PO-CH/NL/0037
PART A

SECRET

(Circulate under cover and notify REGISTRY of movement)

PO -CH /NL/0037

PART A

1986 BUDGET EXCISE DUTY OPTIONS ON ALCOHOLIC DRINKS TOBACCO AND FUEL

DD'S 25 years 20/01/95 . NAgs

PO -CH /NL/0037

PART A

STARTS:- 9-01-85
ENDS:- 13-02-86

CLOSED
CONT... ON:-
PART B

5.74

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

9 January 1985

Major General W D Mangham Esq CB
The Brewers' Society
42 Portman Square
LONDON
S1H 0BB

Dear Major General Mangham,

We spoke recently about the Chancellor's meeting with the Brewers' Society. I am writing to confirm that the Chancellor will be pleased to see Mr Edward Guinness and yourself on Tuesday 21 January at 11.00 am in the Treasury (please note that this is a change of venue).

Please do not hesitate to contact me if you think I could be of assistance.

Yours sincerely,

Debbie Lester

MRS D C LESTER
Diary Secretary

FROM: P WYNN OWEN

DATE: 14 January 1985

PS/Customs and Excise

cc PS/Chief Secretary
Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Monger
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Davies
Mr Lord

EXCISE DUTIES ON ALCOHOLIC DRINKS

The Chancellor has seen Mr Jopling's letter to him of 13 January and has commented that he has considerable sympathy for giving favourable treatment to spirits (because of whisky) and recouping by doing a little more on cigarettes.

Rw.

P WYNN OWEN

The Brewers' Society

42 PORTMAN SQUARE · LONDON W1H OBB

TELEPHONE · 01-486 4831 (16 LINES)
TELEX · 261946

From: Major-General W. D. Mangham

21st October, 1985.

G. W. Monger, Esq.,
H. M Treasury,
Parliament Street,
London, SW1P 3AG.

Miss Sinclair
22/10

Dear Mr Monger,

I enclose some notes we have prepared on the excise duty on beer, and related issues, which we hope you will take into account in your review of the situation prior to next year's Budget.

The Chairman of the Society and I will be seeking an interview with the Chancellor of the Exchequer on this subject early next year, when we would intend to refer to some of the points made in these notes.

I am sending copies to Mr. Bryce Knox at H. M. Customs & Excise and Mr. R. J. Packer at MAFF.

Yours sincerely,

David Mangham
Director

Enc.

Mr Monger

Do you want to acknowledge this?

22/10

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Registered Office: 42 Portman Square, London, W1H 0BB
A company limited by guarantee

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THE BREWERS' SOCIETY

BEER DUTY

Duty and Volume

1. Between May 1979 and March 1985, beer duty increased by 142%, which is over twice the increase in the RPI (70%). This is on top of the general increase in the rate of VAT from 8% to 15% in June 1979. The duty increase in March 1985 was for the sixth year in succession, a sequence unparalleled in our history.

2. These tax increases have had most impact on the least affluent members of the community, who have a greater propensity than others to drink beer instead of wines or spirits, and who have been hit hardest by the recession.

3. These increases have also had a demonstrable effect on the level of beer consumption, which started to decline within months of the 1980 budget. Although the rate of decline has now slowed down, the beer market shows no sign of participating in the general economic recovery.

4. In contrast, the duties on wines and spirits have been increased by considerably less than the RPI (as shown in Annex A). In the case of table wine, this took place against the background of a rapidly increasing market, but we appreciate the constraints imposed on the UK by the E.C.J. decision.

5. The duty on spirits, however, has been increased by only 51% over the same period as is mentioned in paragraph 1.1.

6. The purpose of this action is believed to have been to help Scotch Whisky sales and hence production, but the trends in the table below suggest that the

principal effect has been to encourage imported spirits. This growth in imported spirits clearly implies that jobs have been exported. Moreover, the relative cheapening of spirits as against beer must have had a depressive effect on the consumption of beer.

Consumption of Spirits
(Percentage change on previous year)

Calendar Year	Scotch Whisky	Imported Spirits	Total Spirits
1980	-4.5	-9.7	-5.6
1981	-4.9	-6.0	-5.2
1982	-6.2	-1.7	-5.7
1983	-0.6	+4.5	+2.8
1984	-2.5	+9.2	+0.6

Effect on the Brewing Industry

7. Over 95% of beer sold in this country is UK produced, utilising UK produced raw materials and containers. In comparison 8% of wine (including fortified and made wine) and 75% of spirits are home produced.

8. The Society has previously observed that the decline in the beer market from its peak in 1980 - the annual loss now stands at over 4.5 million barrels (or 11%) - is equivalent to the total production of one of the national brewers. Well over a dozen breweries have in fact been closed, with a loss of some 13,000 jobs.

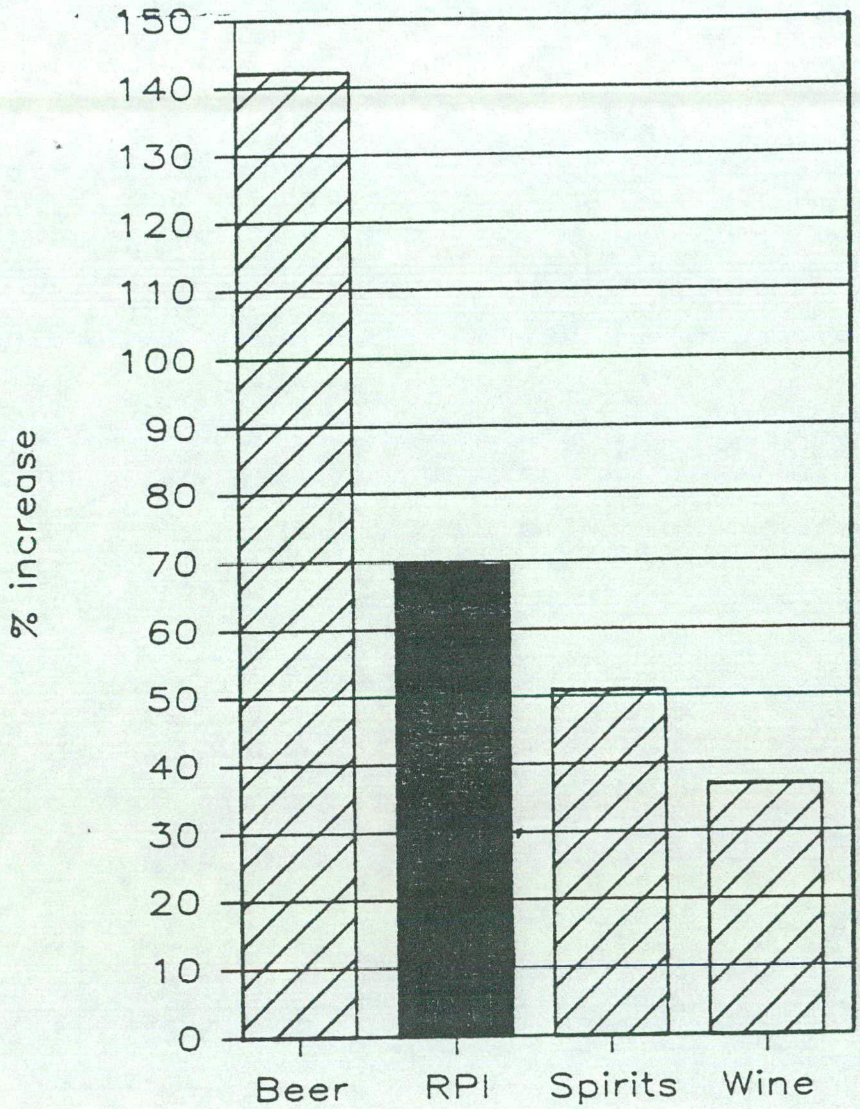
9. Pubs and clubs such as working mens' clubs - which employ 400,000 people - are largely beer orientated and their viability depends to a substantial extent on the sale of beer, rather than of other drinks and products. The high price of beer and the decline in its consumption has been particularly relevant to establishments such as these.

The decline in beer sales is confined to the kinds of beer they sell - that is draught beer and beer in returnable bottles, as against the kinds of packaged beer sold in supermarkets and similar outlets - and for these former kinds of beer the decline in the market since 1980 stands at 15%.

October, 1985.

Increases in excise duties and RPI

Between May 1979 and March 1985



C

Shall I arrange? Before Christmas

LORD ERROLL to CH/EX 12/11

AA

The Automobile Association

Head Office: Fanum House, Basingstoke, Hampshire RG21 2EA
Telephone: Basingstoke (0256) 20123

D 14/11

Or finally refer this one to GST?

~~Debbie~~ Jacky

Chairman
THE RT.HON.LORD ERROLL OF HALE

Director General
O.F. LAMBERT

Budget rep → to MCU → FP → then advice back to C.

R 14/11

12th November 1985

My dear Nigel,

Last year I had the great pleasure of a private meeting with you and we discussed various aspects of motoring taxation. Our discussions proved most helpful and I hope very much that your many duties will permit us to meet again this year.

If a meeting can be arranged, I would like, after taking up a point or two from our previous discussions and correspondence, to have an exchange of view with you on aspects of motoring taxation, tolls, the Channel Link, the roads programme and fiscal aspects of unleaded petrol.

As you know, the Association carries out regular and extensive research amongst our 5.9 million members and indeed it may be that you would find it helpful to discuss the above matters with me as Chairman of the AA.

I look forward to hearing that you are agreeable to a meeting and, if so, perhaps our respective offices could then arrange a mutually convenient date and time.

Yours ever,

Freddy

BR

HM TREASURY – MCU
RECD. 19 NOV 1985
No Ack
FP
CHX
REF. No. 1/398/85

The Rt. Hon. Nigel Lawson, MP.,
Chancellor of the Exchequer,
Treasury Chambers,
Parliament Street,
London, SW1P

18

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

The Rt Hon Lord Erroll of Hale
The Automobile Association
Fanum House
BASINGSTOKE
Hampshire
RG21 2EA

26 November 1985

Dear Freddie

Thank you for your letter of 12 November.

I would be delighted to meet you again this year. I have asked my office to make the necessary arrangements.

Yours
Nigel

NIGEL LAWSON

CH/EX
to
LORD
ERROLL
26/11

The Scotch Whisky Association

Limited Liability Registered in Scotland No 35148

TEL: 031-229 4383 TELEX: 727626

20 ATHOLL CRESCENT · EDINBURGH EH3 8HF
REGISTERED OFFICE

SCOTCH WHISKY ASSOC → CHEX 10/12

FROM
THE CHAIRMAN

CHEXCHEQUER
11 DEC 1985

JARM/AS/SWA

10th December 1985

HM TREASURY — MCU
11 DEC 1985
EP
cc APS/CHX

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Square
LONDON
SW1P 3AG

CHX
12752/85

Dear Chancellor

When we last met I stressed the need for the Government to inject optimism into the Scotch Whisky Industry and this is still an urgent need, because without it there will be reluctance to invest in stocks in anticipation of an upswing in sales.

As we have said before, we do not seek any favourable tax treatment, simply less unfavourable tax treatment. The Industry continues to bear heavy costs because of the adverse tax regime under which it has to operate and further faces increasingly difficult market situations both at home and abroad.

The enclosed Report puts forward three main points for your consideration:

1. A statutory maturation allowance to reflect the legal requirement of maturing scotch whisky for a minimum of three years. This allowance would reduce but not eliminate the discrimination in the present corporation tax system against scotch whisky, in particular the quality brands.

2. A continuation of the move towards equalisation of excise duty on a per degree of alcohol basis. We appreciate the efforts that you have already made but unfortunately our home sales are still 19% below their 1979 level.

3. An increase in the period of duty deferment from four to eight weeks, which will bring the U K more into line with existing European Community practice and reduce the financial burden the industry has had to face, because it was more convenient for the Government to collect the duty at source instead of at the time of actual sale to the public.

I would appreciate an opportunity to discuss the Report with you in the New Year, and if you are agreeable to this, I shall be in touch with your Private Office as regards a suitable date. If, in the interim, you feel it would be useful to have discussions with any of your Treasury colleagues or their officials, this can easily be arranged.

With kind regards,

Yours sincerely

J A R Macphail

enc

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

Major General W D Mangham Esq CB
The Brewers' Society
42 Portman Square
LONDON
W1H OBB

16 December 1985

Dear General Mangham

Thank you for your letter of 5 December.

I would be delighted to meet with the Brewers' Society again this year. I have asked my office to be in touch with the details.

Yours ever
Nigel

NIGEL LAWSON

From Major General W D Mangham CB

The Brewers' Society

42 PORTMAN SQUARE · LONDON W1H 0BB

TELEGRAMS · BREWSOCIETY · LONDON W.1
TELEPHONE · 01-486 4831 (16 LINES)

The Rt Hon Nigel Lawson MP
The Chancellor of the Exchequer
H M Treasury
LONDON SW1P 3AG

5 December 1985

Dear Chancellor,

The Chairman designate of the Society, Mr Edward Guinness, would be very pleased if he and I could come and see you, preferably in the first half of January, to discuss the position of the industry and the treatment of beer in the forthcoming Budget.

As usual I have already sent a paper to your officials outlining the areas of concern within the industry.

I look forward to hearing from you.

Yours sincerely,

Desmond Mangham

Director

BR

FP.

CHX 12497/85.

CC Mrs Lester

Scotch Whisky Assocn rang - Meena provisionally arranged Wed 29 Jan at 4.00pm. SWA will ring on Mon 6/1 to confirm.

DL 24/12

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

HMIT

J A R Macphail Esq
Chairman
The Scotch Whisky Association
20 Atholl Crescent
EDINGBURGH
EH3 8HF

19 December 1985

Dear Mr Macphail

Thank you for your letter of 10 December.

I would be more than happy to meet with you again this year. I have asked my office to make the necessary arrangements.

Yours ever

Nigel Lawson

NIGEL LAWSON

PMP

NL/37
A

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

SECRETARY OF STATE FOR TRANSPORT

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

HM TREASURY – MCU
REC. 18 DEC 1985
ACTION FP — Mr Murray
COPIES TO PS/CHX, CST, FST, MST, EST, PS/S – PMiddleton, Sir T Burns, Mr Cassell, Mr Monger, Mr Scholar, Mr Sinclair, Mr Cropper, Mr Davies
CHX
13/11/85

December 1985

Dear Nigel

I shall be writing to you as usual in January to let you have my proposals for vehicle excise duty in the 1986 Budget. However I thought it might be opportune if I gave you now my preliminary thoughts about how our policy on the taxation of vehicles might develop in the longer term. There are two main issues.

Balance between VED and fuel duty

I have been wondering whether our earlier discussions - and indeed those of our predecessors - on the future of VED have been framed in too stark a perspective. We tend I think to limit ourselves to the options of abolition and retention. But there are important considerations relating to the balance between VED and fuel duty; retention of VED does not necessarily imply retention at its present level.

One of the main difficulties about the present level is that of evasion. £90m per annum is a sum which we - and the Public Accounts Committee - cannot easily ignore. As I promised in my letter of 15 February to Leon Brittan, my officials have been doing a lot of work on various aspects of evasion and enforcement, some of them in liaison with the Home Office, some - the longer term aspects - as an internal review. It is clear that while there is yet scope for improvement of our enforcement performance, there is, unhappily, no panacea for evasion.

It is however noteworthy that the problem would be less if the balance between VED and fuel duty were altered to increase fuel duty at the expense of VED. The amount of money lost would be reduced; reinforced, hopefully, by less of an incentive to evade in the first place. I am of course

— wrong

mindful of the Home Secretary's point that a very low (eg merely cost-covering) level might not be taken seriously, and would itself constitute an incentive to evade. But there must be a level of VED which would minimise evasion and at the same time reduce the current level of loss. A better balance would also be struck between the desirability of making tax proportional to use and the need politically to cushion the very high-mileage essential users.

As it happens such a shift would also offer special advantages as far as lorries are concerned. I have in mind the international side of road haulage. Our rates of VED are the highest in Europe; in some cases they are ten times those of our fellow member states. VED forms about 5% of such lorries' operating costs, so the VED discrepancy means a competitive disadvantage of several percentage points. Our hauliers are finding some difficulty in maintaining their share of cross-Channel traffic, and the tax disparity is distinctly unhelpful to them in their struggle. The Road Haulage Association have left me in no doubt that they view this as a real disadvantage they would like to see removed. This is of particular importance, of course, if UK hauliers are to be in a position to get a proper share of the business as we achieve liberalisation of freight movement. I have toyed with the idea of a scheme of VED rebates for time spent out of the country; but this would be administratively costly and burdensome, particularly for Customs and Excise staff, and I have therefore not pursued it.

However the sort of shift in balance which I have in mind would bring the tax paid by international hauliers closer to that of their foreign competitors, and promote fairer competition. At the same time, higher DERV duty would bring us a greater contribution from foreign lorries coming here. I do not have a large shift in mind for lorries: no more than £100m. A reduction in VED of more than this would make it difficult to match the pattern of lorry groups' taxes with their track costs, an objective I have been keen to promote in previous Budgets, and continue to espouse. But this would allow us to bring down VED on 38 tonners to somewhere near the German rate, which would be a sizeable step in the right direction for our international hauliers.

In making changes of this kind we should need of course to bear in mind the petrol/DERV pump-price differential, to which I attach some importance. To minimise undesirable effects we should need to make sure that increases in the tax on the two fuels were roughly in step.

Depending upon your reaction to these longer term ideas I hope to write to you more fully about them in due course. Needless to say I would not ask you to make substantial shift from VED to fuel duty in the 1986 Budget; more thought still needs to go into the idea, and may be we need to consult colleagues. But I would suggest that we might prepare the way for change by leaving the rate for the private car at its present level, and by giving slightly more emphasis to fuel duty than to VED this year in matching lorries' taxes with their track costs (perhaps increasing fuel duty by 2p or so in excess of revalorisation in each case, thereby preserving the existing petrol/derv tax differential).

Level of total motor taxation on lorries

The second issue is the current burden of motor taxation specifically on lorries. (I have in mind here not the balance between VED and fuel duty, but the combined impact of both.) As you know, under transport policy commercial vehicles are taxed in relation to their track costs. Although the costs form a floor for tax, not a ceiling, there is certainly an expectation on the part of the industry that taxation levels will not rise too far above their share of road costs. We give, perhaps, a grain of credence to this view, and at the same time hint at a rationale when we paraphrase the Armitage report recommendation to the effect that "if there is any excess of tax it should be allocated in the main to the heaviest vehicles since they cause more environmental problems".

