

GAS

The £1 bn.

TAKE SOME rotting plant and animal life, fold geologically, apply pressure and leave for a few million years. The product of that recipe we now know as North Sea oil and natural gas. Had the existence of these natural resources been known back in Norman times, or at the time of the land enclosures and the highland clearances, and their future value appreciated, we can be sure these most valuable of natural resources would very quickly have found their way into private hands. We might have found that they were still in private hands today, or that we had gone to the expense, as we did with our resources of coal, of buying back the British heritage for the British people. Fortunately for us, we are now in a more enlightened age, and all political parties agree that the oil and gas reserves in British territory belong to the nation, and cannot be claimed as the sole property of any individual or company.

So there is no problem with determining ownership. However, we ought not to be concerned with mere title, which itself is just paper. What ought to concern us is the *benefits* of ownership, what they are and who gets them.

So what are the benefits of ownership? In pure economic terms it is what the market will give you to encourage you to allow someone access to your resource. If we are talking about land then the benefit of ownership of land, again in economic terms, is the rent that the land attracts. The economic rent of land is measured by the production that can be obtained by that piece of land in excess of that produced at the margin. Thus all the benefits of ownership of the North Sea oil and natural gas reserves would accrue to the British nation if the economic rent of these resources were paid into the Exchequer.

Some might argue that this is an over-simplification and that the economic rent of these natural resources is not easily determined. Let us skate over that minor difficulty for the time being with the promise that we shall come back to it later.

UK Domestic Gas Pricing Policy: the Cost in Revenue to Taxpayers			
	1977/78	1978/79	1979/80*
	Prices: Pence per Therm		
Central heating oil: average schedule prices	23.1	23.2	31.1
Domestic Gas: average revenue from consumers	18.5	18.5	18.5
So: Underpricing of gas	4.6	4.7	12.6
Domestic gas sales: million therms	6,964	7,895	3,000
Cost to Exchequer: £m.	320	371	378
Grand total in 2½ years: £1,069m.			
*First six months: estimates.			

WHAT HAPPENS in practice? This is the point at which the North Sea oil and the natural gas stories diverge, each taking their separate path. We are going to concentrate on the natural gas saga. To do so, we need to go back to when natural gas was first discovered in the North Sea.

When the extent of the natural gas reserves was appreciated, the Government was faced with a problem. They knew that there were vast profits to be made and would not countenance that these profits should be left in private hands.

But the vast majority of Members of Parliament, Government officials, civil servants and all those who make the grand decisions which steer the nation do not know of, and therefore do not understand, the concept of economic rent of land. So the Government looked around and saw sitting there on the sidelines the predecessors of what we know as the British Gas Corporation. They were at that time producing gas expensively from coal and just beginning to produce it less expensively from oil. What more logical decision could be made than to give the natural gas coming out of the North Sea to the nationalised gas industry?

This was done in a unique way. The nationalised gas industry was made the sole purveyor of natural gas and a monopoly purchaser. Now if you are a producer of gas and are

required to sell your product to one single purchaser, naturally you are rather restricted when it comes to negotiating the price. To its credit, the gas industry used its monopoly purchasing privileges to the full and has consistently negotiated prices with the gas producers that are only marginally above the cost of gas production. We cannot therefore say that the private companies, who have gone out into the hazards and uncertainties of the North Sea and drilled for, discovered and brought ashore our natural gas, are receiving the economic rent of the natural gas resources. They are therefore not receiving the *benefits* of ownership.

THE BENEFITS of ownership must have passed to the nationalised gas industry. So the problem was solved! The benefits have come to the nation – or have they? Let us look a bit more closely at what happens now. The British public can be schizophrenic when it comes to nationalised industries. It sometimes seems that the cardinal sin of any nationalised industry, greater even than the sin of making a loss, is for it to make a profit.

Imagine, then, the dilemma of the gas industry. Here it has a natural resource, which it has obtained, virtually at its cost of production, but which it cannot sell at the full market value – otherwise the nationalised industry would make an unacceptably handsome profit! Remember, the

NICHOLAS TOMKINS REVIEWS GAS PRICING POLICY

bonanza

market value of the resource is far above the cost of production. So what does it do?

In this particular case the gas industry decided that industrial and commercial consumers should pay the full market related value of any gas that they wished to purchase. But domestic consumers were charged at a rate sufficient only to cover the remaining costs of the Corporation. In other words, the charge to the domestic consumer is a balancing item. Charge the domestic consumer too much and the gas industry will make a profit, charge them too little and it will make a loss.

