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PRIME MINISTER

Gas Prices and Targets, and Taxes on Gas

(E(79) 64 and 65)

BACKGROUND

There has been a long series of Committee and Cabinet decisions on gas prices, the latest of which was an inconclusive discussion on 30th October, (E(79) 14th Meeting) which led to the two present papers.

2. The position so far reached is:

(i) Ministers have agreed on the price increases to be sought in 1980-81.

(ii) They have agreed in principle that gas prices should be returned to "economic levels" (roughly, to a price related to that of oil) by the end of the PESC period.

(iii) They have recognised that this may require very big annual increases, and have questioned whether it would be better to have two small increases a year, or one big one.

(iv) They have recognised that such increases would leave the British Gas Corporation with very large profits which owe nothing to good management. Under present arrangements these profits are lent back to the Government, against the day when the Gas Corporation needs to draw upon them to finance new investment. Ministers have considered that it might be better presentationally to cream off the profits by way of tax.

3. The two papers before the Committee therefore deal:

(i) with the phasing of price increases in 1981-82 and later years;

(ii) with the best way of creaming off the profits.

HANDLING

4. I suggest you take the two papers consecutively. The pricing one comes first. You should invite the Secretary of State for Energy to introduce this, and then seek comments from the Chief Secretary, Treasury, and from any other Ministers who wish to speak. Sir Kenneth Berrill may also wish to join in.

5. The key issue is straightforward: is it better to spread out the misery, or to concentrate it? The figures in the paper demonstrate that, for any given financial target, rather bigger increases will be needed on a twice-a-year basis than on a once-a-year basis. The total take from the consumer would of course be the same over the year as a whole. But presentationally, the pattern would look worse. The Secretary of State for Energy therefore proposes a single annual increase each April (with the alternative of an increase in July, which means losing £30 million revenue a year). He suggests that this should be a planning assumption, on the basis of which the industry would be set firm financial targets. The actual phasing of price increases would be settled each year as circumstances dictated. The Chief Secretary concurs. You may feel, on reconsideration, that the presentational advantages of a twice-a-year increase are outweighed by the disadvantages which he describes. But you will want to give the other arguments a run first.

6. You might then turn to the problem of excess revenues. Here the batting order is reversed: the Chief Secretary should introduce the paper, and the Secretary of State for Energy (who has agreed it in draft) should comment. It is common ground that the profits of the BGC should be syphoned off in some way, and not merely re-lent to the Exchequer as at present. (This leaves the initiative with the Corporation, and reduces the incentive to efficiency). You might take the Committee through the three options posed in the Chief Secretary's paper:

(i) PRT. Although you yourself favoured this route originally, it has the major disadvantage that a substantial part of the revenue would leak away to foreign-owned oil companies, thus reducing the contribution which BGC makes to reducing the PSBR. It would also require renegotiation of individual contracts with each company: the BGC would lose its statutory sole buying rights, and would be in a weak position in these negotiations. It does not seem a very attractive proposition.

(ii) A prior charge on BGC profits. Because it would be treated by BGC as a cost, it would be passed on automatically to consumers (i.e. it would justify the price increases which have been agreed for other reasons) and it could be presented as a way of spreading the benefits of cheap gas over the community as a whole, rather than over the minority who happen to use gas as their main fuel. It requires legislation, and could not be introduced until 1981-82 (unless imposed retrospectively) but it does not involve the oil companies at all. It could if necessary be adjusted to reflect the declining value to BGC of their present 'cheap gas' contracts, as these run out. On balance, this seems the preferable course, economically and politically.

(iii) A charge on the consumer. In logic there is a good case for taxing all consumption on energy - e.g. by removing its zero-rating for VAT purposes. But one thing at a time. The consumer has first to digest the considerable increases in prices which the Government has already agreed. Some part of those price increases could, in theory, be collected from the individual consumer as a surcharge on his bill, (which is what this course implies). But it is administratively untidy, would lead to lots of demands for individual exemptions, and would involve the Government much more directly.

7. There is one extraneous factor, not explained fully in the paper. Mr. Howell apparently believes that course (ii), while preferable on other grounds, would stand in the way of privatisation of the Gas Corporation. He considers that course (i), which would put the BGC much more into the position of a private sector gas distributor, is preferable on this ground. Since he has not yet put forward his proposals for privatisation of BGC, and was not ready to do so in this paper, it is difficult to judge this argument. But (as in the case of privatisation of BNOC, which you have already discussed with him) the PSBR cost of an ideal privatisation solution is very high: you may feel that it is not practical politics for the next few years. In that case, option (ii) is almost certainly the best one.

CONCLUSIONS

8. Subject to the course of discussion, I think the conclusions of this meeting will be:

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(i) To confirm that gas prices should be raised over a period of four years to the oil-related level (as already agreed).

(ii) To agree that, in addition to the two increases already determined for 1980-81, gas prices should increase in April /or alternatively, in July/ 1982, 1983 and 1984, by 10 per cent in real terms (on top of any increase needed to keep pace with movements in the RPI).

(iii) To agree that the Secretary of State for Energy, in consultation with the Chief Secretary, Treasury, should now enter into discussions with the British Gas Corporation about financial targets which would require increases on this scale.

(iv) To agree that once these targets have been negotiated, they should be publicly announced and the implication for prices made clear, so that consumers have the right signals about the future course of gas prices and can plan their equipment and insulation accordingly.

(v) To agree that the consequent higher profits of the BGC should be reduced by the imposition of an Exchequer charge on gas, on the lines of option (ii) in E(79) 65.

(vi) To invite the Chief Secretary, Treasury, in consultation with the Secretary of State for Energy, to devise a detailed scheme for such charge, and to bring fresh proposals to the Committee in time for legislation in the 1980 Finance Bill.

RTA

(Robert Armstrong)

23rd November, 1979