As you know from our discussions at the time of the last Budget, I am concerned that the amount by which taxation on lorries exceeds their track costs should not increase so far as to cast our policy into disrepute. The rise in the published amount from £30m to £260m in three years was worrying, and earlier this year it appeared that it might continue to increase dramatically. An increasing gap between the two rather suggests that expenditure is not keeping up with the costs being imposed on the road system. That is shown in practice by the backlog of renewal work on motorways and trunk roads which carry over half of all heavy lorry traffic. I am grateful to you for recognising this problem and increasing the PES provision to more realistic levels.

Nevertheless there is a risk that revalorisation of rates would result in a continued increase in the proportion by which revenue exceeds costs, because of growth in traffic, and a reducing share of roads expenditure attributable to lorries. This worries me. It would be helpful if we could reach an understanding on how we might approach the problem. The published estimate of excess of tax over cost this year amounted to about 20% of expected revenue. Can we agree, I wonder, that in the absence of overriding factors, we should aim in subsequent Budgets to hold the projected excess at no more than that (or at the 1985/86 outturn percentage if that were higher)? Insofar as projected revenue increase might need to be curtailed I would envisage the main constraint being on vehicle excise rather than DERV duty (so as not to negate the shift in balance I discussed earlier). Since road track costs are set to rise faster than inflation, the constraint should not in the short term mean total revenue from lorries increasing by less than the rate of inflation, though in some years the increase in individual VED rates would need to be held below it. And for the 1986 Budget, as far as we can see at the moment, there would be a need to reduce some VED rates. In the long term, the effect on revenue of constraining lorries' motoring tax in this way will depend on the extent to which the road programme keeps pace with the damage lorries do to the roads.

I should welcome your reactions to these ideas, or discuss them with you if you if you like, so that I may construct my proposals for the Budget accordingly.

Yours ever
Nicholas

NICHOLAS RIDLEY

BR

HM TREASURY — MCU

30 DEC 1985

FP

cc APS CHX

cc PS/CST, PS/FST, PS/EST
PS/MST, Sir P Middleton
Sir T Burns, Mr Bailey, Sir G Littler, CU Budget Rep
CHX Mr Anson Mr Cassell, Mr Monck, Mr Scholar, Mr Monger, Mr Turnbull
Miss Sinclair Mr Culpin
Mr Crappet, Mr Lord, Mr H. Davies

13368/85

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

CONFIDENTIAL

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London
SW1P 3AG

23 DEC 1985

20 December 1985

Dear Chancellor

As usual at this time of year my officials are submitting to your officials in the Inland Revenue a Memorandum outlining those changes which we would like made to the taxation system, which would be of benefit to the industries we sponsor.

As you will no doubt be aware, farmers have been facing a disastrous year for farm profits, due to a dreadful harvest coming at a time when high interest rates and changes emanating from Brussels have put many farmers under pressure. Although the Annual Review has not yet been completed, it is likely to show that the aggregate income of farmers has dropped by substantially more than 30% compared with 1984. Moreover, farming clearly faces long term adjustments which are going to require farmers to be ready to seize new opportunities and develop new enterprises. I have particulary in mind the need for farmers to be ready to develop non agricultural enterprises; successful moves in this direction can have a highly beneficial effect on rural economies. In framing any measures which you feel able to take in the budget to help small business and to encourage enterprise, I very much hope that you will have in mind the needs and the potential of our farming community.

My Department's Memorandum will give particular emphasis to the need for reforms to Capital Gains Tax. There is, I believe, a widespread sense that CGT should not continue to tax money gains due to inflation: long term owners merit greater relief. I should also like to see tax changes which would allow farmers, forced to sell part of their land to reduce borrowing levels, to roll over their CGT liabilities. In addition the Memorandum suggests further extensions of retirement relief against CGT and some small but necessary reliefs from Capital Transfer Tax, these measures being intended in the main to help elderly farmers hand over to the younger generation. This is a trend that we need to encourage.

Turning to the withdrawal of capital allowances, there has been wide concern in the industry regarding the new system of writing down allowances for plant and machinery and buildings and works. As for agricultural buildings and works, the Financial Secretary in this year's Budget debate offered to consider introducing balancing adjustments in order to meet some of the very strong criticism that had been directed at writing down these items at 4% per annum, that is over a 25 year period. We were grateful for this suggestion, but I am now convinced by the representations of the farming organisations that this, if applied to all agricultural buildings and works, would create more problems than it would solve. I would therefore ask that such a measure should not be introduced but that further consideration be given to its application to truly short-life buildings; for those buildings with an expected life of as little as ten years a writing down period of 25 years is clearly inappropriate. I know that your officials are in touch with mine and with the NFU on this and it is to be hoped that a definition for short-life buildings can be found that would make it easier to include this relief in legislation.

On the excise duty front, I understand that my officials are due to have a meeting with officials in Customs next month. I will write to you further in the light of the outcome of that meeting.

Yours sincerely

C Llewellyn

for MICHAEL JOPLING
(Approved by the Minister
and signed in his absence)

179

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

NL/37

The Rt Hon Nicholas Ridley MP
Secretary of State for Transport
Department of Transport
2 Marsham Street
LONDON SW1P 3EB

24 December 1985

Dear Nick

Thank you for yuour letter of 18 December about vehicle taxation.

It is helpful to have this indication of your thoughts on the future of this area of taxation; and we shall want to consider the points you make in our deliberations in the coming weeks. I shall, of course, keep you in touch with developments on this front.

Yours
Nigel

NIGEL LAWSON

CH/EX
RIDLEY
24/12

I await official advice.
But tho' I have some sympathy with M'R, he ignores the vital political dimension (plus, incidentally, the embarrassment of reversing what we did – v. successfully – in the 1985 Budget).
At first glance, I wd be sympathetic to the propositions (a) that VED for cars shd henceforth be kept constant in real terms, with any excess over revaloration being ~~[illegible]~~ confined to the petrol tax (given the prospect for the oil price) & (b) that the Derv duty be increased to the level of the petrol duty, & the extra revenue given back by way of VED reductions for lorries etc
(a proposition not advanced by N-R, but which has obvious merits). [illegible]

[Pat def E.]

1 - [initials]
2 - [initials]

BR

HM TREASURY - MCU

13 JAN 1986

ACTION: EP

cc APS/CHX
PS/CST
PS/FST
PS/MST
FST

REF No

BL Public Limited Company
106 Oxford Road
Uxbridge, Middlesex UB8 1EH
Telephone: (0895) 51177
Telex: 263654
Cables: Leymotors Uxbridge Telex

FROM RAY HORROCKS, C.B.E.

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London
SW1P 3AG

6th January 1986

C. You may like to note this BL Budget rep'.
Rs 14/1

Dear Chancellor,

In your preparations for the national Budget this March, may I enter a plea for particular consideration to be given to the serious difficulties which major UK manufacturers like Austin Rover face currently due to the continued relative strength of sterling.

Our present concerns reflect the developments in the economy since the late 1970's when, following the sharp appreciation of sterling in 1980/81, the UK became a very profitable market for overseas car manufacturers - often more profitable than their own home markets. For companies such as Austin Rover, however, greatly increased competition from imports produced a fall in domestic margins. Inevitably, the strong pound also sharply reduced profits in export markets.

Over the same period, however, Austin Rover brought its manufacturing costs under tight control by such measures as capacity reductions, and the introduction of new technology and improved working practices; the result has been that productivity in many areas now matches the best in Europe.

On the criteria which most continental European manufacturers are able to apply, this should have resulted in a satisfactory level of return from Austin Rover's activities. Indeed, by the end of 1984, following the gradual depreciation of sterling which took place over the year, the Company had re-established its competitiveness, and could look forward to profitable volume growth in the UK and export markets. However, this was reversed at the beginning of 1985 when interest rates were raised to check speculation against the pound, while sterling appreciated further following the March budget.

Austin Rover's problems are not now a result of uncompetitive efficiency, or even cost levels, but relate to volumes and margins. A more competitive pound would provide the fundamental change in the commercial environment that is needed to overcome these limitations.

The Rt Hon Nigel Lawson MP

In the motor industry where long lead-time investment is essential to sustained competitiveness, the prospect of an eventual move to more competitive exchange rates as North Sea oil revenues decline does not reflect the urgency of the situation. We also note and understand the Prime Minister's recent rejection of a reduction in interest rates when sterling again came under speculative pressure related to world oil prices. Nevertheless, we urge that calls for lower interest rates are heeded. A reduction from present levels would be anti-inflationary in terms of industry's cost base and, most significantly, lower rates could help achieve a managed reduction in the sterling exchange rate, especially versus crucial EMS currencies.

As far as the motor industry is concerned, it is not only Austin Rover that would benefit from such action; the UK motor components industry has suffered a serious decline in volumes in recent years and must also invest and expand its volume base at home and abroad. Further, current parities must be a disincentive for multi-national car manufacturers to modify their sourcing policies in favour of UK production.

In addition to this major concern regarding the sterling exchange rate, there are a number of more specific areas where action in the forthcoming Budget could greatly assist our continued recovery. These are addressed in detail in the Attachment; the most important to Austin Rover is the prompt alignment of UK company car tax breakpoints with those adopted by the EEC draft directive on emissions.

Your sympathetic consideration to the needs of manufacturing industry for a more competitive pound, and to the points made in the Attachment would greatly assist Austin Rover to fund the continued investment in new technology and models that is necessary to sustain its recent hard-won competitiveness. I hope you will feel able to respond to these points in the Budget.

Yours sincerely

R Horrocks

RAY HORROCKS
Group Chief Executive - Cars
BL Public Limited Company

cc: The Rt Hon Leon Brittan, QC,MP.

ATTACHMENT

SUBMISSION TO THE CHANCELLOR ON BEHALF OF

BL's CAR COMPANIES

1. TAXATION OF COMPANY CAR BENEFITS

The EEC, including the UK Government, has recently agreed on new standards for the control of car exhaust emissions within the Community, subject to reserves by Denmark and Greece. Engine capacities of 1400cc and 2000cc have been established as the breakpoint between differing levels of permissible emissions and, by implication, between the technologies necessary to achieve compliance.

All automobile manufacturers are now directing a substantial part of their product development and engineering efforts to ensuring that their products comply with these new emissions norms when they take effect after 1988. Germany has already introduced incentives to encourage early compliance and the Netherlands will do so in early in 1986.

Against this background, the continued existence of the current and unrelated UK company car tax breakpoints of 1300cc and 1800cc creates a unique handicap for UK manufacturers, for whom competitiveness in the UK company car market is very important. For Austin Rover, so too is the need to develop sales in continental EEC markets. While the breakpoints of the UK company car tax structure differ from those of EEC emission regulations, meeting both involves a duplication and inherently wasteful use of scarce product engineering and development resources. This inevitably detracts from the attention the company can give to other product developments, and results in additional costs to be borne by consumers.

We urge, therefore, that UK company car tax breakpoints are aligned with the EEC emissions breakpoints as soon as possible. Ideally, we would like to see this effective in the 1986/87 Tax Year, but if this is not feasible, then we would seek an announcement in the 1986 Budget of implementation in the 1987/88 Tax Year.

Prompt action would avoid resources being misapplied; it would also curtail the advantages which importers of cars with 1800cc engines currently enjoy over Austin Rover's new 2.0 litre engine which has been designed with the new emission standards very much in mind.

In the re-aligned UK company car tax structure, we would wish to see diesel engined cars treated no differently from cars with petrol engines. Diesel engines generally derive from the same cylinder block as petrol engines, and any different treatment for tax purposes would recreate the distortion of product development that we wish to see removed.

2. DUTY EXEMPTION OF FUELS FOR ENGINE RESEARCH AND TESTING.

The taxation of fuels used in connection with engine research and testing is, in effect, a tax on research and development, and costs BL's companies around £2m per year for fuels used in static testing alone. We request that urgent consideration be given to amending the provision of the Hydrocarbons Act as they relate to the supply of duty free oils for manufacturing, so as to cover at least the fuels used in static engine testing. Acknowledging the need for suitable control procedures, we would also welcome relief from duty on mobile testing.

This subject has already been discussed with HM Customs and Excise by the Society of Motor Manufacturers and Trades, whose representations we fully support.

3. PUBLIC UTILITY AND RATES CHARGES

Considerable public concern has been expressed about the way that the Water, Electricity, and Gas industries are being forced by Government to increase their prices. As substantial users of these utilities we share that concern.

In similar vein, we have noted a recent report about the potential impact of reduction in HMG grants to Shire Counties, Oxfordshire CC in particular. Oxford is one of the two main areas of the UK where ARG's activities are concentrated, and the suggested £10M reduction of HMG's grant to the County Council could lead to a very significant (circa 16% or £0.5M) increase in ARG's total rates bill in Oxford City and County.

Together with the impact of increased public utility charges, such rate increases will inevitably have inflationary effects.

4. THE NATIONAL INFRASTRUCTURE

As manufacturers with our main production activities in Birmingham and Oxford and receiving and delivering goods by road, we are very concerned that the national road infrastructure should continue to greatly assist. Not only will such improvements improve the efficiency with which the whole economy works, but Austin Rover's costs and efficiency will benefit directly from the completion of the motorway link between Birmingham and Oxford. We urge that such projects proceed with all possible speed.

5. INTEGRATION OF PAYE AND NIC

Companies are required to maintain two incompatible system in order to administer PAYE and NIC collections on behalf of HMG. It would be helpful if this duplication could be eliminated. It has been argued that because PAYE is administered on a cumulative basis through the tax year while NIC, being based on weekly remuneration, is non-cumulative, it is not possible to integrate the two systems.

Even if it is not possible to put NIC onto a cumulative basis similar to PAYE (and we are not convinced of this), we cannot understand why an intergrated system of administration and collection is not possible. We would urge that this matter be reviewed urgently, to secure the benefits of electronic data processing and of new technology for HMG and for UK industry.

NL/57
A

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SWIA 2HH

From the Minister

HM TREASURY MCU
15 JAN 1986
ACTION CU - Mr Walters
CHX, CST, FST, MST, EST
Sir P Middleton, PS/CE
Sir T Burns, Mr Butler,
Sir G Littler, Mr Cassell,
Mr Monck, Mr Burgner, Mr Monger
Mr Scholar, Miss Sinclair
Mr Haigh, Mr Pratt,
Mr Romanski
CHX 105/8/85
Mr Cropper, Mr Davies, Mr Lord

CH/EXCHEQUER
REC. 13 JAN 1986
ACTION
COPIES TO

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London
SW1P 3AG

13 January 1986

Dear Nigel

EXCISE DUTIES ON ALCHOLIC DRINKS

I wrote to you before Christmas on other taxation issues and indicated that I would write separately on this subject following the meeting arranged by Customs and Excise officials to hear departmental views. That meeting was held this week and the views expressed will no doubt be reported to you. I should, however, record my comments on the treatment of duties on alcholic drinks in your forthcoming budget.

Our distilling and brewing industries together contribute approximately 0.6 percent to GDP and provide employment, particularly in the case of Scotch Whisky, in disadvantaged areas. There have been significant reductions in sales of both beer and Scotch Whisky since 1980 and it would, I think be damaging if duties were to be increased in real terms.

If one looks at the current relativities, spirits are, of course, taxed much more heavily than any of the other alcoholic drinks having regard to alcohol content. Conceptually, therefore, there is a case for maintaining the direction which you took in your last budget of treating spirits more favourably. Moreover, there are good grounds for doing so having regard to the particular problems of the Scotch Whisky industry which, though an extremely important export earner, has been losing market share to other drinks, including wine, both at home and in overseas markets.

I am aware of the case which has been put to you by the Scotch Whisky Association in connection with deferment of duty payment and the treatment of Scotch for corporation tax. I confine myself to saying that they seem to me to have a reasonable case for some aleviation which is deserving of your consideration. If, however, you do not feel disposed to introduce the changes that they request, it does, in my view, underline the case for more favourable treatment on excise duties.

As regards cider, sales have remained static since the large increase in duties in 1984. I would be inclined, as last year to favour a flat rate increase applied to both cider and beer which would actually represent a rather larger percentage increase on current rates and continue the process of bringing the duties of both products more closely into line as regards alcohol content.

To sum up, I hope that you will not feel it necessary to go further than a general increase in duties in line with inflation and that it will be possible to treat spirits relatively more favourably.

Yours Ever

Michael

MICHAEL JOPLING

RAC Motoring Services
49 Pall Mall, London SW1Y 5JG
Telephone: 01-839 7050

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for Ld Gowll folder

- MCU

FP

CLAPS/CHX
PS/MST

CHX 10556/86

PP/JS/JAW/JH/3030

13th January 1986

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
The Treasury
Parliament Street
London
SW1P 3AG

Dear Chancellor

MOTORING TAXATION AND ROAD EXPENDITURE

I enclose the RAC's representations concerning motoring taxation and related public expenditure for consideration when preparing your Budget Statement.

Inevitably, many of the points in the memorandum have been put to you and your predecessors in the past, but I would draw your attention especially this year to our views on the level of Vehicle Excise Duty. In the light of the exceptionally high percentage increase last year, I hope you will agree that no further increase would be justified this year.

I have purposely omitted from the memorandum any reference to the concessionary Vehicle Excise Duty applicable to all cars registered before 1947, as it only affects a very small minority of vehicle owners.

Whilst we welcomed your decision last year to maintain the £60 level, we ask again that you give consideration to our request for extension of the scope of this concession to cover all cars registered more than 25 years ago.

I understand that there are less than 50,000 such private vehicles currently licensed and therefore the loss of revenue involved would be negligible.

We hope that you will give sympathetic consideration to this proposal as well as to the contents of our memorandum.