Admittedly, this worked quite well for a number of years. Then as time went by prices rose all round, but gas prices didn't rise quite as much; gas prices to the domestic consumer, that is – industrial and commercial consumers were charged the full whack. Gas in the domestic sector got cheaper compared to the alternative fuels. When oil, the principal alternative, became not only expensive but difficult to obtain, the rush of domestic consumers to convert their central heating systems to gas became virtually a stampede.

In the meantime, the Gas Corporation had been doing what they could to put prices up, to try to halt the rush. Current cost accounting helped here. They were able to apply some supplementary depreciation to augment the depreciation given by the historic cost method. That may be double dutch to most people, but the overall effect was that gas prices could be raised without gas corporation profits increasing: depreciation isn't profit, you see! Aren't accountants wonderful?

But this still was not enough. The next trick was to pay in advance some of the loans that the gas industry had received from the government. We are now told that very shortly the position will be reversed, and the gas industry will be lending money to the Government. Again all this achieves higher gas prices without higher profits being declared by the gas industry.

HAVEN'T WE lost sight of the initial objective, which was to determine who was receiving the

benefits of ownership of the natural gas reserves? Well it must be blatantly obvious by now that virtually the sole recipient of this benefit so far has been the domestic consumer of gas, and the extent of his benefit has been in direct proportion to his consumption of gas. Only recently, with the pressure to raise domestic gas prices, has there been some benefit to the Exchequer.

Gas consumers are not by any means the whole nation. So somehow or other in this long and complicated story, the benefits of ownership of the natural gas resources, which everyone has agreed belong to the nation, have been restricted to those in the nation who consume gas in their homes, and not equally by every citizen! We may argue that the benefits of ownership of natural gas is better going to a fairly substantial section of the nation, rather than to a small number of private individuals and companies. With this we must agree.

But on the other hand if there is a quick, easy and convenient means by which the benefits of ownership can be conferred on the whole nation,

would that not be even more desirable? Government has many means of persuasion. And there is no doubt that it could persuade the British Gas Corporation to increase the price of natural gas to the domestic consumer to its full market value.

At the same time, the government could fix a level of payment from the British Gas Corporation to the Exchequer which would represent the transfer of the benefits of ownership of natural gas from the gas industry to the nation. The payment would have to be given a name. It might simply be the rent of natural resources; it might be called a royalty; it might even be called a tax – now that rings a bell doesn't it? Weren't we reading something in the press recently about a tax on gas? Could it be that the politicians, civil servants and Government officials have discovered the principles of economic rent of land, and have decided that economic rent belongs to the nation and are setting out to collect it? Or is it just a happy coincidence of natural justice and pragmatism?

But there are dangers. For if the people of Britain come to understand that the benefits of ownership of natural gas can accrue to the nation as a whole, by collecting in one way or another the economic rent of that natural resource, might they begin to question the principles and benefits of all our other natural resources?

MULTI-BILLION POUNDS HANDOUT

● Cont. from P. 5

Auctions were a precondition of a free market in oil licences, which was desirable "because it would permit the companies which are most efficient, best financed, most knowledgeable about the geology and most anxious to explore to obtain licences from companies which have run out of money to explore, which do not consider any remaining prospects worth exploring or lack the latest geological expertise to identify them."

But the Government, reveals Lilley, is reluctant to permit companies to sell licence interests – "since cash sales draw attention to the value of what governments gave away for nothing."

WHATEVER the relative merits of the different systems, the real obstacle in Britain is a political one: an apparent desire – in both the Labour and Tory Parties – to

leave oil companies with a large slice of unearned economic rent.

Government Ministers claim that discretionary allocation ensures rapid exploration. This is spurious, and Lilley draws on "an obvious analogy between the price of land and the price of oil acreage." He declares:

"... we have no lobby urging that land be given away free to responsible property speculators to encourage them to undertake more building! Why then should it be necessary to give away oil leases to encourage the oil industry to do the very thing that it would be prepared to pay heavily for the right to do?"

Lilley correctly identifies the substantial reason for the retention of bureaucratic discretion: "The exercise of discretion gives to officials individually and collectively prestige, power and a sense of importance which would be lost if they were reduced to the role of auctioneers."

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