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EUROPEAN COUNCIL, VENICE
12/13 JUNE 1980
NORTH SEA OIL POLICY

Brief by the Department of Energy

OBJECTIVE

If question is raised, to persuade our partners of the constructive contribution to Community objectives made by our North Sea policies.

POINTS TO MAKE

(a) North Sea Policies [for use as necessary]

1. North Sea Oil Exports

About half our production is exported and over half these exports go to the rest of the Community - in 1979 it received 22 million tonnes. In the first quarter of 1980 other Community countries took some 66% of our total exports - one third of our total production. Our exports to the Community should continue to increase as our production continues to rise over the next few years. [Annex B shows North Sea disposals].

2. North Sea Oil Prices

Prices for North Sea oil follow but do not lead world market for similar high quality, low sulphur crudes. We have made clear to the companies operating in the North Sea our expectation that this will continue. All but about 1% of sales are at term prices with no additional premia. [Annex A can also be drawn on as necessary].

3. Supply of Off-shore Equipment

Other Member States' companies have enjoyed a high level of involvement. For example, of 35 major oil and gas platform structures so far ordered for the UKCS, 19 were built by other Member States' companies, or by EC/UK or EC/Norway joint ventures. Of the remainder, most involved a substantial input from other Member States' companies, in the provision of technology, topside, fabrication, steel etc. Other Member States' companies particularly Dutch, French and Italian, have also been much involved in off-shore installation work. This involvement has brought them valuable business and helped enhance their role in world markets.

4. Increased UKCS Production [Defensive - if raised]

We have indicated previously that scope for increasing production from the North Sea in the short-term would at best be very limited. Production is already at the highest level compatible with good oilfield management. Our policy has been to bring fields into production as fast as possible. By the end of 1979, 14 fields were in production. It took the UK only 4 years to reach production of over one and a half mbpd, much quicker than any other country (Libya: 6 years; others longer). With platforms costing £500 m or more no-one has developed fields to leave them non-productive. However, we agreed at Luxembourg that Energy Ministers should examine the possibility of increasing production as one component of a study of several possible aspects of dealing with short-term supply problems. This study has just begun.

[If necessary] We must now await the Commission's report to September Energy Council on short-term supply problems. Can take the subject no further in meantime.

5. Depletion [Defensive]

We are considering depletion policy against the long term background of managing a limited resource. Will explain fully to partners before any announcement is made.

6. North Sea Oil 'Wealth'

North Sea oil contributed only 2.5% of UK GNP in 1979 and will contribute only 6% even at peak production.

7. We are not yet net exporters. Even at peak production we will only be marginal net exporters. Rising world oil prices

damage an open, essentially trading and manufacturing economy such as the UK (with about 30% of GDP in exports).

Background

1. UKCS Oil Production 1980 Forecast

Our production in 1980 is expected to be in the range 80-85 m tonnes (towards the lower end) compared with consumption of about 90 m tonnes. This suggests that we shall probably need rather less imports in 1980 than our 12 M tonnes 1980 net oil import target. But we may need it if anything went seriously wrong with North Sea production this year (although we have no reason to expect this), and production fell below 80 m tonnes. If asked to quote figures we should stress the uncertainty surrounding them.

2. North Sea Exports and Prices

Production will probably rise until about 1984-86 even if the Government adopts a conservationist depletion policy (see paragraph 7 below). The pattern of approximately 50% UKCS oil consumed in the UK and the rest exported is likely to continue. Annex B illustrates crude disposals to Community Member States in 1979 and first quarter of 1980.

3. It now seems generally accepted that our prices follow the world market for similar high quality crude (in practice that produced by Algeria, Nigeria and Libya). BNOC's latest price rise of $2 was announced on 28 May, and followed a general $2 per barrel increase by practically all OPEC producers including the Africans.

4. Seventh Round of Off-shore licensing

The arrangements for the Round were announced on 1 May. The Round is to be of about 90 blocks, larger than the 70 blocks originally proposed. There will be full opportunity for participation by Community companies.

5. Increasing UKCS Production in a Sub-crisis

The question of increasing UKCS supplies to the Community during a crisis/sub-crisis was raised briefly at Luxembourg. The

Prime Minister made no commitment. But the Presidency's conclusions record that:

> "The European Council considers that the Community should clearly co-ordinate its response to the immediate problems of oil supplies, and invites the Council and Energy Ministers to consider what further action is requir[ed] taking into account the undertakings given by the Member States in the framework of the agreement on supplies in the event of a crisis, and with special reference to the possibility of increasing production of hydrocarbons."

6. The 13 May Energy Council confirmed that the scope for increasing indigenous hydrocarbon production (Dutch and Danish gas - at German insistence - as well as UKCS resources) should be one element in further examination of possibilities for dealing with short-term oil supply difficulties. The Energy Council agreed to return to this question in September on the basis of these studies, which the Commission have now begun at official level. The German Cabinet is reported to have said recently that it expected the UK to take account of the interests of her European partners in setting oil and natural gas policy, in particular at times of oil supply difficulty. There is in fact little if any scope for increasing UKCS production in an emergency, or helping in other ways (eg, diverting BNOC oil to the Community). Having agreed already in the Energy Council to the scope for increased UKCS production being examined we can appear helpful whilst, without committing ourselves, explaining if the subject is raised that the practical scope is extremely limited.

7. Depletion

Ministers agreed on action to defer net exportable surpluses of oil during the 1980's and discussions are under way with the oil companies PSBR implications are also being examined. Arrangements would be made to explain the policy to our partners before any announcement.