Yours sincerely
Jack Williams

J A Williams
Chairman
Public Policy Committee

Enc

RAC

MOTORING TAXATION AND ROAD EXPENDITURE

OBSERVATIONS BY THE RAC

JANUARY 1986

1. GENERAL COMMENTS

a) The recent Autumn Statement by the Chancellor of the Exchequer has revealed the Government's current intentions relating to public expenditure - including a welcome increase of road expenditure. It is understood, moreover, that the strategy could be expected to permit some taxation reductions in the next Budget Statement - although more recent official statements give less cause for optimism in that respect.

b) In accordance with representations made in earlier years, the main objective of the RAC continues to be a fairer deal for motorists and motor cyclists - and for road transport users generally - by provision of adequate value for money in return for the immense contribution to the national revenue obtained from motoring taxation, constituting about 10% of the total taxation income.

c) In spite of the increase of road expenditure, there is such a large and ever-widening gap between the motor tax revenue and the national road expenditure, that there will still be justifiable expectations by motorists to obtain benefit from any tax concessions as well as from increased investment in roads, which can also help considerably to reduce motoring costs.

d) Recent public opinion polls have revealed that the various forms of motoring taxation are unpopular with 70 per cent of those questioned - and more than 60 per cent considered that road expenditure was inadequate.

2. MOTORING TAXATION

a) The total income from motoring taxation during the current financial year is expected to exceed £12,000 million - as stated by Mr Barney Hayhoe MP in the following reply to a Parliamentary Question by Mr Roy Hughes MP on 3 April 1985:-

	£ million
Fuel duty	6,300
VED	2,500
Car Tax	760
VAT on vehicle sales	1,550
VAT on fuel	1,050
	12,160

b) Motorists and motor cyclists also contribute additional large sums to the National Exchequer in other ways - including VAT on various motoring services, eg, vehicle repairs and maintenance, and even on part of the fee for the official motor cycle riding test. Complete figures in this respect are not available but Parliamentary Questions have revealed that these items raise in the region of a further £700 million per annum - and this takes no account of the vast sums that must be involved in VAT on car parking charges, about which information is not readily available.

c) Motoring taxes have been raised repeatedly - and not just to keep pace with inflation. Income from motor taxation has risen from £4,443 million in 1978/79 to the estimated £12,160 million in the current year - an increase of 174 per cent. During the same period inflation has risen by 88 per cent - whereas the petrol tax has risen by 165 per cent and the Vehicle Excise Duty by 150 per cent.

d) In 1985, the Budget not only raised the petrol tax by 4.1p per gallon in accordance with the predicted 5 per cent inflation rate for the following year, but it also raised VED by over 11 per cent - from £90 to £100 for cars - more than twice the predicted inflation rate.

e) This clearly demonstrates the strength of the case to claim a fairer share of any tax concessions in 1986. The RAC has stated in earlier years - after swingeing motor tax increases - that "enough is enough". The extra taxation imposed by the last Budget was "more than enough"! It was all the more disturbing that the motor tax increases were declared to have been decided on the same basis as other Excise Duties on alcohol and cigarettes which must generally be regarded as luxuries - whereas road transport, including cars and motor cycles, is mostly used for essential, unavoidable purposes.

f) It should not be overlooked that a very high proportion of employment relates to the motor industry and all the ancillary services required in connection with ownership and use of motor vehicles. Prospects for increased employment will depend considerably on the continued growth of motoring which could be stifled by excessive taxation.

g) Information hereunder provided by the Society of Motor Manufacturers and Traders shows how expansion of car ownership in the UK has lagged behind the growth in other European countries during recent years:

CAR OWNERSHIP PER 1000 POPULATION

COUNTRY	1960 FIGURES	1983 FIGURES	% INCREASE
UK	108	295	173
Netherlands	48	329	585
Belgium	83	331	299
Italy	40	342*	755
France	107	380	255
W Germany	81	402	396
Luxembourg	107	431*	303

*1982 Figures

h) The RAC strongly supports the views of the motor manufacturers that the 10% Car Tax - imposed on the sale of new cars and motor cycles, as well as the 15% VAT - involves an objectionable "tax on tax".

Removal of the 10% Car Tax should also benefit purchasers of second hand cars and motor cycles, the prices of which are influenced by the levels of the purchase prices for new vehicles.

Selection of motorists for such extra taxation is another example of unfair discrimination.

j) The unfair requirement for motor insurers' to pay the costs of hospital treatment for injuries caused by road accidents has also been criticised as "unfair discrimination" during a Rayner investigation. Regrettably, the recommendation for abolition of this burden and representations in that respect by the motoring organisations have been rejected by successive Health Ministers.

3. TOLL CHARGES

a) The RAC continues to campaign for abolition of toll charges at estuarial bridge and tunnel crossings. The imposition of such additional taxation is considered to be unfair and illogical.

b) Such charges are exceptionally onerous for those motorists who must travel across estuaries when travelling to and from work - which can involve additional expenditure of £10 or more per week, in addition to the tax paid in respect of the use of a motor vehicle for such purposes - including more than half the cost of every gallon of petrol consumed.

c) The reasons why the RAC contends that toll charges must cease are fully explained in the attached copy of the submission made to the House of Commons Transport Committee to assist its investigation of this controversial matter.

d) The declared intentions of the Secretary of State for Transport to introduce private sector funding of the urgently required additional Dartford/Purfleet Tunnel would be an unacceptable plan if it extended further the inefficient and unfair additional taxation which results from the imposition of toll collection on our high speed road network.

e) It is imperative that a fairer and more efficient method be found for the servicing of any such injection of private sector funds particularly as it is possible that the Dartford/Purfleet plan might soon be followed by other private sector funding schemes where additional crossing facilities are required, e.g. the Severn and Tyne estuaries. Insensitive handling of this issue could do much to damage the growing awareness that there are public needs which can be efficiently financed through the use of private sector funds.

4. ROAD EXPENDITURE

a) The RAC has consistently criticised the grossly inadequate level of public expenditure on construction and maintenance of the national road system.

b) In regard to maintenance, the justification for such views has been demonstrated by the recent report on "Expenditure on Motorways and Trunk Roads" produced by the Comptroller and Auditor General as well as an earlier report by the House of Commons Transport Committee.

c) Information received indicates that a large part of the recently announced planned increase of road expenditure during the next three years will be applied to tackle the problem of the backlog of repairs on all-purpose trunk roads and motorway reconstruction. In spite of this it is not expected to be adequate to meet all the requirements and to prevent further backlog occurring.

d) In any event, there is also increasing need for more resources to cope with the continually deteriorating situation in regard to the maintenance of local authority roads.

e) It must not be overlooked that there is an equally important need for expansion of the new construction programme. Plans for modest acceleration of this are welcome, but they are only a small move in the right direction.

f) It is unsatisfactory to say that insufficient schemes would be ready for implementation if more resources could be made available. Action must be taken rapidly to expedite the procedures in order to maintain continuity of progress in future at an acceptable rate - with a guaranteed flow of sufficient resources in the pipeline to avoid serious delays.

g) A motor tax moratorium need not and should not in any way inhibit the necessary expansion of the road construction and maintenance programme, since there is every reason to anticipate that the colossal £9,000 million gap between motor tax revenue and national road expenditure will continue to increase as a result of traffic growth unless there is substantially greater investment in the national road system.

h) The inequity of the current worsening situation is undeniably demonstrated by the road track cost statistics published by the Department of Transport which show that for cars, etc, the ratio of taxation revenue to attributed road costs rose from 2.8:1 in 1980/81 to 3.4:1 in 1984/85 and for all vehicles in the same period from 2.2:1 to 2.6:1.

j) Whilst recognising - as frequently stated by Government spokesmen - that there is now very large expenditure on maintenance of the motorway network which carries a very high proportion of the traffic, the RAC must point out that this in no way justifies lack of sufficient resources for other essential purposes. In fact, problems caused by increasing road works on the motorways accentuate the need for greater expenditure to reduce such difficulties.

k) Regrettably, the additional risks created by necessary road works will cause more road accidents. Reduction of capacity inevitably makes the likelihood of accidents much greater. Experience has shown how contra-flow systems make road transport users especially vulnerable to serious accidents which are frequently causing deaths and serious injuries in such circumstances. Without expansion of the national motorway network - and expedition of the completion of missing links - there will not be spare capacity to alleviate the situation nor will it be possible to divert traffic from congested motorways to other more satisfactory alternative routes.

l) In addition we draw attention to the need for greater expenditure on many other measures which are urgently required to increase both the efficiency and safety of the motorways and the remainder of the main road network in the years ahead - particularly taking account of the greater risks which will result from traffic growth. The RAC has complained repeatedly about unsatisfactory design standards for many new roads - especially the construction of single-carriageway by-passes on main routes to the ports where it had previously been anticipated that dual-carriageway roads would be provided. There is, moreover, a growing concern about the clear lack of sufficient capacity to accommodate the traffic on the M25 and other motorways.

m) Representations calling for other desirable safety measures - such as more lighting on motorways, safety barriers on central reservations of all-purpose "near motorway standard" roads, provision of more effective emergency warning signals on motorways and improved maintenance of rapidly deteriorating road signs - have usually attracted replies indicating that progress in this respect will be extremely slow due to the lack of sufficient resources which can be made available for such improvements.

n) Whilst appreciating the extent to which there has been avoidance of further cuts in the road programme during recent years - and welcoming such progress as is being made in regard to the initiation of new schemes - the RAC must nevertheless contend that the situation is far from satisfactory in regard to the current and planned future levels of expenditure, still only in the region of £3,000 million per annum.

o) In such circumstances, the RAC strongly supports the contentions by the British Road Federation - supported also by similar demands from the CBI and the TUC - that the national road expenditure should be substantially increased. The provision of an extra £8,000 million for an expanded programme over the next ten years would still leave the proportion of motoring taxation used for such purposes in the United Kingdom far below the proportions so used in most other European countries. This would only raise the level from the deplorably low current proportion of about 25% to approximately 39% - whereas the average for European countries is about 55%.

p) Whilst it has been frequently claimed that the Government's expenditure on roads has been increased substantially since 1979, the improvement in real terms is not so impressive. At first glance, the figures are attractive - £1,665 million in 1984/85 as compared in real terms with £1,508 million in 1978/79. What is sometimes overlooked is the fact that in 1972/73 the expenditure - again in 1978/79 constant price terms - was £2.047 million. So the base figure which is so often quoted by the Government was, in fact, a very low one and even today's increased expenditure leaves a great deal to be desired in comparison with the expenditure of earlier years. In any event, the record in this respect needs to be examined over a longer period.

q) The RAC must contend therefore that there is no justification for complacency on the grounds that the situation now is better than it was - since the situation was so deplorable when the expenditure reached such a low level.

CONCLUSION

a) In accordance with the views expressed and the information provided the RAC anxiously and urgently calls for a progressive new approach to the Government's policies in regard to both motoring taxation and road expenditure - so that Britain's 28 million drivers can obtain the more efficient, more economic and safer use of the roads in the years ahead which they deserve.

b) This would also be beneficial to the national interest because efficient and economic road transport makes a major contribution to the national economy. It helps greatly to prevent inflation of the cost of living since the transport costs are a major ingredient in the price of almost all services and commodities.

c) About 90% of the movement of people and 80% of the movement of freight is undertaken by road transport. The 1984 Family Expenditure Survey reveals that the average household expenditure in 1983 on purchases of motor vehicles, spares and accessories - together with maintenance and running costs - was over £17 per week. This exceeds all other categories of expenditure covered by the Survey except housing and food. Therefore, high motoring taxation has an inflationary effect on the cost of living and new measures to facilitate use of private and commercial road transport more efficiently and economically should be applauded by the public in general.

d) Regardless of the declared need for greater road expenditure, the RAC must urge - taking account of all the circumstances described - that the excessive level of motor taxation now clearly justifies an emphatic demand for a freeze. If there will be further increases of any motor taxes in the next Budget Statement, these should be no more than the expected rate of inflation - but no increase of Vehicle Excise Duty this year could be justified since this was raised in March 1985 by more than twice the rate of inflation during the ensuing year.

TOLLED ESTUARIAL CROSSINGS

RAC SUBMISSION TO THE HOUSE OF COMMONS TRANSPORT COMMITTEE

INTRODUCTION

Having made repeated representations to successive governments over many years for abolition of toll charges at estuarial crossings – but without yet achieving any success – the RAC is extremely pleased that the House of Commons Transport Committee has now recognised the need for this controversial matter to be investigated without further delay.

The introduction of toll charges to recover the cost of constructing bridges and tunnels at many of the major estuarial crossings had reluctantly to be accepted by the RAC – at a time when the restriction of resources for a grossly inadequate road construction programme caused the Government to argue that, unless such a financing system was accepted, urgently needed bridges and tunnels would not be built.

Safeguards, however, were promised to restrict use of the toll income primarily to recovering the construction expenditure and the operational costs and to make reasonable provision for maintenance in the years ahead. After sufficient income for this purpose had been obtained, the toll charges were to be abolished – and this was to be achieved within specified fixed periods.

Circumstances have changed drastically since then and as a result the current financial situation is chaotic. Road transport users have played their part and have paid immense sums as toll charges for many years but the deficits in the accounts have grown bigger and bigger – and now there is little likelihood that many of the debts could be extinguished within the forseeable future. Meanwhile rapidly rising toll charges attract increasing resentment from Britain's over-taxed road transport users.

Representations about this sorry state of affairs were made in 1978 to Mr William Rodgers – who was then Secretary of State for Transport. His response maintained the official attitude which had been adopted by successive governments for many years – and he refused to consider any alteration of the financing system, contending that the estuarial toll crossings provided exceptional benefits to road transport users who would otherwise have to travel to their destinations along more circuitous routes.

In response to the RAC's contention that the debts should be written-off – in the same way as the railways had benefited greatly from such policy decisions in the past – it was stated that fares paid by railway users provided 59% of British Rail's income. This was at a time when the surplus income from motoring taxation not used for road transport users' benefit was in the region of £4,000 million and the estimated cost of abolishing the toll charges existing then was in the region of £200 million.

Similar representations were made in 1983, to Mr David Howell – who was then Secretary of State for Transport – but his response maintained the same attitude, again endeavouring to justify the continued imposition of toll charges because the estuarial crossings provide exceptional benefits to road transport users.

The reasons why the RAC still strongly maintains that the Government policy must be changed and that the toll charges should be abolished as soon as possible are amplified in the following observations under the specific headings listed in the terms of reference for the investigation initiated by the House of Commons Transport Committee.

THE UNDERLYING PRINCIPLES WHICH HAVE JUSTIFIED THE POLICY OF SUCCESSIVE GOVERNMENTS OF IMPOSING TOLLS ON ROAD USERS ONLY FOR ESTUARIAL CROSSINGS

The above-mentioned main underlying principle – exceptional benefits to road transport users – alleged by successive governments to justify the imposition of toll charges, has been an expedient way to extract additional revenue from road transport users – in addition to the immense and ever-increasing contribution they pay by other forms of motoring taxation which is now over £10,000 million per annum.

Whereas users of other modes of transport have benefited from huge subsidies and arrangements to write-off large debts, road transport provides a colossal surplus to the National Exchequer which is increasing each year – now over £7,000 million per annum since the national expenditure on roads is less than 30% of the tax income. Annual figures issued by the Department of Transport on road track costs – relating motor tax revenue to road expenditure and other public costs attributable to road transport – demonstrate clearly how all categories of road transport have for many years been getting less and less road investment in return for the taxation they pay.

This unsatisfactory situation is all the more irritating for those who must pay tolls because the policy defined by successive governments has not been applied consistently. There are many estuarial crossings where toll charges have never been imposed – and others where the official policy for the recovery of tolls is no longer applied in accordance with the original intentions. Thus by accident of location many road users incur expenditure liabilities not applicable elsewhere.

In earlier years nationalistic opposition to toll charges in Wales and Scotland probably reduced governments' enthusiasm for raising some toll charges to take account of the effects of inflation on the interest charges and the increasing debts. In some cases it became evident that it would be impracticable to recover sufficient income for payment of the debts because traffic would be insufficient for this purpose – but excessive increases of the charges would be unacceptable and moreover would probably cause a reduction of the traffic using the crossings.

It has been admitted that it will never be practicable to recover the debt at the Erskine Bridge in Scotland by imposing adequate toll charges for this purpose. Therefore, the policy now is to "set the limited objective of fixing tolls at a level which, while having full regard to the economic needs of the areas served by the bridge, is likely to yield the best result in terms of revenue". It has been stated that by adopting this policy the Secretary of State would be implementing as far as possible the intention of the Government, when presenting the Erskine Bridge Tolls Bill to Parliament in 1968, that the full cost of the bridge should be recovered.

Then there is the ludicrous situation in regard to the Humber Bridge where the debt is now rising by over £20 million per annum. Presumably the same expedient policy as initiated at the Erskine Bridge will inevitably be applied there if the toll charges are not abolished – and perhaps elsewhere.

The circumstances in which the RAC reluctantly accepted the concept of tolls many years ago no longer apply. Most of the tolled crossings are demonstrably indispensable components of the motorway and major trunk road system. Moreover the financial situation now makes the prospect of debt clearance by toll revenue a virtual impossibility. Extrapolation of the present trend reveals an impossible and unacceptable future for debt recovery and a very hollow ring to promises by Government.

There are questionable predictions by the Government's spokesmen that there may be an exception to this – the Dartford/Purfleet Tunnel – but, in any event, it would be unfair to continue toll charges there for that reason and to abolish them elsewhere.

The policy to charge tolls does not even have the merit of consistency. For instance, the river Medway crossing on the M2 – a very large bridge by any standards – is not tolled.

No toll charges have been imposed at the Avon Bridge on the M5 motorway, or the recently-opened Kessock Bridge in Scotland. No such charges will be imposed at the Conwy Tunnel now under construction in North Wales. Whereas tolls are charged on the M25 ring-motorway at the eastern crossing of the Thames – at the Dartford/Purfleet Tunnel – there are no charges at the western crossing – the Runnymede Bridge.

Such inconsistencies are illogical and objectionable, with uneven loads of tax which road users have to bear by virtue of their location.

The underlying principles were really questionable from the start because exceptional benefits are also obtained by users of motorways not including estuarial crossings. The definition of such principles has been an expedient way for governments to justify such methods to obtain additional finance from road transport users regardless of their more than adequate contribution to the National Exchequer by payment of other motoring taxes which has expanded colossally in subsequent years as a result of the rapid growth of vehicle ownership and traffic on the roads.

