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MR TURNBULL

6 June 1984

BNOC

We do not agree with Peter Walker and consider that there is a strong case for abolishing BNOC.

We have been involved in the official discussions and have considered the issues carefully. Given our commitment to a market-based North Sea policy and our general wish to reduce the size of the public sector, we start from the premise that BNOC should be abolished unless there is a good reason to keep it.

- Security of Supply

BNOC can only make a very limited contribution to security of supply. The only way, short of force majeure, in which BNOC could redirect supplies which we would not otherwise receive, is not to renew term contracts when they become due. Over a 3-6 month period, this would produce at most an extra 100,000 barrels per day for the UK. This compares with UKCS production of 2.5 million barrels per day.

We would be able to safeguard the UK's interests without BNOC. In a sub-crisis (a world shortfall of less than 7%) we would rely on the series of informal assurances with UKCS producers to maintain supplies. In a full crisis, the IEA allocation scheme would come into force. In both these cases the Government could, if necessary, take wide-ranging powers under the Energy Act 1976 to regulate supplies within the UK.

Peter Walker argues that the more important role for BNOC in times of crisis is in providing the Government with a greater insight into the market place. We consider that the Department of Energy together with the major oil companies can provide Ministers with sufficient and more soundly-based information.

- Market Stability

BNOC does not play a pivotal role in the stability of the world oil price.

It is true that the BNOC price did assist stability in the Spring of last year but only after it had achieved a totally inappropriate price leadership role. Without the existence of a politically exposed BNOC price, we would probably not have reached such a crisis situation in the first place. In a slack market, the underlying

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interests of producers, consumers and the oil majors are to maintain stability in the market.

Abolition would have the added advantage of removing the UK Government from the diplomatic spotlight, particularly during times of crisis.

We have always stressed that the setting of North Sea prices is subject to market forces, and it is unlikely that OPEC would interpret abolition as a signal that the Government was no longer interested in oil price stability, despite some initial adverse comment.

- Tax Revenue

There is no evidence that BNOC has helped in securing greater tax revenues from UKCS crude. There have been occasions when the BNOC price has maximised revenues but there have also been cases when a policy of holding down prices has cost the Exchequer significant sums of tax revenue.

Furthermore, it has not proved easy to change the BNOC price in either a tight or a slack market. The result is a loss of opportunity profits in the former and trading losses in the latter. Over an extended period the influence of BNOC on tax revenues is likely to be marginal.

The relevance of the BNOC price as a tax reference point will continue to decline as the structure of the oil market changes. The Revenue acknowledge that a BNOC price is not essential for tax reference purposes.

- Costs

Abolition would save £5 million per year of administrative and running costs. The Government would also have to make other arrangements to handle royalty in kind although we do not accept that the use of a private sector agent would be more costly or undesirable in principle.

More importantly, BNOC is not a normal commercial trader. It continually has difficulty in attracting high-quality traders. Abolition would remove the potential for significant BNOC losses in both participation and non-participation trading. The former occur in a weak market when BNOC is forced to make disposals on the spot market. As for non-participation trading, it makes little sense for a public sector body to be involved in speculative commodity trading.

Conclusion

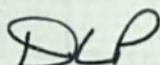
A slightly easier life for the Inland Revenue, a very limited contribution to security of supply and provision of market information does not add up to a convincing case for the retention of BNOG.

The continued existence of the Corporation is incompatible with our desire to reduce the size of the public sector and with a market force based North Sea policy. It results in an unnecessarily high diplomatic profile for the Government every time there is uncertainty in the oil market.

Furthermore, if BNOG is retained, any future Labour Government would have an ideal opportunity to reimpose Government control on North Sea Oil policy. Abolition would make such an objective practically impossible.

The political objections are only valid if Peter Walker encourages the view that BNOG contributes significantly to security of supply. As the reality is different, and if this is clearly explained, the political criticism falls away.

We recommend that BNOG should be abolished.



DAVID PASCALL

D.R.

File

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MR TURNBULL (for your own information)

6 June 1984

cc Mr Redwood

BNO

The BNO Review is with Peter Walker and is likely to be circulated shortly. I expect the Secretary of State to recommend retention based on political considerations and a wish to preserve flexibility. The Chancellor may well agree.

We take the opposite view for the reasons in the attached note which is intended to accompany Peter Walker's forthcoming submission. It is drafted without knowledge of his covering note and may require some small amendments.

I should be grateful for any comments you may have on substance and on handling. I hope our note will persuade the Prime Minister that this issue should be discussed by a small group of Ministers rather than being cleared in correspondence. However, I would also like to avoid a repetition of the DBS case when the Prime Minister won all the arguments but deferred to her Ministers.

DLP.

DAVID PASCALL

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Peter Walker identifies five main issues:

- Tax Reference Price

The existence of a BNOC price is helpful to the Inland Revenue. However the structure of the oil market is changing and the Inland Revenue are having increasingly to consider the spot market in setting a tax reference price for non-arm's length transfers. The relevance of the BNOC price will continue to decline and the Revenue acknowledge that a BNOC price is not essential for tax reference purposes.

- Market Stability

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It is true that the BNOC price did assist stability in the Spring of last year but only after it had achieved a totally inappropriate price leadership role. Without the existence of a politically exposed BNOC price, we would probably not have reached such a crisis situation in the first place. In a slack market, the underlying interests of producers, consumers and the oil majors are to maintain stability in the market.

We have always stressed that the setting of North Sea prices is subject to market forces. The abolition of BNOC could be presented as a logical outcome of such a policy. It is unlikely that OPEC would interpret this as a signal that the Government was no longer interested in oil price stability, despite some initial adverse comment.

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### Tax Revenue

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### - Costs

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More importantly, BNOC is not a normal commercial trader. Abolition would remove the potential for significant BNOC losses in both participation and non-participation trading. The former occur in a weak market when BNOC is forced to make disposals on the spot market. As for non-participation trading, it makes little sense for a public sector body to be involved in speculative commodity trading.

### - Security of Supply

BNOC can only make a very limited contribution to security of supply. We would be able to safeguard the UK's interests without BNOC.

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Ministers with sufficient and more soundly based information.

Additional arguments in favour of abolition include:

- Reduction of public sector involvement.
- Confirmation of our market force policy.
- BNOC's lack of experience in judging the market compared with the oil majors. The Corporation has a disproportionate influence over the setting of "market prices" in the North Sea.
- Removal of the UK Government from the diplomatic spotlight in times of crisis in the oil market.
- BNOC's difficulty in attracting high-quality traders in what is a very competitive business.

#### Conclusion

A slightly easier life for the Inland Revenue, a very limited contribution to security of supply and provision of market information does not add up to a convincing case for the retention of BNOC.

The continued existence of the Corporation is incompatible with our desire to reduce the size of the public sector and with a market force based North Sea policy. It results in an unnecessarily high diplomatic profile for the Government every time there is uncertainty in the oil market.

Furthermore, if BNOC is retained, any future Labour Government would have an ideal opportunity to reimpose Government control on North Sea Oil policy. Abolition would make such an objective practically impossible.

We recommend that BNOC should be abolished.

*D.P.*

DAVID PASCALL