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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

GAS REVENUES

Memorandum by the Chancellor of the Exchequer

The Committee asked me to bring forward a paper, agreed with the Secretary of State for Energy, setting out alternative ways of reducing the excessive profits of the Gas Corporation, whether by an Exchequer Charge on gas, or in any other suitable way (E(79)14th Meeting, Item 1).

2. BGC's Profits

BGC estimate that if gas prices rise in line with the RPI on 1st April 1980 and by 10 per cent in October 1980, and increase thereafter at some 10 per cent in real terms a year, their profit would be:

	Before Corporation Tax	After Corporation Tax
1980-81	620	610
1981-82	1060	860
1982-83	1570	1140
1983-84	2120	1380

In later years Corporation Tax paid could amount to 75 per cent of profits because of the recovery of the capital allowances of earlier years. The pre-tax rate of return on revalued assets would rise from about 8 per cent in 1980-81 to very much higher levels by 1983-84.

3. Possible Means for Reducing BGC's Profits

The following methods might be used:

(i) The application of PRT to exempt North Sea gasfields (i.e. those supplying pre-1975 gas contracts). This could only happen if BGC re-negotiated these contracts with the oil companies at higher prices. This would be a formidable task and in any event PRT would be an inadequate vehicle to collect all the economic rent which the producers would then receive. There would therefore be a leakage of the revenue benefits of higher gas prices to the oil companies. If from 1980 the re-negotiated price of gas is close to market levels the leakage would be of the order of £1bn for 1980 reducing to £100m - £200m by 1985. The PSBR would therefore be higher than it might otherwise be, and national income would be lower to the extent that the revenues lost went to foreign-owned companies.

(ii) A charge on BGC to cream off the economic rent (i.e. excessive profits) from North Sea gas. Corporation Tax would not be a suitable vehicle since it does not affect pre-tax profits and does nothing to force BGC to be more efficient. A special charge could be represented both as a rental (not a tax) by the State on BGC in recognition of its monopoly rights over North Sea gas and as an opportunity for the community at large to share in the windfall benefits from higher energy prices. Subject to discussion with BGC, such a charge looks to be administratively easy to operate. It would be treated as a cost and thus would modify the financial target which would need to be expressed in post-charge terms. We would of course need to consider carefully what we would call this charge publicly.

(iii) It might be possible to levy a tax on the consumer for gas used. But this would appear to be a means for increasing prices, not reducing profits though it would also have that effect. It would therefore have no presentational benefits. It would appear on bills.

4. Of the routes mentioned the charge looks most attractive, though I would not wish to exaggerate the presentational benefits. If my colleagues favour it, further work would be needed on its precise form and this would need to take into account the work already commissioned by the Secretary of State on our policy towards BGC generally. The decision on gas prices would in any event have to be explained on its own merits. The charge would need to be presented as the proper way of dealing with BGC's excess profits and maintaining financial discipline in the Corporation, not as the instrument for raising prices or transferring funds from the Corporation to the Exchequer. These two objectives can already be met in other ways. Presentation would be helped if the legislation for the charge was included, not in a bill for which Treasury Ministers were responsible, but in a bill for which the Secretary of State took responsibility. There would be a broad analogy with the levy on TV companies.

5. Timing

Legislation could not be enacted in time for the beginning of the Corporation's next financial year on 1st April 1980, but it could be effective by April 1981 (the date from which the effects of our decisions on pricing will start to appear in BGC's accounts).

6. Financial Consequences

A charge would reduce BGC's cash surpluses and therefore their deposits with the Government under the "Reverse NLF" arrangements, whereby BGC lend their cash surpluses to the Exchequer. Public expenditure would therefore be higher. It would also reduce BGC Corporation Tax payments but since both these receipts would be entirely offset by additional Government receipts from the charge, the PSBR should therefore be unaltered.

7. British Gas Corporation's Attitude

The BGC will find the charge most unwelcome, particularly as they put forward early this year the recently instituted "Reverse NLF" arrangement in the hope of staving off any such arrangement. The Corporation fear that a charge, though justified initially by the size of their profits, would become a permanent feature irrespective of profit levels. This objection might be to some extent met by an arrangement which related the size of the charge to changes in the margin between the cost of BGC's gas purchases and the market value of its planned sales. As the Corporation bought more gas from the more expensive fields, with a consequent moderation in profit levels, the charge would fall.

8. Conclusion

I invite the Committee:

(a) to consider which of the options mentioned in this paper is most likely to help deal with the presentational problem of BGC's excessive profits;

(b) to agree that further work needs to be done urgently on the subject in the context of our wider policy on gas, so that we are ready to give the best presentation of the decision to raise gas prices;

(c) to agree that our decisions on gas pricing and the consequent financial target for BGC need not be delayed until this further work is completed.

H.M. Treasury
16th November 1979

(G.H.)