In a recent submission at the public inquiry concerning objections to the current proposed 150% increases of toll charges at the Severn Bridge, the RAC pointed out that the Severn Bridge financing arrangement is unique. Whereas the arrangement for other estuarial toll crossings involve the repayment of loans for capital expenditure, the Severn Bridge construction costs were financed by the Government from the national revenue without the need for a loan. The expedient creation of a "notional loan" and the addition of "notional interest" to the debt has been a ludicrous and deceptive way to extract additional income from millions of road transport users travelling across the estuary between England and Wales. In the circumstances, the Severn toll collection costs – over half a million pounds per annum – are even more illogical than at other estuarial crossings where real debts are continually expanding.

It has also been contended that, in any event, the inclusion of the cost of extremely expensive repair works – expected to total £33 million – in the debt to be recovered by toll charges is ultra vires.

It could not have been envisaged when Parliament approved the relevant legislation for such purposes that costs to undertake a major reconstruction of the bridge would have to be recovered in this way. This situation also applies to a lesser extent at some other estuarial crossings where heavier repair costs have been incurred than could have been anticipated.

Therefore, the RAC contends that there is no valid reason to maintain that the underlying principles applicable to the introduction of the toll charging system justify its continuance. Abolition of toll charges is essential to remove inequitable additional taxation in this way.

THE COSTS OF INSTALLING AND OPERATING TOLL SYSTEMS

It is ironic that substantial expenditure must be incurred to install and operate toll charging systems which is a non-productive purpose whereas such resources could be used much more advantageously to increase the inadequate expenditure on construction and maintenance of the national road system.

For example, recent arrangements to expand the toll collection facilities at the Dartford/Purfleet Tunnel – to cope with the greater traffic which will result from completion of the M25 motorway – have required expenditure of over £6 million.

Moreover, the toll charging system – there and elsewhere – conceals the urgent need for expansion of the crossing facilities by construction of additional tunnels or bridges – without which serious traffic congestion will still occur if, or hopefully when, toll charges are abolished.

Urgently required decisions about the construction of such additional tunnels or bridges – for instance at the Severn. Dartford/Purfleet and Tyne estuarial crossings – are likely to be delayed so long as no decision is taken to change the policy relating to the financing of such projects.

In fact this situation seems to encourage expedient, short-sighted contentions by the Department of Transport that there is no imminent need for such decisions to be taken – as stated in response to representations from the RAC concerning the need for an additional tunnel at the Dartford/Purfleet crossing.

In the case of the Severn Bridge an investigation about the need for an additional bridge or tunnel has been initiated but without commitment. An urgent decision in this respect will be essential in the near future when the results of the investigation become available.

There would obviously be even stronger objections than previously from road transport users if there should be proposals for continuance of the existing toll charging policy to recover the high costs of such new construction schemes which would necessitate very much higher toll charges in the years ahead.

It is all the more disturbing that a high proportion of the income from the toll charges is swallowed up in payment of the administration and collection costs.

The exact proportion of the total income cannot be readily calculated because accounting methods at the various estuarial crossings differ – without segregation of such costs in all cases. A typical example, however, is the Severn crossing where in the financial year 1982/83 about 29% of the income was used for such purposes.

THE SCALE AND COSTS OF DELAYS TO ROAD USERS CAUSED BY TOLL SYSTEMS

The need to stop in order to pay a toll charge will always involve a small additional cost to be incurred by every vehicle user – caused by increased fuel consumption as well as a loss of time. When there is traffic congestion which frequently occurs at peak periods – for instance with queues many miles long at the Dartford/Purfleet Tunnel and the Severn Bridge – the individual costs imposed by the delays are very much greater. The total costs in all cases must be very large.

Improvement of crossing facilities for the future is required – as mentioned above – as well as the abolition of tolls to prevent or reduce the delays and resultant costs to be incurred by road transport users.

THE WAY IN WHICH TOLL CHARGES ARE DETERMINED AND THE EXTENT TO WHICH NET REVENUES FROM TOLLS ARE SUFFICIENT TO DEFRAY THE CAPITAL AND MAINTENANCE COSTS OF ESTUARIAL CROSSINGS.

The ever-increasing outstanding debts have demonstrated clearly how the toll charging system has failed to achieve the original objectives. The situation may to some extent have been exacerbated by failure in earlier years, for various reasons, to raise sufficiently the levels of the toll charges.

Even if this has been so, it would be unjustifiable and impracticable now to raise the charges excessively to endeavour to achieve the intended objectives. Moreover, this could be a counter-productive measure if the deterrent effect of much higher charges would reduce the traffic. In any event, there would be valid economic and social objections to imposition of excessive charges.

If increased traffic may be expected to increase the income, this will also cause longer delays to strengthen the case for abolition of the toll charging system – which should be arranged before such problems occur.

THE NET COST TO THE EXCHEQUER OF ABOLISHING TOLLS AT ESTUARIAL CROSSINGS

It is the RAC's view that the cost of abolition of toll charges must be accepted by the Government since it receives all the revenue from other forms of motoring taxation. Local authorities should not be expected to incur any financial liabilities in respect of important estuarial crossings which are part of the national strategic main road network.

In special cases there may even be need to compensate local authorities for abolition of the right to obtain income by means of toll charges – for instance, at the Tamar Bridge where the income has already more than repaid the construction costs and is now used to subsidise the Torpoint Ferry used almost entirely by local traffic. This estuarial crossing facility, however, has provided immense benefits for many years to motorists travelling to the South-West from all parts of the country – without any expenditure having been incurred by the Government in this respect. Therefore the local authorities involved may justifiably expect to be adequately compensated.

The Itchen Bridge is another unusual case with toll charges having been authorised as a traffic restraint measure in spite of strong objections by the RAC and other organisations representing road transport users. The justification or need for such charging powers is still disputed.

It is understood that the debts outstanding following abolition of all the toll charges at estuarial crossings would now be in the region of £500 million – but as the debts are expected to continue to rise, so will the potential cost of abolition of the tolls. Therefore the RAC hopes that the Transport Committee will make a rapid recommendation for the Government to tackle this problem – and also that an urgent decision will be taken by the Government thereafter to change the policy in order to "Stop This Highway Robbery".

Whilst it might take some time to finalise the arrangements – and not all the expenditure would necessarily be incurred in one financial year – the total would in any event be less than 5% of the total annual income from motoring taxation and only about 7% of the current annual surplus not used for the benefit of road transport.

Increases of motor taxation in the annual Budget Statements have frequently taken additional revenue far in excess of the amount required for abolition of tolls. The national road expenditure has not risen commensurately. In fact, as stated in the latest edition of the RAC's publication 'Protecting the Interests of the Motorist', the proportion of the motor tax income used for this purpose has been steadily decreasing for many years.

It would seem essential to tackle the complete problem immediately because any piecemeal proposals involving a need to decide priorities would cause both political and practical difficulties.

Road transport users' organisations might prefer to obtain abolition first of the charges at crossings where the traffic volumes are highest – and this would provide the most advantageous economic return for expenditure to be incurred. This, however, would give low priority to other crossings such as the Humber Bridge where the debts are rising most rapidly.

Motorists in different parts of the UK would undoubtedly expect resources to be made available for this purpose to give the same benefits immediately to those who have to travel across estuaries in all parts of the country. They would resent the inequity of selective arrangements not applicable initially to their areas.

The demand for early removal of toll chages would be particularly strong by road transport users who have to incur heavy expenditure on journeys to and from work – already up to £10 per week at some crossings.

Therefore, the RAC contends that it is essential for the Government to initiate and to implement plans for the abolition of the toll charges at all estuarial crossings as soon as this will be practicable. Further procrastination will be unjustifiable – because the problem will not go away. It will rapidly get worse and more difficult to solve.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

B C Simpson Esq
Chief Executive
Tobacco Advisory Council
Glen House
Stag Place
LONDON
SW1E 5AG

15 January 1986

Dear Mr Simpson

Thank you for your letter of 20 December, enclosing your Council's 1986 Budget submission.

I would be delighted to meet with the Tobacco Advisory Council again this year. I have asked my office to be in touch with the details.

Yours sincerely

Nigel Lawson

NIGEL LAWSON

080

c c MST
Miss Sinclair
PS/CJE
PS/IR

21/1

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

Major General W D Mangham Esq CB
The Brewers' Society
42 Portman Square
LONDON
S1H OBB

17 January 1986

Dear Major General Mangham,

Further to our conversation today, I am writing to confirm that the Chancellor will be pleased to see Mr Edward Guinness and yourself on Tuesday 21 January at 2.30pm in HM Treasury.

Please accept our apologies for this change of time - I do hope it does not cause you any inconvenience.

Yours sincerely,

Debbie Lester

MRS D C LESTER
Diary Secretary

833/042

SECRET

by Ridley bilateral (Close ...)

FROM: K M ROMANSKI
DATE: 23 JANUARY 1986

Sir PM

Agreed in draft.

1. ~~MISS SINCLAIR~~ 23/1
2. MR MONGER 23/1
3. CHANCELLOR OF THE EXCHEQUER

NC/37

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Murray
Mr Cropper
Mr H Davies

Mr Knox (C&E)
Mr Wilmott (C&E)
PS/C&E
PS/IR

Ordinary?

Ch
Pete is gloriously right.
(Apologies for the red pen - sudden shortage of black ones round the corner!)

It wd be most unwise to do anything till we have sorted out our policy!

You have already said you need to talk to Mr Ridley but next week may be too soon? RL 24/1

MR NICHOLAS RIDLEY'S LETTER OF 18 DECEMBER ABOUT VEHICLE EXCISE DUTY AND HYDROCARBON OIL DUTIES

Mr Ridley wrote to you on 18 December proposing a shift in the balance of VED and fuel duty within the total tax burden for both cars and lorries, and also about the total level of taxation for lorries. He normally writes to you about the end of January with specific proposals for VED rates, so he will want a reaction to his proposals before then.

Taxation of Cars

2. On cars, Mr Ridley is concerned solely with the balance of taxation between VED and petrol duty. His medium-term aim is a significant cut in VED, with the revenue lost being made up by real increases in petrol duty. For this year, he is suggesting that VED should be pegged at last year's level, with the balance of revenue (equal to revalorisation of both duties) being raised from petrol duty - which implies about 7.4p per gallon increase instead of 5.2p.

ROMANSKI CH/EX 23/1

3. There are a number of advantages in a shift in taxation towards petrol duty such as Mr Ridley is suggesting:

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(a) the total revenue lost through VED evasion, which has been criticised by the PAC, and is currently thought to be about £90 million per year, would become less significant;

(b) it could make eventual abolition of VED in the long term easier to contemplate;

(c) it would promote a more equitable relationship between total tax borne and use of the roads for private motorists;

(d) it would benefit pensioners and other low income car-owners; and

(e) there would be incentives to increase fuel efficiency in road transport.

4. But there are also important objections to a shift in the balance of taxation on cars:

(a) the increase in petrol duties would affect essential, high-mileage motorists (even if petrol prices were falling because of falling oil prices, this could be offset by the need to increase petrol duty by more than revalorisation to offset losses of North Sea Oil revenue);

(b) it would constrain a useful fiscal instrument for raising indirect tax revenue (it is easier to raise more revenue from two taxes rather than one);

(c) VED is probably generally perceived as a less unpopular tax than petrol duty;

(d) it would reverse the policy of the 1985 Budget where VED was increased by nearly 2½ times revalorisation, whereas petrol duty was only revalorised; and

(e) although a shift would be a move in the direction of abolition, it would not bring with it the main advantages of abolition - the staff savings and the elimination of evasion.

Recommendation

5. You have commented that VED should be revalorised, but that any excess taxation of cars ~~towards petrol duty~~ over revalorisation should come from petrol duty. In our view, the arguments for not revalorising VED and for shifting the balance of taxation of cars towards petrol duty are not persuasive. We therefore recommend simple revalorisation of car VED - if you were to seek more than revalorisation of the petrol duty this year, that would in itself lead to a shift in the balance of the two taxes in the direction sought by Mr Ridley. Mr Ridley is not concerned by the overall level of taxation on cars.

Lorry taxation

6. So far as the taxation of lorries is concerned, Mr Ridley has two separate propositions:

(a) there should be a shift from VED to derv duty in the total tax borne by lorries, amounting to £100 million over an unspecified period; and

(b) total lorry taxation should not exceed total lorry road track costs by more than 25 per cent (the current relationship).

For the 1986 Budget, with these twin aims in mind, Mr Ridley is seeking a reduction in VED of an average of 8 per cent acrossthe board, coupled with an increase in derv duty of 2p over revalorisation - which would mean that lorries would yield £30 million less in 1986-87 than the equivalent of simple revalorisation of both VED and derv duty. For future years, the increases in road expenditure agreed in the 1985 PES round would permit VED to be revalorised and real increases in derv duty within the constraint that total lorry taxation should not exceed road track costs by more than 25%.

Balance of taxation

7. So far as the balance of taxation on lorries is concerned, the following are the main advantages of Mr Ridley's proposal to switch towards raising more of the total taxation through derv duty:

(a) it would link total taxation more closely to mileage travelled;

(b) it would provide an incentive to more efficient use of fuel;

(c) the significance of VED evasion would be reduced (although this would be counter-balanced to some extent by increased evasion of the derv duty by the use of rebated oil); and

(d) it would help the international competitiveness of UK road hauliers - our VED rates are the highest in Europe, and foreign hauliers operating in the UK would bear more tax (but only 6% of lorries engage in international trade, and VED accounts for only 4-5% of their total running costs).

8. The main disadvantages of a shift in the balance of taxation are:

(a) there are bound to be complaints from high mileage hauliers who would lose out under these proposals;

(b) it would operate as a constraint on a potential revenue-raising instrument (this is a less significant factor for lorries than for cars since hauliers are more conscious of the total tax they pay);

(c) it would be inconsistent with previous policy (last year VED on lorries was raised by 50 per cent more than revalorisation whereas derv duty was only revalorised);and

(d) other vehicles using diesel fuel - taxis, coaches and diesel driven cars - would have to bear real increases in their total taxation unless their VED rates were also adjusted accordingly (stage bus services would not be affected as they would be compensated through the bus fuel grant).

9. You raised the possibility of a larger switch from lorry VED to derv duty, by increasing derv duty to the same level as petrol duty. This would imply a duty increase on derv of 12.7p, apart from any revalorisation, and would make derv more expensive at the pumps than petrol, assuming that factor costs stay the same. Such an increase would enable lorry VED to be cut by £200 million, compared with its present yield of £450 million. In fact, a switch of that magnitude is more than Department of Transport would wish for. Some classes of lorry would be paying much more in derv duty than their track costs, so that it would be impossible to achieve an equitable pattern of excess taxation spread over all classes of lorry. (This is already a problem for some of the smallest lorries, but it would be much exacerbated by such a large switch). For some categories of lorry the increase in derv duty could equal or even exceed their present VED, so there are bound to be significant losers under such a switch.

Total level of taxation

10. On the total level of lorry taxation, the main arguments in favour of Mr Ridley's proposal for constraining excess taxation to its present ratio is that a further increase in the excess would cause industrial costs to increase and could lead to criticism from road haulage interests. The excess has already risen from a published figure of £30 million for 1983-84 to £260 million for 1985-86, although this is largely because the number of lorries has increased and the trend towards heavier lorries has led to higher average fuel consumption, rather than through changes in the real level of taxation. The excess is forecast to rise to £300 million in 1986-87 if both duties were revalorised.

11. The main arguments against accepting such a constraint on lorry taxation are:

(a) it would mean forgoing £30 million revenue this year compared with revalorisation (although Department of Transport envisage increases over revalorisation from the lower base over the next two years);

(b) it would be difficult to explain the apparent inconsistency of raising lorry VED rates by more than revalorisation in 1985, cutting them in 1986 and raising them again in 1987 - even though Department of Transport envisage that different categories of lorries would benefit from the reductions or bear the increases;

(c) Department of Transport envisage that it would be articulated lorries, including the heaviest lorries which would benefit from the reductions in VED, which might not be a popular move with the general public, given the perception that these lorries cause the most environmental nuisance; and

(d) there would be a particular danger in announcing an explicit relationship between taxation and road track costs because it could constrain freedom for manoeuvre for future years if road expenditure were not to keep up with the growth in number of lorries, and it would come very close to hypothecation of the revenue (at present policy is stated to be merely that taxation should at least cover road track costs for each class of lorry).

12. A further consideration in deciding what to do about lorry taxation is the decision taken on cars. Logically the two are quite distinct as different arguments apply to the two cases, but they are likely to be linked in public perception. In particular, if the car rate of VED is increased, it would be difficult to defend cuts in VED for lorries, or possibly even leaving lorry rates untouched, especially if petrol and derv duties are both increased by similar amounts.

13. The final, but very important, consideration in determining lorry VED rates is the decision reached on the hydrocarbon oil duty rates. If you were to decide to increase petrol duty by significantly more than revalorisation to recoup lost North Sea Oil revenues, it would probably be necessary to increase derv duty by a similar amount, because of the danger that a wider margin might not be passed on at the pumps, but could be used by the oil companies to increase their profit margins on derv. But a decision to go for a large increase in derv duty would constrain possible action on lorry VED; irrespective of the view taken on the merits of the argument. It is likely to lead to a shift in the balance of taxation in the direction sought by Mr Ridley, but would make it harder to keep total taxation within the constraint he is seeking.

Recommendation

14. Although there are good arguments in favour of Mr Ridley's proposals, the main considerations from the Treasury point of view are the need to maintain revenue from lorries and to avoid the apparent inconsistency of moving lorry VED rates in different directions (albeit for different vehicles) in consecutive years. It is difficult to reach firm conclusions until decisions have been taken on the oil duties. But our general view is that our interests are best served by not agreeing to Mr Ridley's proposals, since that would retain maximum flexibility.

Conclusions

15. On cars

(a) revalorisation of car VED

On lorries

(b) if revalorisation of the fuel duties is sufficient, and VED is also revalorised, lorry VED should also be increased by the equivalent of revalorisation;

(c) if petrol and derv duties are to be increased by significantly more than revalorisation, lorry VED could be left unaltered, provided that the increase in derv duty yields at least the same amount of revenue on revalorising both derv duty and VED on lorries would have done (leaving VED unaltered for ordinary lorries would not necessarily enable Finance Bill space to be saved as we are committed to increasing VED for farmers' vehicles, and last year Parliamentary Counsel advised that if any of the tables of lorry rates are altered they should all be reprinted - but we are pursuing this point); and

(d) lorry VED should not be reduced, no matter how large the derv duty increase.

