Scotland's Oil: Does Oil in Scotland have a future?

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I came, from the United Nations in New York, to Scotland in 1991. Then, as before every UK election, I was interviewed on the question if the oil around Scotland is Scotland's oil. It is fitting – after devolution, in the face of economic globalisation and under the shadow of the threat of the depletion of oil – to take a look at the future for oil in Scotland. What will oil mean for the Scottish economy in 10 to 15 years; what are the opportunities, but also the constraints for a Scottish oil policy to the year 2020. The Fraser of Allander Institute has had recently short visits by many of the luminaries of US economics; they all gave their advice with great seriousness, but virtually none did think it worth mentioning the Scottish oil industry, arguably the most value-adding industry existing in Scotland at this time. Why is there such a relative

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neglect outside Aberdeen for this capital- and technology-intensive industry which would have made a politically distinct Scotland the largest petroleum producer in the current and the new 30-member states' European Union?

There are some reasons. Foremost, to me, appears the asymmetry between Scottish devolution and the ownership and control over offshore petroleum. In developed countries with a federal structure, oil is as a rule primarily under the ownership and to a significant extent control of the federated state. It is only in federated countries of the Third World that the national government tends to reserve all or the main part of resource ownership and benefits to itself. Scottish devolution may have created a federated Scotland within the UK, but oil – ownership, control, tax powers and administration – has been reserved to the UK rather than to the Scottish authorities. Devolution – a federalisation – in Scotland is with respect to oil incomplete. As a result, Scotland loses out on petroleum tax; this may be balanced to some point (rarely recognised by Scottish nationalists) by higher UK treasury allocations ("Barnett formula") to Scotland. It is therefore less the immediate fiscal income, but rather the governance regime which has made oil disappear virtually from the Scottish economic and political agenda: Aberdeen is remote and culturally and politically quite distant from the centres of Scottish politics, population and public perspective. The absence of governance responsibility means that most of the administration is still centred in the DTI in London – as is most of the professional services business (finance, law, accountancy) which the very self-enclosed Edinburgh professional communities have allowed to slip away in the 1970s.

What does this mean for the future? There is a theory, strongly advocated by the "oil depletion school" that oil will simply run out, perhaps faster in the deep waters and reservoirs offshore Scotland. Oil will have had its day; it would have been a short interlude in Scottish history, of little significance (apart from Aberdeen) anyway since most of the oil games were played in London rather than in Scotland anyway. With oil gone, so a Nationalist argument, Scotland would have lost a good part of its value to the UK and could be released without great cost into independence. I suspect this perception is in the minds of most politicians in Scotland; it perhaps explains the quiet surrounding the role of oil in Scotland.

But this scenario is neither necessary nor likely. Petroleum production responds largely to economic logic and the dynamics of technology: The greater general depletion, the higher the price and thus the incentives for developing and applying innovative technology to develop ever smaller fields, extracting ever more of the oil in the existing reservoirs and bringing costs continuously down. Scottish (or UK) oil and gas are therefore not likely to disappear within the next 20 years. The only risk would be a much prolonged slump of oil prices at or below the levels seen last in 1985 and 1998. The continuous increase of demand from China and the relatively successful policy of price stabilisation conducted by OPEC are therefore the best friends of the Scottish oil economy. The main threat would be an uncontrolled opening of the massive and cheaply extractable oil reserves throughout the Middle East – the (illusionary) Christmas wish of the US Neo-Cons.

But does this simply mean "business as usual", a domestic oil economy at Aberdeen, with substantial (but varying) tax income to HM treasury and little interest in Scotland? I would suggest that even in the face of relative decline, the Scottish/UK oil industry has a significant potential in the global economy. This potential is not fully utilised at present. The asymmetry of oil governance between the UK and Scotland throws spanners into the works for an optimal exploitation of the potential of the UK and Scotland in particular as clusters for oil, gas and energy related professional and industrial skills. A look at Houston – centre of a rapidly declining US oil industry – illustrates that you don't need to be in the middle of a booming oil patch to exercise leadership: Texas oilmen, engineers, lawyers and consultants are active around the world. London has become the financial capital of the world's mining industry at the same time that mining has more or less departed from the British Isles. The more complicated offshore extraction becomes, the more technology, technical, managerial and regulatory skills can be developed which then find a place of application throughout the world. Those economies who manage a future, technically more complex phase of oil extraction acquire a competitive advantage – not just in terms of technology, but also of regulatory and industry cooperation initiatives (e.g. the UK "CRINE" initiative and its children) and professional skills. The Middle East oil industry may well become much more important as the region's cost and reserve strengths translate into growth – in particular with respect to gas. But that will mean an increasing input from countries with competitive comparative strength in regulation, fine-tuned taxation, technological, industry-wide organisational and professional skills. Scotland therefore has the potential to leverage its current and future expertise in managing an increasingly complex oil and gas industry into industrial leadership (following Houston). There are already now some entrepreneurial strength, in particular in Aberdeen, though they are not complemented – as in Houston – by professional, financial and organisational competencies. The lawyers and negotiators who met last week in Dubai to discuss the opening up of gas (in Saudi Arabia), oil (in Kuwait and perhaps in Iraq at some time) were either from London or Houston – but not from Edinburgh or Aberdeen. One can argue at length over the reason for such insularity, but in my view it is primarily the asymmetry of governance of the UK-Scottish oil industry which has prevented a petroleum industry cluster as powerful as in Houston to emerge between Aberdeen, Edinburgh, Dundee and Glasgow. That it is possible in principle shows the experience of my department: We had 4 graduate students and 10 K income in 1991; now, in 2003, we have over 200 graduate students, our fees have in some cases quintupled and our total income will approach 2 Million £ - with degree and training programmes for clients from over 50 countries not just in oil, but as well in energy and international business management. Similarly, my own practice has evolved from a focus on mining and petroleum to encompass, by 2004, mediation of complex electricity interconnector disputes, design of legislative and tax policies for renewable energy or arbitrating gaming investment in Mexico. Oil- and energy-clustered professional services therefore have a future in Scotland, taking advantage of the liberalisation of the global economy, the expansion of the EU and its increasingly close relations with Russia, Central Asia and China. But to develop such potential requires full focus and attention of developing Scotland as a cluster of oil, gas and energy related services – and that includes a gradual removal of the asymmetry of governance.