UK oil and gas resources.

In the ninth round, however, Energy Ministers have made it clear that a 'willingness to explore', while necessary, may not be sufficient for a bid to be successful. In particular, they have emphasised two other considerations which will be taken into account in assessing the merits of each application: first, preference will be given to applicants who can demonstrate that a high proportion of

any exploration and development expenditures will have a high UK content; secondly, preference will be given to would-be operators who are prepared to further research and development in offshore technology within the UK.

At first sight, the need to explicitly include these criteria may appear puzzling. After all, does not the UK offshore supplies industry (which is largely Scottish based) already attract some 70%-80% of the £2.5 billion worth of orders placed annually for UKCS developments? Hasn't coping with the hostile environment of the North Sea already brought the UK to the forefront of world offshore technology? Aren't UK firms already successful in offshore markets worldwide?

Taking a superficial and short-term view, each of the above questions could be answered affirmatively. However, deeper and more long-term analysis reveals some disturbing aspects of the offshore supplies industry which go a long way to explaining the Government's extension of licensing criteria in the ninth round.

There is growing concern that the UK share of orders placed may seriously overstate the UK share of actual purchases of goods and services. The latter is of course more important in terms of generating income and employment in the UK. A recent report (SDA (1984)) suggests that the real UK content of offshore expenditures may be between 40%-70%. The new Scottish input-output tables (IDS (1984)) give Scotland only a 21% share of sales to the UKCS in 1979. Problems in accurately measuring the local content of offshore orders arise mainly through the labyrinthine purchasing structure in the oil industry. For example, an offshore operator will typically hire a main

contractor to undertake the design, construction and installation of large offshore structures (eg platforms). The contractor will then sub-contract for major component items such as modules. Each sub-contract leads in turn to further sub-contracting.....and so on. The purchasing chain is so complex that while a contract may be placed in the UK, its fulfilment may involve substantial imports of goods and services.

This, then, is the reason for the Government's interest in the UK content of offshore expenditure in the ninth round. Unfortunately, the very complexity of the purchasing train make adherence to this criterion difficult to monitor and enforce in practice. The UK share of orders places may not be a good proxy for actual UK sales, but the alternative of tracing through every contract chain for local versus imported content is clearly unrealistic. Furthermore, if at some future date an operator developing a major new oilfield claims that, because of price changes or technological developments, it is necessary to switch from a UK to a foreign supplier to the Government can hardly be expected to exercise a veto.

There are likely to be similar difficulties in enforcing the 'UK R & D' criterion. Concern over the lack of R & D into offshore technology in the UK has found its fullest expression for over a decade in two recent reports (NEDO (1985), SDA (1985)). Both reports suggest that UK offshore R & D expenditure is currently running at some £80 million per annum, about half of which is spent by oil companies and the remainder by suppliers and academic/research institutions. This figure compares unfavourably with those of other countries such as Norway which, with a much smaller offshore industry, spends over £70 million annually on oil-related R & D. It is also interesting to note that the whole of the UK oil-related annual R & D expenditure is only a quarter of that made by one major multinational oil company (Shell) in 1982. The main reason for the lack of UK offshore R & D, is that in the 1970's rush to extract oil and gas, reliance had to be placed on imported technology. This technology came mainly from America through the establishment of branch plants in the UK, especially in Scotland. The crucial question is what will happen to the UK offshore supplies industry in the next ten to twenty years when the global market continues to expand and the UK market starts to contract.

A forthcoming study (Gregory et al (1985)) suggests that, in the absence of indigenous ability to develop, produce and market appropriate products for new offshore provinces, the prospects may not be all that good. The oil industry is essentially peripatetic and could well choose to serve new markets by direct investment in the local rather than by export from the UK. Indeed, this study suggests that the export potential of the UK subsidiaries of multinational oil equipment suppliers is already constrained by the global strategies of their parent companies.

The desire to develop indigenous oil-related technological expertise as a safeguard against the future is therefore perfectly understandable. Again, however, it may be difficult to realise this objective in practice. How much, for example, can the oil operators be persuaded to spend in 'promoting' R & D in the UK supplies industry? Even more importantly, will they instigate **original and fundamental** research in the UK (remembering they have existing facilities to do this elsewhere)? How can this be checked and monitored?

In summary, the Government's attempts to promote the UK offshore supplies industry, as evidenced by the criteria for ninth round license applications, are entirely laudable. Such initiatives will be especially welcome in Scotland which has 100,000 jobs dependent, directly or indirectly, on this sector. Unfortunately, there are very considerable, and possibly insurmountable, obstacles to realising such worthy ambitions.

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