16. If you agree with these conclusions you may wish to discuss the issues with Mr Ridley, as he suggests in his letter, as he will be disappointed at the outcome. Or, if you prefer to write, we can provide you with a draft reply.

K. M. Romanski

K M ROMANSKI

Gerry Tullberg 2913 ~~5448~~ 5085 ✓ OVERTAKEN

The Scotch Whisky Association

Limited Liability Registered in Scotland No. 35148

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REGISTERED OFFICE

Written before my conversation with Col. Bewsher on 27 Jan.
DL 28/1

c.c. PS/FST
PS/MST
Miss Sinclair
Mr Romanski
Mr Murray
Mr McKenzie
PS/C&E
Mr Whitmore, C&E
Mr J. Bone, C&E
PS/IR
Mr A. Walker, IR.

HFOB/KPT/RCE

24th January 1986

Mrs D Leicester
Chancellor's Diary Secretary
HM Treasury
Parliament Street
London
SW1P 3AG

Dear Mrs Leicester

You will doubtless recall that when we last spoke I said I would advise you nearer the time of the names of those forming the Association's delegation to meet the Chancellor at his Treasury office at 2.30 pm on Thursday 30th January. Our delegation will be:

Mr J A R Macphail OBE	Chairman, The Scotch Whisky Association Chairman, The Highland Distilleries Company plc Chairman, Robertson & Baxter Limited Chairman, The North British Distillery Company Limited
Mr R S Temple	Member of Council Finance Director, The Distillers Company plc
Mr I C Straker	Member of Council Chairman, the Association's Public Affairs Committee Chairman, Seagram Distillers plc
Professor D I MacKay	Economic Adviser to the Association
Colonel H F O Bewsher OBE	Director General and Secretary, The Scotch Whisky Association

I shall of course let you know if there should be any last minute changes. That apart, I look forward to seeing you on Thursday next.

With kind regards meantime,

Yours sincerely

HFO Bewsher

H F O Bewsher

covering CONFIDENTIAL

H.M. CUSTOMS AND EXCISE
KING'S BEAM HOUSE, MARK LANE
LONDON EC3R 7HE

Please Dial my Extension Direct:
Use Code (01)-382 followed by
Extension Number 5.093

From: P G WILMOTT
Date: 29 January 1986

Ch – To note familiar departmental stances.

RS 29/1

MINISTER OF STATE

cc Chancellor
Financial Secretary
Miss Sinclair
Mr Romanski

WILMOTT TO MST 29/1

TAXATION OF ALCOHOLIC DRINKS AND TOBACCO : INTERDEPARTMENTAL MEETING

We have now held the inter-departmental meeting with officials from the sponsoring Departments and DHSS to which Miss Frankis' note of 11 December gave your approval. I attach for your information the agreed note of the meeting. None of the points made was new to us, but you may expect the Ministers concerned to write formally with their views (Mr Jopling has already done so.)

Pse let me have a quick note on the case for, & the effects of, removing the duty differential for Scotch whisky.

P G WILMOTT

Internal circulation: CPS, Mr Knox, Mr Jefferson Smith, Mr T Jenkins, Mr Whitmore

CONFIDENTIAL

TAXATION OF TOBACCO AND ALCOHOLIC DRINKS: CONSULTATION OF OTHER GOVERNMENT DEPARTMENTS

INTRODUCTION

1. Customs and Excise convened an inter-departmental meeting of officials to discuss, as in previous years, the taxation of tobacco products and alcoholic drinks. The report below summarises the views expressed by the Department of Health and Social Security, Department of Trade and Industry and Ministry of Agriculture, Fisheries and Food at the meeting on 8 January 1986, at which the official Treasury was also represented.

2. All views expressed in discussion were those of officials. In most cases Departmental Ministers will write formally to the Chancellor of the Exchequer before the Budget.

ALCOHOLIC DRINKS

Levels of duty

3. MAFF expressed the hope that the difficulties currently facing the brewing and spirits industries would be taken into account when duty levels were set. The duties had been increased in real terms in 1985, and should, in MAFF's view, be no more than revalorised in 1986.

4. The view of DHSS remained much the same as last year. Their "Drinking Sensibly" policy was to make people aware of the harm caused by alcohol misuse and price levels were an important signal: it would be undesirable to allow the real cost of alcohol to fall. This year DHSS would again regard revalorisation as the minimum acceptable, but hoped for increases higher than this, if possible as part of a longer term progressive rise.

Relative tax burdens

5. DHSS felt that beer, as the most widely consumed alcoholic beverage, was responsible for the greatest damage to health. It was therefore important that the duty level should be kept up (this did not mean though that DHSS were asking for more lenient treatment of other drinks).

6. Customs and Excise pointed to an apparent trend towards a reduction in differentials between the different drinks duties, measured per degree of alcohol. This was seen by DHSS as rational and sensible, since alcohol was the harmful ingredient. MAFF also favoured this development as rationalising conditions of competition.

7. For MAFF the relatively high level of duty on spirits and the special problems of the industry suggested that this sector should be given favourable treatment. Ideally MAFF would want to see any increase in duty on wine and beer weighted towards the former, consumption of which was relatively buoyant, but they accepted that the European Court Judgement constrained such action. On cider MAFF felt that there was a case for increasing the duty by the same monetary amount as for beer.

8. In discussion of the Scotch Whisky Association's request for an increased period of duty deferment, MAFF said that they believed there might be a case for giving this for at least wine and spirits. It was relevant that the beer and cider industries had not sought such action. Customs and Excise thought the beer and cider trades would be bound to ask for longer duty deferment once it was granted to other industries. DHSS pointed out that if this were to result in lower prices to the consumer, they would be opposed to the idea; but both MAFF and Customs and Excise thought it more likely that any financial advantage gained from deferring the payment of duty would go to increase profits rather than to cut prices.

TOBACCO PRODUCTS

Levels of duty

9. DHSS said they were mainly concerned with cigarettes. Recent figures from the Office of Population Censuses and Surveys had shown a substantial incidence of smoking among young people. The government was under increasing pressure from medical and other groups to combat the health risks of smoking. Fiscal policy had an important part to play, alongside voluntary agreements and health warnings etc in stopping people smoking. DHSS were in no doubt that price was the most important factor affecting consumption and they would support sustained increases in tobacco taxation in real terms.

10. DTI said that tobacco had been harshly treated in recent years. The industry was an important employer in high unemployment areas; heavy duty increases could mean more redundancies. DTI also expressed the concern felt by the tobacco industry over cheap imported cigarettes. These accounted for a very small share of the market at present but it was getting larger. DTI would prefer any increases to be in the specific rather than in the ad valorem element of the duty.

Relative tax burdens

11. DHSS said that the health case against hand-rolled cigarettes was the same as that against manufactured cigarettes. But pipes and cigars were as dangerous as cigarettes only if inhaled, and little used by young people. DHSS hoped for revalorisation of these duties but attached less importance to the maintenance or increase of the real level of these duties.

12. DTI referred to the arguments of the tobacco industry in relation to pipe tobacco and cigars. In particular DTI pointed out that more than 50 per cent of cigars were smoked by people in lower income groups.

HM Customs and Excise

January 1986

LP6.28

CONFIDENTIAL

FROM: P WYNN OWEN
DATE: 30 January 1986

PS/CUSTOMS AND EXCISE

cc PS/Minister of State
PS/Financial Secretary
Miss Sinclair
Mr Romanski
Mr Wilmott (C&E)

TAXATION OF ALCOHOLIC DRINKS AND TOBACCO: INTERDEPARTMENTAL MEETING

The Chancellor has been prompted by Mr Wilmott's note of 29 January on the interdepartmental meeting to ask for a quick note on the case for, and cost of, increased duty deferment for Scotch whisky.

P WYNN OWEN

PWO to PS/C+E 30/1

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

M/S 31 JAN 1986 - 53

C/ To note. No mention of poor Swansea/police coordination point raised by Ld Ferroll.
Ro 3/2

The Rt Hon Douglas Hurd MP
Secretary of State for the
Home Department
Home Office
50 Queen Anne's Gate
LONDON SW1H 9AT

31 January 1986

MST.
MR CASSELL
MR SCHOLAR
MR MURRAY
MR CROPPER
MR H. DAVIES
PS/C&E
MR KNOX
MR WILMOTT, PS/FR

MINISTER OF STATE
31 JAN 1986
ACTION MR ROMANSKI
PS/CHANCELLOR
PS/CST, PS/FST, PS/EST
SIR P. MIDDLETON
SIR T. BURNS

Dear Home Secretary,

Our officials have been discussing a proposal to strengthen the enforcement of vehicle excise duty. Time is running short if a provision is to be included in the Finance Bill 1986 and in the interests of facilitating a quick decision I thought it would be helpful if at this stage I commented on the policy aspects of the proposal as I see them.

Currently, when VED evasion is proved in court, the offender has to pay a fine of up to five times the annual rate of duty plus a mandatory element of all back duty owed. I should like the relevant legislation amended so that the mandatory element is increased to twice back duty owed. This measure would give a clear signal of the Government's determination to tackle VED evasion vigorously: Treasury Ministers and I have come under sustained Parliamentary pressure on this. And it would enable much better use to be made of resources, by encouraging many more offenders to accept out of court settlements, which are at a rate of 1½ times back duty plus a charge of £10. This would increase the effectiveness of enforcement manpower in my Department; and it would ease pressures on the police, where they undertake enforcement work, and reduce the load on Magistrates Courts. I would also expect such a measure to increase the deterrent to VED evasion.

I understand that your officials and Malcolm Rifkind's (who are also involved in these discussions) have been able to support the proposal for multiple back duty in principle, though this is subject to consultations with the relevant Courts Associations. However, it seems that the Magistrates' Association have seen difficulty in it because, though recognising that it should relieve pressure on the courts, they have doctrinal reservations about the limitation on their discretion by the use of mandatory penalties.

I hope you will agree that this is a case where the practical and political advantages are such that we should proceed without necessarily having the support of the Courts Associations. In the Commons debate last October on the PAC report which had been critical of the extent of evasion, we were asked to consider a mandatory minimum penalty. Failure to pay VED, a fixed rate tax, where continued evasion manifests that the offender has the means to run a car, is surely in a different category from the generality of crime, offences against the person etc, where one would not question the case for the courts retaining discretion over penalties. Moreover, the question of principle seen by Magistrates cannot really be decisive since the existing provision on repayment of back duty is mandatory on the courts. I am anxious to include this provision in this year's Finance Bill, both to obtain the resource advantages as soon as possible and also to meet renewed Parliamentary demands for strong action against VED evasion. You may yourself see this as fitting in well with the current crime prevention initiative following the Prime Minister's recent seminar - not to speak of any possible application to the analogous case of TV licence evasion.

We need to have reached agreement on this by the middle of next month in order to meet the deadlines for this year's Finance Bill. I should therefore welcome a quick response from you and from Malcolm Rifkind to whom I am copying this. I am also copying it to Nigel Lawson and John MacGregor.

Yours sincerely,
Richard Allan
(Private Secretary)

for NICHOLAS RIDLEY
(approved by the Secretary of State + signed in his absence).

RESTRICTED

RECORD OF A MEETING HELD AT 4PM ON TUESDAY 4 FEBRUARY IN HM TREASURY

Those Present:

Chancellor of the Exchequer
Financial Secretary
Minister of State
Miss Sinclair
Mr Whitmore (C&E)
Mr Bolton (IR)

Mr Macphail - Chairman of Scotch Whisky Association (SWA)
Col. Bewsher - Director, SWA
Professor Mackay - Economic Consultant, SWA
Mr Temple - Finance Director, Distillers
Mr Straker - Chairman, Seagrams

Mr Macphail thanked the Chancellor for seeing the SWA. They had been pleased by the last Budget, but there was a long way to go. They had three main requests concerning stock relief, duty per degree of alcohol and duty deferment.

2. The industry was over-taxed by £31 million per annum. Assuming £5 profit per case, which was good going, that meant the profit on 9 million cases was lost. It was ironic that the 1915 statute which imposed the statutory minimum three year maturation period was now used by the SWA as the basis for demanding a special three year CT allowance for the industry. Otherwise the industry would be severely damaged by the long-term effects of the abolition of stock relief. Total trade was down 18 per cent on its peak and 1985 exports were the worst, in volume terms, for 13 years.

3. The duty rate per unit of alcohol on whisky still left it severely discriminated against compared to other alcoholic drinks (see Figure 9 on page 15 of the SWA's written representation).

4. Duty deferment should be increased from 4 to 8 weeks. The tax should in theory be levied at the point of purchase. It was easier for the Government to collect the duty earlier, but this meant producers paid up to 3 months interest, which could amount to up to 58p per case.

5. Col. Bewsher said a move on duty deferment would bring the UK more into line with the rest of the EC. The Chancellor said he had made a substantial change on duty deferment in 1982/83, which went a long way towards meeting the SWA requirements. On duty per degree of alcoholic strength, he noted whisky was gradually being brought into line with other alcoholic drinks.

6. Professor Mackay appreciated what had been done since 1979, but the market was moving faster. Tastes were changing to the detriment of the industry. The Exchequer would benefit from a duty shift towards other drinks. SWA demands were within the realms of possibility. The table beneath page 20 of the SWA booklet showed that it was almost impossible for the industry to thrive. Companies such as Macallan Glenlivet or Macdonald Martin Distilleries, which held malts a long time, were crippled and this dragged the whole industry down.

7. The Chancellor said a CT exemption for one industry could not be ring-fenced, even if he was persuaded of the need for it. But the continued battle to get inflation down would help. As for duty per unit of alcohol, EC regulations prevented him from substantially increasing duty on the buoyant wine market.

8. The Chancellor asked about the home market, which he thought was performing a little better. Mr Macphail said much depended on the period. The 12 months to October 1985 saw the home market down 2 per cent, since the last Budget it was up 8.8 per cent, and since October 1985 it was down 5.2 per cent. More realistically, the home market was 18 per cent down on its standing 5 or 6 years ago.

It could not be seen as buoyant. As for volume, an increasing proportion was being taken by cheap, own-label brands, especially at Christmas.

9. The Minister of State asked about the decision by all spirits manufacturers not to advertise on television. Mr Macphail said opinions differed, but the general view was that spirits, like cigarettes, ran the risk of being banned if they overdid such advertising.

10. The Minister of State asked about the market age structure. Mr Macphail said more scotch drinkers were dying than taking it up. Professor Mackay said there were no detailed figures, but their impression was younger people were moving to white spirits, wines and the like. The Minister of State observed that it did not matter if it was an old people's drink, provided everyone turned to it as they grew older! The Chancellor said increased longevity should assist the industry! Mr Macphail said vodka drinkers did not seem to progress to scotch. The Chancellor said the problem was scotch had once had an enormous 52 per cent share of the spirits market, which naturally fell as the variety of products grew.

11. Mr Straker said scotch now had 48 per cent of a much smaller spirits market but, more importantly, the image of scotch was being eroded. Everything possible was being done in the US and Japan to market it, but it was hard to find the money for this,given the vast amount being taken by the Exchequer. The industry had serious problems. In 8 years employment had fallen from 27,000 to 16,000. He felt very strongly that if the Chancellor could not restore the stock relief position with a statutory maturation allowance, at the very least he should not take any more from the industry. Professor Mackay said he was aware of the CT constraints on the Chancellor, but even 3 to 4 per cent inflation over a period of years could cripple the industry. The sums were not large in

Exchequer terms. Mr Macphail pointed out Mr Straker's company was in the impossible position of requiring a 122 per cent return on mature scotches to break even on them.

12. The Chancellor said he was grateful for the cogent SWA representation and would mull over their points. Since 1979 the Government had accepted the SWA had a strong case. But there was no way it could legally discriminate between spirits, much as it might wish to.

Ro.

P WYNN OWEN
7 February 1986

Copies to:

PS/FST
PS/MST
Mr Scholar
Miss Sinclair
Mr Romanski
Mr Murray
PS/C&E
Mr Whitmore (C&E)
PS/IR
Mr A Walker (IR)
Mr Bolton (IR)

FROM: MRS R LOMAX

DATE: 4 February 1986

cc PS/Minister of State
Sir P Middleton
Mr Monger
Mr Scholar
Mr Pratt
Sir Angus Fraser - C&E
PS/C&E

MR KNOX - CUSTOMS AND EXCISE

EXCISE DUTY OPTIONS

The Chancellor would be grateful for quick notes on the following:-

(i) The practical constraints on widening the differential between petrol and derv.

(ii) A comparison between across the board prices - only revalorisation of all the specific duties and VED and a package which combines a complete standstill on all duties (including VED) with 10p increases in both cigarettes and petrol and 9p increase in derv. He would like to see the implications for both yield and RPI.

Rl.

RACHEL LOMAX

LD8.13

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

5 February 1986

B C Simpson Esq
Chief Executive
The Tobacco Advisory Council
Glen House
Stag Place
LONDON
SW1E 5AG

Dear Mr Simpson,

I am writing to confirm that the Chancellor of the Exchequer will be pleased to meet a small delegation from the Tobacco Advisory Council on Wednesday 12 February at 2.30pm in HM Treasury.

You said that the TAC would be represented by Mr Stewart Cameron, Mr Andrew Reid and yourself.

Yours sincerely,

Debbie Lester

MRS D C LESTER
Diary Secretary

The Scotch Whisky Association

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REGISTERED OFFICE

FROM
THE CHAIRMAN

10 FEB 1986

FP

JARM/AS/SWA

7th February, 1986.

The Rt. Hon. Nigel Lawson, M.P.,
Chancellor of the Exchequer,
H.M. Treasury,
Parliament Square,
LONDON,
SW1P 3AG

CC APS/CHX
FS/MST
MST

Dear Chancellor,

May I first of all thank you for seeing the Association's delegation and giving it an opportunity to explain the main problems facing the industry, as a result of both the taxation and duty situations. We are grateful for the time and trouble you have taken to understand the circumstances of our industry.

