Noted

CONFIDENTIAL

Ref. A01526

PRIME MINISTER

A Gas Tax or Levy
(E(80) 19)

BACKGROUND

This paper deals with a loose end left over from the E discussion on gas prices before Christmas.

2. The issue is straightforward: given that prices are going up, and that targets have been set accordingly, how can the high profits of BGC be creamed off, to the benefit of the Exchequer? The real effect on the PSBR is stated to be nil, because BGC's profits are lent to the Exchequer at present - the so-called 'negative NLF' arrangement - though in fact there may be a net gain because the Exchequer will not have to pay interest on BGC's lending.

3. The paper by officials examines four options, and comes down in favour of a levy on gas purchased. The two Ministers agree. They want to make an early announcement, and perhaps to legislate if possible in the Finance Bill (though this point is in dispute). They also want to consult with BGC, and to reserve a final position on the amount of levy until this has been done.

4. The paper does not discuss the important issue of public presentation of the decisions taken. As things stand, the chosen options will appear as an arbitrary import by Government. You may care to inquire about this. For example, could the levy be justified as a substitute for PRT? How do the levy proposals rate in income terms against the PRT which would have been payable if 'old gas' were not exempt? Would not a justification on these lines make it easier to defend future price increases?

HANDLING

5. It should be possible to dispose of this paper fairly quickly. You might call on the two joint authors to speak in turn - the Chancellor first, the Secretary of State for Energy second and then perhaps Sir Kenneth Berrill. After that, one or two other Ministers might wish to intervene. But you may wish to emphasise that you are not re-opening the decision on gas prices; this is an argument about presentation and about accounting arrangements, not about substance.

6. If, however, Ministers wish to get into detail, there are three points which are worth pursuing:

(i) Should legislation be in the Finance Bill, or separately? The Chancellor will report on the enquiries officials have been making: there is a serious risk that this legislation would make the Finance Bill hybrid, and they will advise that it should go into a separate Bill. There is no place for this as yet in next year's programme. Mr. Howell may however propose that a very short Bill be added to this year's programme, to take the place of his BNOC Bill which he and the Chancellor agree should now be postponed to next year. The Chancellor of the Duchy will not be at this meeting; but I understand he would say that there is no hope of finding time for a new Bill. The spare time has already been used up with the new Social Security Bill.

(ii) The exact nature of the levy. Paragraph 5 of the cover note sets the upper limit as the amount of economic rent accruing to BGC, but notes that BGC will wish to retain some part of their profit as a 'cushion'. The paper is drafted in terms of a fixed price per therm of gas purchased. An alternative, and more sensitive, version (put to me by the CPRS) would be to charge levy on the difference between the various beach prices of BGC gas and either the gross selling price of the gas or its oil-related value. The amount of the levy, as a percentage of this difference, would be so determined as to recover a proportion, possibly rising over time, of this difference, leaving the balance with the Corporation. This links with the 'substitute for PRT' point I have referred to above.

(iii) Public expenditure effects. Paragraph 6 points out that, although the PSBR effect of the levy is neutral (in practice even beneficial, given that BGC will not receive interest on the loans they would otherwise make to the Exchequer), its effect on public expenditure is, perversely, to increase it. This is, of course, an optical illusion; but it has its presentational difficulties. One way of postponing the impact, again proposed by the CPRS, would be to make the levy payable a year in arrears.

CONCLUSIONS

7. You should be able to guide the Committee to endorse the five conclusions listed in paragraph 9 of the joint paper, modified as above. The conclusions would then be:

(a) that BGC's excessive profits for 1980-81 onwards should be reduced by a levy on their purchases of PRT-exempt gas [collected a year in arrears].

(b) That the Government should announce its intentions soon with a view to taking the necessary powers as soon as practicable [either in the Finance Bill; or in separate legislation in the present or next Session of Parliament].

(c) The levy should be set at the level which will secure for Government the desired proportions of the economic rent going to BGC [on the lines of the formula proposed by the CPRS or by a direct analogy to PRT foregone].

(d) BGC's financial targets should be adjusted accordingly.

(e) Treasury and the Department of Energy officials should consult BGC, consider the appropriate form and level of the levy, and report back to Ministers accordingly. [It should be possible for the final step to be cleared between the Secretary of State, Chancellor of the Exchequer and yourself without troubling E Committee again].

RtA

(Robert Armstrong)

25th February, 1980