8. The following are attached:

Annex A: UKCS Prices

Annex B: North Sea Oil Disposals

Department of Energy
9 June 1980

ANNEX A

UKCS Price Setting

1. UKCS crude is comparable to African crudes (Appendix 1). The participation agreements entitle producers to the market price for crude oil which they must sell to BNOC. If the price cannot be agreed there is provision for recourse to expert determination.

2. Although some 70% of UKCS oil production passes through BNOC's books only one sixth of the oil BNOC is currently selling is its own equity oil. Participation oil makes up the bulk of the remainder purchased at the market price prior to selling. BNOC is not therefore a free market price setter.

3. HMG has no statutory powers to determine UKCS prices. Reserve powers exist in the Energy Act 1976, but may be exercised only in an emergency or to implement formal obligations to the EEC or IEA. This power would, in any case, not extend to crude oil traded offshore.

Crude Oil Market Development and Government Intervention in UKCS prices

4. Between 1974 and mid 1978 world oil prices were relatively stable. Term prices were set by a Saudi marker with differentials for other crudes reflecting quality differences and location only. Spot prices were close to term prices.

5. The Iranian crisis changed the market from demand constrained to supply constrained. During 1979 spot prices rose well above term prices and the term market became fragmented with a widening of the differential for sweet light crudes including North Sea oil. The downward trend of price in real terms from 1975 to the end of 1978 was reversed and real prices are now about 50% above the 1974 level.

6. This anarchy in the market led to considerable pressure for Government to intervene on UKCS prices particularly from the middle of 1979; both BNOC and companies were urged to be moderate with price increases.

7. In November 1979 the timing of BNOC's increase was premature, albeit by only a few days, and attracted much international criticism.

Further increases in 1980 have been better timed; the decisions being unannounced for longer giving the impression that the UK was last to come into line (although the effective date of increases was similar to that for other producers.) In addition the price has not exceeded the official prices of any of the comparable African crudes. During January settlement of UKCS crude prices below the market level was achieved only through pressure being applied to a number of companies. The most recent increase of $2 across all grades, effective 20 May brings the price of Forties to $36.25 per barrel. Many OPEC countries in fact charge premia in addition to the official price. Against this background UK prices look very moderate (see Appendix 2).

UK Interest in oil prices

8. Much play has been made by our partners of the value of North Sea oil to us. But we are not yet self sufficient and increases in world oil prices are a net cost to the economy. Some 30% of GDP comes from international trade; thus GDP will be affected by any recession caused by high oil prices and the loss will not be offset by higher oil revenues (which in total only account for a few per cent of GDP).

Community benefits from UKCS

9. There is no restriction on exports and about one third of UK production is exported to the EEC. Only 1% of output is sold at spot prices; all the rest is sold at term prices and there are no premia or surcharges equivalent to those levied by some OPEC countries.

OP(H) Division
D/Energy

ANNEX A
Appendix 1

CRUDE OIL QUALITY COMPARISONS

1. Oil prices are related to the quality of the crude. In general crudes from Nigeria, Algeria and Libya are closest in quality to those of North Sea crudes.

2. There are two major aspects:

(i) Yield differentials
The lighter the crude (in terms of specific gravity), the larger the yield of the higher value products like gasolene, naptha and gas oil. From light North Sea and North African crudes these products may total 60-70% of the product yield, whereas Gulf crudes yield 50% or less of these products.

(ii) Sulphur content
The lower the sulphur content the higher the value of the crude, especially to purchasers in countries with strict pollution controls. North Sea and North African crudes contain only 0.1 to 0.3% by weight of sulphur, compared with 2% for Arabian Light and 3 - 4% in some other Gulf crudes.

3. Under normal market conditions, North Sea crudes could be expected to command a quality preium of about $3 per barrel over Arabian Light.

ANNEX A

Appendix 2

$ per barrel

COUNTRY/CRUDE	OFFICIAL PRICE	REPORTED PREMIA OR SIGNATURE BONUS	APPROX PERCENTAGE OF OUTPUT SOLD WITH PREMIA	TOP TERM SELLING PRICE
Iraq Kirkuk	30.18	7.50	10	37.68
Libyan Es Sider	36.50	3.00	less than 5	39.50
Iran Light	35.37	2.50		37.87
Nigerian Bonny Light	36.69	3.00	less than 5	39.69
Algerian Saharan Blend	35.21	3.00		38.21
Qatar Dukhan	31.42	6.00	25	37.42
Indonesian Minas	31.50	5.40	15	36.90
Kuwait	29.50	5.50	25	35.00

These prices compare with a fixed term price with no extras of $36.25 barrel for UK Forties.

Saudi Arabian crude at $28/barrel is generally recognised to be under-priced.

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ANNEX B

EUROPEAN COUNCIL

North Sea Oil Disposals

Disposals	1979 Amount	%	1980 (1st quarter) Amount (Provisional figures) m tonnes	
UK	38.2		9.9	
EXPORT	38.9	50.5%	9.8	49.7%
EC	22.4	29.1%	6.5	33.0%
NON-EC	16.5	21.4%	3.3	16.7%
Total	77.1		19.7	

Exports				
BELGIUM	0.2	0.5%	-	-
DENMARK	2.9	7.5%	0.6	6.1%
FRANCE	2.7	6.9%	0.7	7.1%
IRELAND	-	-	-	-
ITALY	-	-	-	-
NETHERLANDS	7.0	18.0%	1.5	15.3%
W GERMANY	9.6	24.7%	3.7	37.8%
(Total EC)	(22.4)	(57.6%)	(6.5)	(66.3%)
OTHER	16.5	42.4%	3.3	33.7%
Total	38.9		9.8	

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