I am sorry that it has once again been necessary to bring up the question of the inflationary factor on maturing stocks of Scotch Whisky and the very unfair and adverse effect that it has of loading the industry's annual tax charge. It is estimated that the historical cost of whisky stocks is some £1600m and if we assume an inflation rate of 5.5% and Corporation Tax at 35% we have an inflation, but in fact a non existent, profit of £88m, which at 35% gives a tax charge of £30.8m per annum.

If your officials are in any way dubious about the above method in arriving at the charge I would refer them to the COSA Actual/Estimate column on Page 21 of our presentation, which adds up to £88.4m, if you include £9.3m being the COSA adjustments in respect of Arthur Bell, I.D.V. (Export) Ltd, Inverhouse and Charles Mackinlay & Co. Ltd. The tax charge on £88.4m at 35% is £30.94m.

This is the equivalent of confiscating the post tax profits on 9 million cases of whisky, if we assume a £5 per case profit, which most of us would be delighted in practice to receive. To put the matter in perspective the Home Trade accounts for, at the present time, 12 million cases per year.

We explained to you how seriously the present system jeopardises the profitability of the industry, particularly of those companies producing the high quality products including malts and deluxe blends which are so important to the image of Scotch Whisky as a prestigious product. In that connection, you may be interested to know that I have today heard from Wm. Grant & Sons Ltd. that, after including the real cost of replacing plant and machinery, their effective tax charge on a replacement cost basis comes to 97%. In this situation, the company can be forgiven for wondering what is the purpose of staying in business?

The present situation is manifestly unfair and adversely affects the whole industry and it must, of necessity, take every step to eliminate what is seen to be a serious and continuing discriminatory system. I do not wish to be rude, but there is a view that the industry is being subjected to an annual tax surcharge, currently £30m because of administrative expediency.

We cannot believe that the changes necessary to rectify this unfair situation would pose undue problems for the Government and frankly consider that it only requires the necessary political will to implement them.

As regards the other two matters raised, the industry is very much aware of the constraints placed upon you regarding duty and is very appreciative of the steps you have taken on its behalf to enable it to move towards competing on equal terms with other alcoholic beverages, but as figure 9 on page 15 shows there is still a long way to go before the Scotch whisky industry ceases to operate at a disadvantage in the market place as a result of the taxation burden placed upon it.

Finally, on the question of duty deferment, it seems logical that the duty should be raised at the eventual point of sale, but it was obviously simpler and more convenient for the Government to raise it at an earlier stage, which of course meant the industry funded the outlay for anything up to three months. Four weeks credit for duty is already in force and the proposal of a further four weeks deferment goes some way to reducing an overhead, which puts the industry in a less competitive position compared with the alcohol beverage producers on the continent.

You will recall that as soon as duty deferment was implemented half the benefit therefrom was immediately taken away from the industry by the Customs and Excise abolishing tolerances in assessing spirit strength.

I hope that you will be able to see your way to injecting some optimism into the industry. It certainly needs it at this time.

Yours sincerely,

J.A.R. Macphail

FROM: MRS R LOMAX
DATE: 5 February 1986

MR KNOX - CUSTOMS AND EXCISE

cc Minister of State
Sir P Middleton
Mr Monger
Mr Scholar
Mr Pratt
Mr Jefferson Smith - C&E
Mr Wilmott - C&E
Mr Bone - C&E
Mrs Hamill - C&E
PS/C&E

ALTERNATIVE EXCISE DUTY OPTIONS

The Chancellor was grateful for your minute of 4 February.

2. He has asked for one further package, along the same lines, which would have a scorecard effect of approximately zero. He guesses this might combine a complete standstill on all the specific duties (including VED) with increases of 9p for cigarettes and petrol and 8p for derv. If this does not work however he suggests you shade down the increase for derv accordingly.

3. The Chancellor may wish to refer to this at Monday's overview meeting, so could you please copy to the full overview cast list? And - if possible - could you meet the deadline for overview papers (circulation on 6 February).

RL

RACHEL LOMAX

For info

cc Chancellor
FST
MST
EST
Miss O'Mara
Mr Pickering
Mr G White
Mr Kemp
Mr Cropper
Mr Davies
Mr Lord

002/

gmp

Hattersley claims that the cost of the current level of unemployment is between £21.5bn and £24 bn per year on the basis of figures that every unemployed person costs £6300-7000 per year in benefits and lost taxes.

He claims that the cost of unemployment in these terms has risen by £14 bn since 1979 and that the total cost of current levels of unemployment is equivalent to a reduction in income tax from 30p to 12p in the £.

"Let me make just two points. First, even accepting RHG's figures, this sort of extrapolation is absurd. Is the RHG suggesting that unemployment will fall to zero? Overnight? That's what would be needed to make sense of these figures. But it won't, and he knows it won't. If it were so easy, where were the tax cuts under the last Labour Government which, on RHG's analysis, also "wasted" large sums of money on unemployment.

More seriously, the RHG really cannot bandy these figures around without saying how he will conjure up this reduction in unemployment. How will he set about creating gainful employment for all these people? A great surge in spending is no doubt in his mind - but the consequent surge in interest rates and inflation, and the devastating effects of that on the real productive industry of the economy, seem not to be in his mind. How many real jobs would he destroy in his attempt to create a few temporary ones?"

1986 ECONOMIC STRATEGY PAPER

ECONOMIC STRAT-EGY PAPER

SECRET

FROM: M C SCHOLAR
DATE: 6 February 1986

CHANCELLOR

cc: Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Cassell
Mr Monck
Mr H P Evans
Mr Odling-Smee
Mr Pratt
Mr Cropper
Mr Lord
Mr H J Davies

CABINET 13 FEBRUARY: ECONOMIC STRATEGY PAPER

I attach, for your 10.00 am meeting tomorrow, a draft paper for next week's Cabinet discussion of the economy and Budget prospect.

2. It has, unfortunately, been necessary to draft the paper before your discussion of the forecast and the economic background to the Budget. The draft is, therefore, very much a shot in the dark. In the light of your views, and tomorrow's discussion, we will need to revise it quickly, so as to be able to send it across to No 10 in the course of the day (unless No 10 take the view that, in the present rather exceptional circumstances, it would be best not to circulate the paper until, say, Tuesday).

3. One or two points in the annexes are still being checked and brought up to date.

MCS

M C SCHOLAR

SECRET

Good ... But ... All ...

273/001

ECONOMIC STRATEGY

[actually there has been remarkably little turbulence, considering the dramatic change in oil prices.]

1. Our approach to the 1986 Budget comes at a time of considerable turbulence in the markets, resulting from a precipitate fall in the price of oil [and uncertainty about the dollar]. The current oil shock has already reduced prices to more than [30%] below their level at end-November.

Dust by no means settled

Overall uncertainty remains

2. We are weathering these storms - although there may be some way yet to go. In so doing we are being greatly helped by the strong underlying performance of the economy, on growth, inflation and on external account; and above all by the reputation we have built up for sound and prudent policies.

[Lower oil prices will be good, beneficial for economy in long run + years. So for UK than other countries; the main adverse effect is on Govt finances. And large changes always disruptive in short run.]

Economic Prospects

3. After the strong growth during 1984 in world output and trade 1985 saw some slow-down in activity. But lower oil and commodity prices in 1986 will have beneficial effects on the oil-consuming countries, and the forecast for the major industrialised countries is for output growth averaging 3 per cent. Inflation will stay low: indeed there may be stable prices in the economies of Germany and Japan.

4. The UK economy grew rapidly in the second half of 1984 and first half of 1985, at an underlying annual rate of about 4 per cent. I expect 1986 to be a further year of steady

slightly discouraging ... worth mentioning recent pause non-inflationary growth, at a rate very slightly below that of 1985 as a whole.

5. The improvement in the performance of the economy - to which our policies have been consistently directed - shows up in a number of recent indicators. On productivity, for example, 1985 saw further substantial gains: up about 4 per cent in manufacturing, an increase similar to, or a little higher than the average increase of the previous five years. Our performance here compares very favourably with that in earlier years; and also with that of the majority of our competitors abroad. Comparative figures are set out in Annex 1. ? 3½

6. Capital spending has generally been rising faster than output in recent years and further growth is expected in 1986, as a response to higher profits and continued expansion in output. Exports performed well in 1985, responding to the rapid growth in world trade: indeed, UK exporters increased their share of world trade. The prospect is for continued growth, albeit at a slower pace. Even after the fall in oil prices, another substantial current account surplus is in prospect for 1986, helped by rising earnings from our increasing stock of overseas assets.

7. 1986 is likely to see a sizeable rise in consumer spending. This reflects rapid growth in real disposable incomes - itself the result of the high level of wage settlements in 1984-85

Unit lab costs

and the reduction in inflation this year. Earnings are currently rising at or above 7½ per cent. With inflation likely to fall below 4% this year, the average employee's pay may rise by 4-5% in real terms during 1986.

ordering

8. Employment is likely to be nearly 1% higher in 1986 than in 1985: this represents about another 200,000 jobs. But despite five years of continuous output growth and a growth in employment of over 700,000 since the summer of 1983 unemployment remains at an unacceptably high level. It is unlikely to fall substantially while wages rise well ahead of prices, and while our unit labour costs are increasing much more than those of our competitors. International competitive pressure should restrict the ability of some employers to agree to large settlements, but it remains vital to press on with measures to improve the operation of the labour market.

Important to appreciate scale of what has happened - cheap oil under 24 $80.

9. The main uncertainty at present is the oil price. Over the past few months spot prices have fallen from $30 to under $16 a barrel - almost back to pre-1979 levels and well below them in real terms - and prices could fall further still. Although there are, of course, beneficial effects for the UK economy in lower oil prices, the markets are nervous, and are reacting unpredictably to news of OPEC and non-OPEC policies; and there are fears, too, about the effects of these changes on some major oil producers, and through them on the international financial system.

nervous: not quite the right word

10. Annex 2 sets out key figures from the forecast.

Borrowing

11. The Public Sector Borrowing Requirement (PSBR) for the current financial year looks like turning out close to the £7 billion figure in the Budget (and below the £8 billion ? real in the Autumn Statement). But there is still a considerable margin of error, and the outturn could be above or below the present forecast by £1 billion or more.

12. For 1986-87, the 1985 Financial Statement and Budget Report (FSBR) projected a PSBR of £7½ billion or 2% of GDP. But since then we have announced revised public expenditure plans, adding about £4 billion to public spending programmes. About half of that came from rolling forward the Reserve, but the rest was met by increased privatisation receipts. ?? Although these additional receipts score in the accounts as negative expenditure their economic impact is much more akin to additional government borrowing than to lower public expenditure. Other things being equal, therefore, we would need to adopt a PSBR some way below £7½ billion in order to maintain a fiscal stance which is no looser than we have so far planned.

13. But other things are not, of course, equal. In particular, only a part of the very large fall in oil prices was allowed

Clearly no higher than 7½ in MTFS, & probably better lower.

for in last year's projections. There is a case for taking part of the strain of lower oil revenues on temporarily higher borrowing. Nevertheless, with markets volatile and uncertain and further falls in the oil price - at least for a time - very much a possibility, my view is that we should aim to set a PSBR for 1986-87 below £7½ billion and perhaps [close to] just below the level of this year's estimated outturn.

creates wrong impression. Presents this opposite to privatisation argument. needs more of a build up.

Fiscal position

14. Last year's Autumn Statement gave, for the first time, no figure for the fiscal adjustment. Parliamentary and public comment, therefore, started from the £3½ billion fiscal adjustment figure projected in the 1985 FSBR, although informed opinion quickly guessed last autumn that the actual figure would inevitably turn out to be a good deal lower than this.

[fall in oil prices since end Nov has reduced expected oil revenues next year by £x billion.]

Sharply

15. The fall in oil prices over the past few months has further limited the room for manoeuvre. Every $1 fall in the dollar oil price, assuming an unchanged sterling dollar exchange rate, reduces revenues by about £½ billion. The pressures for higher public expenditure remain intense: substantial claims on the 1986-87 Reserve are already in view, and the rise in domestic interest rates in January will increase the total of debt interest, already running at over £18 billion a year. Were it not for buoyant non-oil revenues we would almost certainly be facing the need to increase taxes next year.

or Effect of changes on exchange rate) or £ ready reckoner.

but this is away

16. Much may change between now and Budget day. But, on present indications, I expect there to be little scope for any new measures in the Budget, after providing for indexation. This makes it the more important to concentrate on measures which will improve the performance of the economy, to improve incentives, efficiency and the free operation of markets, as the best way to ensure growth of output and [illegible] employment.

17. Annexes 3 and 4 set out the revenue effects of various tax changes, together with the tax burden.

Summary and Conclusion

18. Our policies continue to deliver steady growth - now about to enter its sixth year - and declining inflation, although unemployment remains stubbornly high. The difficult financial conditions over the past month or so have underlined the importance of the sound financial policies we have adopted, which have allowed us to take a firm stand in the face of strong and unwelcome pressures in the markets. We need to stick to these policies in the Budget, so as not to put at risk the good prospects for continuing growth, declining inflation, higher employment, [and, if employers are more successful in controlling their pay costs, a fall in unemployment].

don't [illegible] is appropriate [illegible] [illegible] [illegible]

19. I seek colleagues' views on the appropriate level of the PSBR for 1986-87 (paragraph 11), and on the broad shape of the Budget (paragraph 14).

(N.L.)

Labour Productivity in manufacturing, annual average growth in the UK [illegible] six-yr growth

1969-1975	2.1
1970-1976	2.9
1971-1977	2.8
1972-1978	2.0
1973-1979	0.7
1974-1980	0.3
1975-1981	1.3
1976-1982	1.4
1977-1983	2.4
1978-1984	3.1
1979-1985	3.6

Source: CSO

Labour productivity in manufacturing, annual average growth in major industrial countries

	1969-1979	1979-1985
United States	2.5	2.5
Japan	8.3	8.3
Germany	4.5	2.9
France	5.4	3.5
United Kingdom	2.3	3.8
Italy	5.1	3.8
Canada	3.0	1.6

Source: OECD

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ANNEX 2

SELECTED ECONOMIC INDICATORS

	1979	1980	1981	1982	1983	1984	1985	1986 (1)
World GNP, (2) in major 7 economies (per cent change)	3½	1	1½	- ½	2½	4½	3	3
UK GDP, (2) (per cent change)	2½	- 2½	- 1½	2	3½	2½	3½	3
Domestic demand, (2) (per cent change)	4	- 3½	- 2	2½	5	2½	2	3½
Retail prices Q4 (per cent change)	17½	15½	12	6	5	5	5½	4
Interest rates (average 3-month interbank)	13½	16½	14	12½	10	10	12	13 (3)
Current balance (£ billion)	- ½	3	6	4	3	1	3½	4
Unemployment (UK, per cent excluding school leavers)	5	6	9½	11	12	12½	13	13 (4)
Sterling Index	87	96	95	90½	83	78½	78	74 (3)
Oil prices,$, North Sea	20½	34½	37½	33	30	29½	27½	17½ (3)
PSBR, financial years, per cent of GDP	4.8	5.4	3.3	3.1	3.2	3.1	2	2 (5)

(1) Provisional pre-Budget figures.

(2) At constant prices.

(3) Early February.

(4) Not a forecast. Figures based on assumptions in PEWP.

(5) As in 1985 MTFS .

REVENUE EFFECTS OF TAX CHANGES

A. Direct Taxes: Indexation

The RPI increased in the year to December 1985 by 5.7 per cent. With indexation by this amount and statutory rounding, the figures for the main allowances and other thresholds would be:

Personal allowances	1985-86 £	1986-87 £
Single and wife's earned income allowance	2205	2335
Married allowance	3455	3655
Bands eg		
30% rate	0-16200	0-17200
60%	over 40200	over 42700

The total revenue costs of indexation of income tax (reflected in the forecast) are £1140m in 1986-87, and £1490m in a full year, at forecast 1986-87 prices and incomes.

B Indirect Taxes: Indexation

The effects of 5.7 per cent revalorisation of the exercise duties (including VAT effects, price changes rounded) are as follows:

	Typical Price Change	Revenue effect (1986-87 prices) £m	RPI impact £m
Beer	1p/pint	100	0.07
Wine	5p/70cl light wine	20	0.02
Spirits	31p/bottle	45	0.04
Tobacco	5p/20 King size	150	0.14
Petrol	5p/gallon	260	0.13
Derv	5p/gallon	65	nil
VED	£5/car	100	0.05
Overall effect (reflected in forecast)		740	0.45

Note: First year and full year revenue effects are virtually identical.

C. Ready Reckoner: Illustrative Tax Changes

£ million at forecast 1986-87 income levels

INCOME TAX	1986-87	Full Year
Allowances and Thresholds		
1% above indexation on all statutory allowances	210	175
1% above indexation on all statutory allowances and thresholds	245	190
Rates		
Change basic rate by 1p	1175	975
CORPORATION TAX		
Change main rate by 1 percentage point	180	310
Change small companies' rate by 1 percentage point	16	30
OTHER TAXES		
Change VAT rate by 1 percentage point (1)	700 (2)	925

(1) A 1% change in the VAT rate would change the RPI by 0.5%.

(2) Provisional forecast

THE TAX BURDEN

Since the Government came to power total taxes and NICs as a proportion of GDP at market has risen by about 5 percentage points, though the ratio has fallen slightly since 1981-82. The figures are as follows:

Table 1

	Total taxation* as a % of GDP (market prices)
1978-79	33.9
1979-80	35.2
1980-81	36.4
1981-82	39.3
1982-83	39.1
1983-84	38.6
1984-85	39.2
1985-86 (estimate)	38.7
1986-87 (assuming indexation)	38.6

* Including NICs and the local authority rates.

Personal sector

2. Despite reductions in income tax, total personal taxes (direct and indirect, including employees' NIC and domestic rates) in 1985-86 are about £15 billion higher in real terms (ie 1985-86 prices) than they were in 1978-79. For income tax and national insurance contributions the following table shows how the proportion of gross pay they represent has risen, particularly for the low paid:

Table 2

Income tax and NICs as a % of gross earnings*

	½ average earnings	Average earnings	2 average earnings
1978-79	16.0	27.8	31.4
1981-82	20.8	29.3	32.2
1982-83	20.8	29.8	32.3
1983-84	20.1	29.6	31.7
1984-85	19.3	29.2	31.5
1985-86 (estimate)	19.0	29.0	31.5
1986-87 (indexation)	19.3	29.1	31.7

* Adult male earnings (all occupations). Married couple, wife not working: the couple are assumed to have no children, to avoid distortion of the figures from the abolition of child tax allowances.

3. These figures reflect the rise in the standard employees' NIC rate from 6½% to 9%. The lower rates introduced in the 1985 Finance Act do not affect the cases shown. So far as income tax is concerned, personal allowances have increased by over 19% in real terms since 1978-79 and have increased slightly faster than earnings. The basic rate has been reduced from 33p to 30p, but the 25p reduced rate band has been abolished.

4. As the table shows, indexation of allowances in the Budget would lead to a very slight rise in the proportion of incomes taken in tax and NIC. This is because earnings are assumed to rise by 7% compared with the indexation percentage of 5.7%.

5. Since 1978-79 total taxes paid by businesses (outside the North Sea) have fallen slightly as a percentage of GDP. Within this total, the major change has been a fall in employers' NIC and NIS as a percentage of GDP, partially offset by an increase in business rates, as the following table shows:

Taxes paid by businesses £bn in 1984-85 prices
(figures in brackets are %s of GDP)

	Corporation tax[1]	Taxes on self employment incomes	Employers' NIC and NIS	Rates	Other[2]	Total
1978-79	6.7 (2.2)	2.2 (0.7)	9.3 (3.1)	4.5 (1.5)	3.5 (1.1)	26.2 (8.6)
1984-85	6.6 (2.1)	2.5 (0.7)	8.0 (2.5)	5.5 (1.7)	4.2 (1.3)	27.0 (8.3)

1. Excludes North Sea, but includes ACT
2. VED, car tax, road fuel duty, duty on rebated oils, capital taxes.

BR/11

SECRET

CST
FST
MST
EST
Sir P Middleton
Sir G. Littler
Sir T. Burns
Mr F. Butler
Mr Cassell
Mr Scholar
Mr Odling-Smee
Mr H. Evans
Mr Cropper
Mr Lord
Mr H. Davies

PSR

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

7 February 1986

David Norgrove Esq
No 10 Downing Street

Dear David,

PAPER FOR ECONOMIC CABINET

I attach a draft of the Chancellor's paper for the Cabinet discussion of economic strategy next Thursday. The Chancellor would like to know that the Prime Minister is content, before it is circulated to other Cabinet colleagues on Monday.

Yours ever
Rachel

RACHEL LOMAX
PRINCIPAL PRIVATE SECRETARY

SECRET

ECONOMIC STRATEGY

Memorandum by the Chancellor of the Exchequer

1. The approach to the 1986 Budget is inevitably dominated by the dramatic changes taking place in the oil market. The large price fall that has already occurred means a sharp reduction in prospective oil tax revenues.

2. The current North Sea oil price of [$16-17] per barrel is some [45 per cent] below the end-November level - a change almost as great as the price increases of 1973 and 1979. It is hard in current circumstances to make a reliable judgement about the new level at which oil prices may settle. We therefore have to consider the Budget against the prospect not merely of greatly reduced oil revenues but also considerable uncertainty about how large the reduction will be.

3. Our current estimates suggests that if oil prices settle at $15 a barrel our revenues from the North Sea will be reduced to £6 billion for the next financial year. This compares with receipts of £12 billion in 1984-85. In last year's Medium Term Financial Strategy (MTFS) we expected revenues of £11½ billion for 1986-87.

4. There has inevitably been some turmoil in financial markets as they have responded to the oil price change. Sterling has fallen by about [7½] per cent and there has been persistent upward pressure on short term interest rates. So far we have weathered the collapse in oil prices and consequent financial market turbulence pretty well - though it may not be over yet. In so doing we are helped both by the underlying strength of the economy, in terms of growth, inflation and the external account; and above all by the reputation we have acquired for sound and prudent policies.

Fiscal position

5. Faced with this background my judgement is that we must approach the Budget with considerable caution. This means trying to avoid going above the £7½ billion Public Sector Borrowing Requirement (PSBR) figure set out in last year's MTFS. If anything there is a strong case for going somewhat below it.

6. Much may change between now and Budget Day. Because non-oil revenues are now projected to be higher than expected I hope to be able to avoid a net increase in taxes in the Budget. But there looks like being little, if any, scope for a net reduction in taxation. We should just meet the public expenditure planning total set for the current financial year. The need to cope successfully with the unprecedented situation which the oil price fall has created for the public finances underlines the importance of holding public spending next year similarly within the planning total we have announced.

Economic prospects

7. But while lower oil prices have a profound impact on what is possible in the Budget, they should not greatly affect our overall economic performance - although there will be significant changes within the economy. For the world as a whole, lower oil (and commodity) prices will have beneficial effects in 1986 on the oil-consuming countries. The forecast for the major industrialised countries is for output growth averaging 3 per cent - a little better than achieved last year. Inflation will stay low: indeed in Germany and Japan it is likely to approach zero.

8. For the UK, the oil price fall has not caused me to revise my view that 1986 will be a further year of steady growth, at an annual rate of about 3 per cent , accompanied by declining inflation. Different parts of the economy will be affected in different ways by lower oil prices. While the oil sector will not do so well, manufacturing industry in particular should benefit considerably.

9. The UK economy is now in a stronger position to take advantage of the opportunities created by lower oil prices. The underlying improvement shows up in a number of indicators. Last year manufacturing productivity increased by a further 4 per cent. Since 1979 it has now grown at an average annual rate of 3¾ per cent. As the table below shows, our performance here compares very favourably with the recent past; and even with the majority of our principal overseas competitors.

Output per man hour in manufacturing
annual average growth rates, per cent

	1973-79	**1979-85**
US	1½	2½
Japan	6½	6½
Germany	3	3
France	5	3½
UK	1	3¾

10. Capital spending by business has generally been rising faster than output in recent years and further growth is expected in 1986, as a response to higher profits and continued expansion in output. Exports performed well in 1985: indeed, UK exporters increased their share of world trade. The prospect is for continued export growth, albeit at a slower pace. Even after the fall in oil prices, another sizeable current account surplus is in prospect for 1986, helped by rising earnings from our increasing stock of overseas assets. (Our net overseas asset position is now second only to that of Japan).

11. This year is likely to see a significant rise in consumer spending. This reflects rapid growth in real disposable incomes - itself a result of the high level of wage settlements in 1984 and 1985 and the reduction in inflation expected this year. Earnings are currently rising at or over 7½ per cent. With inflation likely to fall to 4 per cent this year, the average employee's pay may rise by some 4 per cent in real terms during 1986.

12. However, this excessive earnings growth remains the chief threat to jobs. Despite five years of continuous output growth, and a growth in the number of people in work of over 600,000 since the last election, which I expect to continue, unemployment is unlikely to show much of a reduction while wages rise so far ahead of prices. The plain fact is that, despite our very good productivity record, UK unit labour costs have been increasing much more rapidly than those of our competitors.

13. Annex 1 sets out key figures from the forecast. Annexes 2 and 3 set out the revenue effects of selected tax changes, together with a note on the tax burden.

Summary and conclusions

14. The dramatic change in oil prices has had a major - and adverse - impact on the public finances; but I very much hope that, thanks to the sound financial policies we have been following, it will prove possible to avoid raising taxes overall in the Budget. The impact of lower oil prices on the UK economy as a whole is more neutral. I expect to see continuing steady growth for the sixth year in succession; and lower inflation. This is a measure of the strength of our underlying economic performance.

15. I seek colleagues' views on the appropriate shape of the Budget in the light of the circumstances I have outlined.

N.L

SECRET

ANNEX 1

SELECTED ECONOMIC INDICATORS

	1979	1980	1981	1982	1983	1984	1985	1986 (1)
World GNP, (2) in major 7 economies (per cent change)	3½	1	1½	- ½	2½	4½	2½	3
UK GDP, (2) (per cent change)	2½	- 2½	- 1½	2	3½	2½	3½	3
Domestic demand, (2) (per cent change)	4	- 3½	- 2	2½	4½	2½	2	3½
Retail prices Q4 (per cent change)	17½	15½	12	6	5	5	5½	4
Interest rates (average 3-month interbank)	13½	16½	14	12½	10	10	12	13 (3)
Current balance (£ billion)	- ½	3	6	4	3	1	3½	3½
Unemployment (UK, per cent excluding school leavers)	5	6	9½	11	12	12½	13	13 (4)
Sterling Index	87	96	95	90½	83	78½	78	74 (3)
Oil prices, $, North Sea	20½	34½	37½	33	30	29½	27½	17 (5)

(1) Provisional pre-Budget figures.

(2) At constant prices.

(3) February 7.

(4) Not a forecast. Figures based on assumptions in PEWP.

(5) Brent price for delivery in March, as of February 7.

ANNEX 2

REVENUE EFFECTS OF TAX CHANGES

A. Direct Taxes: Indexation

The RPI increased in the year to December 1985 by 5.7 per cent. With indexation by this amount and statutory rounding, the figures for the main allowances and other thresholds would be:

Personal allowances	1985-86 £	1986-87 £
Single and wife's earned income allowance	2205	2335
Married allowance	3455	3655
Bands eg		
30% rate	0-16200	0-17200
60%	over 40200	over 42700

The total revenue costs of indexation of income tax (reflected in the forecast) are £1140m in 1986-87, and £1490m in a full year, at forecast 1986-87 prices and incomes.

B Indirect Taxes: Indexation

The effects of 5.7 per cent revalorisation of the exercise duties (including VAT effects, price changes rounded) are as follows:

	Typical Price Change	Revenue effect (1986-87 prices) £m	RPI impact £m
Beer	1p/pint	100	0.07
Wine	5p/70cl light wine	20	0.02
Spirits	31p/bottle	45	0.04
Tobacco	5p/20 King size	150	0.14
Petrol	5p/gallon	260	0.13
Derv	5p/gallon	65	nil
VED	£5/car	100	0.05
Overall effect (reflected in forecast)		740	0.45

Note: First year and full year revenue effects are virtually identical.

C. Ready Reckoner: Illustrative Tax Changes

£ million at forecast 1986-87 income levels

INCOME TAX	1986-87	Full Year
Allowances and Thresholds		
1% above indexation on all statutory allowances	210	175
1% above indexation on all statutory allowances and thresholds	245	190
Rates		
Change basic rate by 1p	1175	975
CORPORATION TAX		
Change main rate by 1 percentage point	180	310
Change small companies' rate by 1 percentage point	16	30
OTHER TAXES		
Change VAT rate by 1 percentage point(1)	700(2)	925

(1) A 1% change in the VAT rate would change the RPI by 0.5%.

(2) Provisional forecast

ANNEX 3

THE TAX BURDEN

Since the Government came to power total taxes and NICs as a proportion of GDP at market has risen by about 5 percentage points, though the ratio has fallen slightly since 1981-82. The figures are as follows:

Table 1

Total taxation* as a % of GDP (market prices)	
1978-79	33.9
1979-80	35.2
1980-81	36.4
1981-82	39.3
1982-83	39.1
1983-84	38.6
1984-85	39.2
1985-86 (estimate)	38.7
1986-87 (assuming indexation)	38.6

* Including NICs and the local authority rates.

Personal sector

2. Despite reductions in income tax, total personal taxes (direct and indirect, including employees' NIC and domestic rates) in 1985-86 are about £15 billion higher in real terms (ie 1985-86 prices) than they were in 1978-79. For income tax and national insurance contributions the following table shows how the proportion of gross pay they represent has risen, particularly for the low paid:

Table 2

Income tax and NICs as a % of gross earnings*

	½ average earnings	Average earnings	2 average earnings
1978-79	16.0	27.8	31.4
1981-82	20.8	29.3	32.2
1982-83	20.8	29.8	32.3
1983-84	20.1	29.6	31.7
1984-85	19.3	29.2	31.5
1985-86 (estimate)	19.0	29.0	31.5
1986-87 (indexation)	19.3	29.1	31.7

* Adult male earnings (all occupations). Married couple, wife not working: the couple are assumed to have no children, to avoid distortion of the figures from the abolition of child tax allowances.

3. These figures reflect the rise in the standard employees' NIC rate from 6¾% to 9%. The lower rates introduced in the 1985 Finance Act do not affect the cases shown. So far as income tax is concerned, personal allowances have increased by over 19% in real terms since 1978-79 and have increased slightly faster than earnings. The basic rate has been reduced from 33p to 30p, but the 25p reduced rate band has been abolished.

4. As the table shows, indexation of allowances in the Budget would lead to a very slight rise in the proportion of incomes taken in tax and NIC. This is because earnings are assumed to rise by 7% compared with the indexation percentage of 5.7%.

5. Since 1978-79 total taxes paid by businesses (outside the North Sea) have fallen slightly as a percentage of GDP. Within this total, the major change has been a fall in employers' NIC and NIS as a percentage of GDP, partially offset by an increase in business rates, and 'other' taxes as the following table shows:

Taxes paid by businesses £bn in 1985-86 prices

(figures in brackets are %s of GDP)

	Corporation tax[1]	Taxes on self employment incomes	Employers' NIC and NIS	Rates	Other[2]	Total
1978-79	7.1	2.4	9.9	4.7	3.7	27.7
	(2.2)	(0.7)	(3.1)	(1.4)	(1.1)	(8.6)
1985-86 (estimate)	8.2	3.1	8.0	5.9	4.8	30.0
	(2.3)	(0.9)	(2.2)	(1.7)	(1.4)	(8.4)

1. Excludes North Sea, but includes ACT
2. VED, car tax, road fuel duty, duty on rebated oils, capital taxes.

BRIEF 10/2

H.M. CUSTOMS AND EXCISE
KING'S BEAM HOUSE, MARK LANE
LONDON EC3R 7HE
01-626 1515

FROM: T M JENKINS

DATED: 10 February 1986

A good subject for Ash Wednesday

1. Mr Jefferson Smith   JJ 10/2.

2. Chancellor of the Exchequer

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
Mr Monger
Mr Romanski
Mr Murray
Mr Cropper

C. A fit joke for opening the meeting, though bear in mind it also stands for "Action on Smoking and Health!" See also Mr Fowler's letter tucked in blue folder. R 11/2

PS. I have asked for a note on "Skoal Bandits" by noon tomorrow.

BUDGET DEPUTATION: TOBACCO ADVISORY COUNCIL

I attach briefing, in the standard format, for your meeting with the Tobacco Advisory Council at 2.30 pm on 12 February. Mr Jefferson Smith will provide official support from Customs and Excise. + Mr Romanski from HMT.

T M Jenkins

Internal circ: CPS, Mr Knox, Mr Jefferson Smith, Mr Wilmott, Mrs Boardman

TOBACCO ADVISORY COUNCIL: 1986 BUDGET DEPUTATION

1. Organisation.

The TAC represents the UK tobacco manufacturers. Their delegation will be led by Mr Stuart Cameron (Chairman of Gallaher Ltd) as Chairman of the TAC. He will be accompanied by Mr Andrew Reid (Chairman of Imperial Tobacco Ltd) and Mr Bryan Simpson (Chief Executive, TAC).

2. Purpose of meeting.

The TAC is on the short list of organisations normally seen by Ministers before the Budget.

3. TAC's written representations.

The TAC's written representations call for:

(a) any increase in the duty on cigarettes and hand-rolling tobacco to be limited to that required for indexation (the revalorisation factor this year is 5.7%, thus an increase of 5p per 20 cigarettes would require a 6.1% increase in the specific duty element, and produce £190 million revenue in a full year with an RPI impact effect of 0.15%)

(b) nil increases on cigars (as in 1985) and pipe tobaccos (as in the last three Budgets).

4. Points for the discussion.

In support of this the TAC are likely to argue that:

(a) Cigarettes duty increases since 1979 have been above inflation and greater than those for other excise duty goods.

Comment

Duty on cigarettes has been over-indexed by about 23% since 1979, although there have been marked variations between Budgets, the largest increases coming in 1981 and 1984. However, since 1980 revenue has also increased by 11% in real terms, and the duty could clearly bear more than indexation on revenue grounds. The BMA and Royal Colleges of Physicians have argued for a conscious policy of over-indexation on health grounds. Cigarettes have not borne such hefty increases as beer, cider and petrol, but they have been taxed more heavily than wine, spirits and derv, since 1979.

(b) Consumption of all tobacco products has fallen by over 20% since 1975 (most markedly for cigarettes and pipe tobaccos and since 1979), largely due to tax increases.

Comment

Tax increases undoubtedly have affected consumption, but there has also been a strong secular trend against smoking on health grounds. Clearances of cigarettes during the first 10 months of 1985 show a small (0.4%) increase over the same period in 1984. (Clearance of home products in the period actually fell by 3% but this was balanced by increassed import penetration). Since 1980 consumption has fallen about 18%.

(c) As a result of the drop in consumption, over one third of the jobs in the UK tobacco industry have been lost since 1974, with the majority since 1980.

Comment

Although the drop is partly due to fiscal changes, the secular trend against smoking and the introduction of new machinery are also relevant. (Consumers may well have switched expenditure from tobacco to other areas, thus giving rise to increased employment elsewhere).

(d) UK manufacturers are at risk from increased import penetration and static export potential.

Comment

Before 1983, imports accounted for under 2% of the UK cigarette market: in the first 10 months of 1985 this had risen to 9.5%. An important factor has been the readiness of some European producers to use spare capacity to meet special orders for "own brands". There are some grounds for believing that a sharp price increase could encourage smokers to look for cheaper alternatives (imported cigarettes tend to be cheaper). Cigarette exports grew by nearly 20 billion in the period 1974-82, offsetting about 60% of the decline in domestic sales in that period, but they peaked in 1983.

(e) Pipe tobacco and cigars merit special treatment because of pipes' importance to the elderly and poorer smokers, the concentration of employment in disadvantaged areas, and depressed markets.

Comment

The market for pipe tobacco and cigars remains in gradual decline. Their manufacture is principally based in the Celtic fringes and Liverpool. The health arguments for increases are less strong than for cigarettes. Nevertheless there are revenue arguments against allowing the presumption to become established that these products will be automatically excluded from normal indexation.

5. Points to raise.

None. The TAC will not expect detailed comment in advance of the Budget Judgement.

2153/64

FINANCIAL SECRETARY TO THE TREASURY

Pmp

FROM: N WILLIAMS
DATE: 10 February 1986

PS/CHANCELLOR

C/ To note.

Ro 11/2

cc PS/Chief Secretary
PS/Minister of State
PS/Economic Secretary
Mr Cropper
Mr Davies
Mr Lord

BUDGET DEPUTATION: SCOTTISH CONSERVATIVE PARLIAMENTARY BACKBENCH COMMITTEE (SCPBC)

1. The Financial Secretary met representatives of the Committee on 6 February.

2. The Committee did not go into any detail about the particular tax issues currently being pressed by the Scotch Whisky Industry - eg duty deferment and stock relief.

3. Instead they talked in general terms about the political attractiveness of helping a Scottish industry, although they did press specifically for no increase in duty.

4. They said that there had been benefit to the industry from the actions taken in the last Budget and that they had received credit for the success of their representations.

6. The Committee said that they would be writing directly to the Chancellor to pursue their points further.

N Williams

NIGEL WILLIAMS
(Assistant Private Secretary)

Ian
Nope.

PKD,
Does anyone need to see this?
I ~ 11/2
png

Rco 11/2

Telephone:
Basingstoke (0256) 20123

From: The Secretary
R.A.Menzies

HM TREASURY — MCU
11 FEB 1986

The Automobile Association
Fanum House
Basingstoke
Hampshire
RG21 2EA

RAM/BSM

10th February, 1986

Dear Mr. Owen,

Thank you for your letter of 3rd February addressed to Lord Erroll which will be placed before him within the next few days.

Yours sincerely,

Tony Menzies

P. Wynn Owen,Esq.,
Private Secretary to the
Chancellor of the Exchequer,
Treasury Chambers,
Parliament Street,
London.
SW1P 3AG

RR3.41

BUDGET - CONFIDENTIAL

FROM: MRS R LOMAX
DATE: 10 February 1986

MR SCHOLAR

cc Sir P Middleton
Sir T Burns
Mr Pratt

BRIEFING FOR THURSDAY CABINET

The Chancellor has seen the list of briefing which you have commissioned for Thursday's Cabinet. He thinks this covers the ground. He is particularly anxious for a very good brief on basic rates versus thresholds. He would like this to cover the arguments in the recent David Howell's speech; the points made by the IFS (John Kay; Fiscal Studies February 1984); the Fowler point, made by Sam Brittan today (this needs handling delicately); what has been achieved so far (including last year's NIC package, which reduced marginal rates for the very low paid); and factual material, in particular cross over points for single and married taxpayers, where the comparison is between the 2p reduction in the basic rate and equal cost increase in thresholds; and the point about unincorporated businesses, discussed at today's overview.

2. The only additional material he has asked for is a speaking note (on which you will need Sir Terence Burns' assistance). This should cover the outlook for 1987; how the fall in oil prices bears on the issue of what happens when the oil runs out - and the debate over the House of Lords report; the case for prudence (including why we should not raise the PSBR, in response to the fall in oil prices).

3. I have not yet fixed a briefing meeting; please let me know if and when you think one would be helpful.

RL.

RACHEL LOMAX

BUDGET - CONFIDENTIAL

LR2.40

ptr

FROM: MRS R LOMAX
DATE: 11 February 1986

MR SCHOLAR

cc Sir P Middleton
Sir T Burns

BRIEFING FOR ECONOMIC CABINET

The Chancellor has had two further thoughts about the briefing for Thursday's Cabinet:-

(i) the speaking note should make the point - in some detail - that the employment measures in the last Budget have not yet fully worked through.

(ii) the brief on rates versus thresholds should explain why a reduced rate band is not on.

Rh.

RACHEL LOMAX

273/002

FLAG H

SECRET

(not used)

SPEAKING NOTE FOR CABINET ON 13 FEBRUARY 1986

1. As the paper I have circulated makes clear, we have seen a dramatic fall in oil prices: and that inevitably has a profound impact on the public finances. At end-November, when oil was trading at $29 a barrel, a fall to $20 would have seemed fanciful. Yesterday the price for oil delivered in April was [$16], and there are not many around who would put money on an oil price as high as $20 through 1986-87.

2. Recently there has been considerable comment about the effect on the UK economy "when the oil runs out". The prospect was of declining oil revenues stretched out over several generations, well into the next century. We now face the likelihood of oil revenues halving between this financial year and the next.

3. Almost certain that we shall face uncertainty all the way up to the Budget and beyond about new level at which oil prices may settle. OPEC arranged their next conference to coincide with the Budget. It appears to be a Saudi objective to maximise uncertainty at the moment. But one thing perfectly clear: prospective oil revenues - which fall £½ billion, all else equal, for every $1 fall in oil price - well below £11½ billion assumed in Red Book last year.

SECRET

4. For the last MTFS we looked forward to a fiscal adjustment of £3½ billion for next year. If oil prices settle at $15 our revenues will have been reduced by £~~6~~5 billion compared to the MTFS assumption. It is only because non-North Sea revenues have been buoyant that I am able to offer the prospect of no increase in taxes this Budget.

5. It is, of course, a considerable disappointment to lose the scope for tax cuts. This time last year we thought that, within a framework of prudent and sound financial policies, there might be scope for significant tax reductions in 1986-87. That prospect has now - temporarily, I hope - receded.

6. Against the background of so much uncertainty we must proceed very cautiously. We cannot be sure that there will be no further slide in the oil price. We must put ourselves in a position so as to be invulnerable - or an invulnerable as it is possible to be - to such a turn of events.

7. That means that we should choose a PSBR no higher than the £7½ billion in last year's Red Book: and my preference would be for one somewhat below that figure. That, in turn, means that there will be little, if any, scope for a net reduction in taxation, after providing for indexation - and <u>that</u> judgement, in turn,

depends on our being successful in holding to the public expenditure totals this year and next.

8. These last few weeks have seen a fair amount of volatility in financial markets. We have weathered this pretty well - thanks to the perception that the underlying economy is strong, and that our policies are right. We must build that same reassurance into 1986-87 - and hope that events will allow us, with such prudence this year, a little more room for manoeuvre in the 1987 Budget.

The Economy

9. Although the assessment of the impact of lower oil prices is, naturally at this time of year, dominated by public finance considerations, the effect on the economy will be profound and pervasive.

10. In the face of the first two oil shocks the industrialised countries adjusted slowly to their loss of income: profits were squeezed and there was damage to investment and growth - and, above all, to employment. It will not be clear for some time to what extent third oil shock will be the obverse of the first two. But we may confidently expect, for industrialised countries as a whole, a considerable terms of trade gain, higher national disposable incomes and - provided it is not

all taken out in wages - improved profitability and investment.

11. For our economy, the immediate effect ~~immediately~~ is more neutral with a loss of net oil exports and deterioration in the terms of trade. But overall growth should be broadly unaffected; we are looking for non-oil GDP to grow by 2½ per cent in both 1986 and 1987. And there should be a further decline in inflation. Most importantly, with the prospect of more lively demand abroad, and with the inflationary consequences of exchange rate depreciation offset by falling oil prices and world inflation, manufacturing industry stands to benefit considerably from these changes. We should, in short, see much more rapid progress than anyone expected with the adjustment which so much worried the House of Lords "after the oil runs out".

12. And, as paper makes clear, we start from a much improved base. For example:-

- it is quite remarkable both how consistently productivity has grown, and how consistantly we have underestimated this. Instead of being at the bottom of the league table we are now second only to Japan, with productivity growth four times as fast as in the '70s;

- exports, too, rose more strongly than we expected in 1984 and 1985: for manufactures some way ahead of the growth in world trade;

- with a further rise in profits in 1985 capital spending by businesses continues to grow faster than output.

13. Our problem continues to be that this very buoyant economy is still not delivering falling unemployment. But there has been a marked improvement in the trend - taking account of the disappointing December and January figures - since spring last year. With the 1985 Budget expansion of the Community programme still less than half completed, with little, if any, of the effects of the NIC restructuring yet felt, with labour force growth slowing down, prospects for further improvement look good. If industry will control its pay costs and get itself into a position to take full advantage of the more lively demand in prospect abroad, we should see a marked increase in its activity and a further marked improvement in the prospects for employment.

14. The task for us, however, is to maintain a framework of policy which makes it easier not harder for industry

to get this right. Most immediately we have to consider a Budget which will cope with the damage to our public finances which has been the first effect of the oil price fall.

TOBACCO ADVISORY COUNCIL

Glen House, Stag Place, London, SW1E 5AG

Telephone: 01-828 2803/2041/2730/5920

Telex: 8953754 TOBCOM

Facsimile: 630 9638

Mr Philip Wynn Owen
H.M. Treasury
Parliament Street
London SW1P 3AH

13 February 1986

Dear Mr Owen,

After the meeting with the Chancellor yesterday I believe you spoke to Mr Brian Simpson, and expressed interest in the PEIDA Research to which Mr Andrew Reid had referred.

I have pleasure in enclosing a copy of the PEIDA Report on Excise Duties, Taxes and Government Expenditure, and I would draw your attention to tables 12 and 13 on page 19.

You may like to know that the TAC had a meeting with officials from H.M. Customs & Excise, who agreed with the conclusions of this report.

Yours sincerely,

Grice

H B Grice
Executive Director

enc.

CH/EXCHEQUER

REC. 14FEB1986

ACTION: MR T. JENKINS 14/2

COPIES TO: CST, FST, MST
MR MONGER
MR ROMANSKI
MR A. MURRAY
MR CROPPER
MR JEFFERSON-SMITH CBE

EXCISE DUTIES, TAXES AND GOVERNMENT EXPENDITURE

PEIDA

EXCISE DUTIES, TAXES AND GOVERNMENT EXPENDITURE

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February, 1985

TABLE OF CONTENTS

PEIDA

EXECUTIVE SUMMARY

1. This report considers the impact of tobacco taxation, relative to the effects of indirect taxes on other excise goods or VAT, on the Retail Price Index (RPI) and the corresponding influence this has on government expenditure/revenue and, ultimately, on wage settlements.

2. Any increase in tobacco taxation has approximately the same impact on the RPI as a similar percentage increase in petrol duties, nearly twice the impact of beer, four times the impact of spirits and over seven times the impact of a similar increase in wine duties. The absolute increase in the RPI amounts to nearly one ninth of a percent for each 5% increase in the specific element of tobacco duty from present levels. This compares with the other excise goods as follows:

Effects on the RPI of a 5% increase in excise duties

Tobacco	Spirits	Beer	Wine	Petrol
0.111%	0.0465%	0.0682%	0.0156%	0.115%

3. To raise £50m in additional tax revenues from tobacco products would necessarily incur an increase in inflation of 0.0638%. However the consequent effects on inflation (and consumption) of raising such a sum in revenue from petrol, beer or VAT would be much lower:

Effects on the RPI of raising £50m from each revenue source

Tobacco	Spirits	Beer	Wine	Petrol	VAT
0.0638%	0.109%	0.0513%	0.0443%	0.0268%	0.031%

4. There would be corresponding costs to the government of any such increases in the general price level, in terms of higher expenditure commitments on welfare payments and lost revenues from provision of higher personal tax allowances. Based on 1982 expenditure levels, for each 0.1% increase in the RPI, the additional cost to the government is estimated to be at least £41.648m in a full fiscal year. Following measures to raise £50m in marginal tax revenue from each of the sources considered, the indirect costs to the

government and the resulting net marginal revenues in a full year would be as follows:

Costs/Net Revenues

(full fiscal year)

	£m	
	Indirect costs	Net revenues
Tobacco	26.57	23.43
Spirits	45.40	4.60
Beer	21.365	28.635
Wine	18.45	31.55
Petrol	11.16	38.84
VAT	12.91	37.09

Thus, while the offsetting loss of revenue would amount to 22% of the gross additional income from petrol and 26% of the same from VAT, much higher costs would be incurred if the required increases in wine taxation (37%), beer taxation (43%), tobacco taxation (53%), or alcoholic spirit taxation (91%) were imposed.

6. The effect of changes in prices on wage settlements is both significant and rapid. Wage settlements appear to <u>fully</u> incorporate higher prices within a matter of months or, at the outside, within two years.

1.0 INTRODUCTION

1.1 The objectives of this paper are threefold:

(a) to identify the impact on the Retail Price Index (RPI) of increasing tobacco taxation, relative to the effects of increasing other indirect taxes or Value Added Tax (VAT);

(b) to evaluate the impact of these inflationary effects on central government expenditure and revenues with regards:

(i) the increased cost of social security and other welfare payments; and

(ii) the loss of revenue to the Exchequer from higher personal tax allowance provisions; and

(c) to analyse the likely effect on wage increases corresponding to any increase in prices.

1.2 Five major excise goods are considered; namely, tobacco, spirits, beer, wine and petrol. The analysis applies current Treasury assumptions to evaluate the effects on the RPI and the impacts on government revenues and expenditure arising from changes in indirect taxation.

Assumptions

1.3 The available data impose a number of simplifying assumptions on the analysis:

(a) Standard unit proxies for each commodity group are required, this enabling a 'typical price' to be determined and a uniform tax structure to be identified. Cigarettes (20 king-size) are therefore used as a proxy for all tobacco products, a standard 75cl. bottle of whisky (40% alcohol by volume) is substituted for all spirits, wine relates to a 70cl. bottle not exceeding 15% alcohol by volume and the unit of quantity relating to petrol is one litre.

(b) While the excise duties applied in the analysis may relate to individual products (from (a)), consumer expenditure data relates to broader commodity groups i.e. tobacco, spirits and all wines. Where necessary, therefore, information regarding the selected excise products has been applied to aggregate spending levels for each commodity group. This makes the implicit but reasonable assumption that the behaviour of aggregate spending can be represented by the individual products selected.

(c) It is assumed that all tax changes are passed on to the consumer.

1.4 Statistical data relates to 1982 (unless otherwise specified), the latest year for which published information regarding excise revenues, consumption and prices is available.

2.0 METHODOLOGY

2.1 Any increase in indirect taxation will lead to an increase in the price of a taxable product and, hence, in all consumer prices, the extent of the latter increase depending on the importance of such expenditure in the construction of the Retail Price Index. Economic theory suggests there will be three consequent effects on prices and patterns of expenditure:

(a) a substitution effect;
(b) an income effect; and
(c) secondary or multiplier effects.

2.2 Following any increase in price, from higher taxation or otherwise, there will be a change in the quantity of a product consumed. Total consumer spending on the good may rise or fall, depending on its price elasticity of demand. Consumers' patterns of expenditure will change, either to allow increased spending on the higher-priced good or to substitute spending in favour of now relatively cheaper products. The new pattern of spending will influence the marginal tax revenue accruing to the government from the tax change.

2.3 An increase in the price of a good will also reduce consumers' real income. Since they will have to spend more to purchase the same amount of the more expensive product, their total spending power will have been reduced.

2.4 Secondary price effects follow if the higher-priced commodity is required as a factor of production (or distribution) in the manufacture of other final goods and services. The initial price increase will then be reflected in the prices and consumption patterns of these goods and services too.

2.5 In principle, therefore, a price change for one commodity will have an impact on the demand for and prices of many other commodities. In practice, however, it is impossible to estimate the full extent of these 'ripple' effects. Nonetheless, the main impact of any individual price change, on the RPI, tax revenues and consumption, will be accounted for by the first-round, direct effects.

2.6 In the following sections, the economic consequences of increasing indirect taxation on the major excise goods are considered. Latest Treasury model assumptions for each of the goods are applied. Section 3 determines the price effects alone of any change in indirect taxation on tobacco products, spirits, beer, wine and petrol. In particular, the inflationary impacts of indexing any change in respective levels of indirect taxation to the rate of change of prices are evaluated and the importance of secondary price effects in the present context are discussed. Section 4 adopts a more comprehensive approach to studying the inflationary and revenue effects of a change in indirect taxation. Changes in consumer spending patterns, following any substitution or income effects, and revenues from producers as well as consumers are also considered. The inflationary effect of any attempt to raise a standard sum in marginal tax revenue from each of the excise sources (taken to be £50m) is then calculated. For comparison purposes, the wider consequences of these inflationary measures are discussed. Section 5 considers the impact on government revenues and expenditure, while Section 6 assesses the likely effects on wage settlements resulting directly from any initial increase in indirect taxation. Finally, Section 7 draws together the conclusions of the paper.

3.0 INDIRECT TAXATION AND THE RPI

3.1 Any increase in the price of a consumer (or producer) good, by whatever means, will have repercussions on the overall level of prices in an economy. Thus, any increase in indirect taxation on a good will, under assumption (c) in para 1.3, cause the retail price of that product to rise by the amount of the marginal tax change. In addition, the index of all consumer prices will also rise, the extent of this increase being dependent on the weight apportioned to the higher-priced product in the construction of the index. This section considers the inflationary consequences of such a rise, caused by an increase in indirect taxation on tobacco products, spirits, beer, wine and petrol.

3.2 Indirect taxation comprises excise duty and VAT. For each of the excise products, details regarding typical price, basic price, excise duty and VAT are shown in Table 1. A problem arises with beer, alcoholic spirits and wines since a large proportion of sales are 'serviced' (i.e. sold in public houses, restaurants, etc.) and prices charged vary accordingly. For our purposes, a weighted average typical price for each has been derived (weighted by spending).

Table 1

Price Breakdown of Excise Products (1982)

	Cigarettes (20 king-size)	Whisky (75cl. bottle)	Beer (pint)	Wine (70cl. bottle table wine)	Petrol (litre)
Typical price	102.00p	950.00p	57.00p	350.00p	37.18p
VAT	13.30p	123.88p	7.43p	45.64p	4.85p
Duty	41.36p* 21.42p+	434.00p	14.30p	74.76p	15.54p
Basic price	25.92p	392.12p	35.27p	229.60p	16.79p

* specific
\+ ad valorem

3.3 Two different indices of overall price inflation may be considered relevant - the Retail Price Index (RPI) and the Consumer Price Index (CPI). The RPI measures the change in the cost of a basket of goods and services taken to be representative of all household expenditure. The relative importance, or 'weights', attached to the various commodities in the basket are derived from the Family Expenditure Survey and are revised annually in the light of changing patterns of consumer expenditure.

3.4 The CPI measures the aggregate change in prices of all items of expenditure, including those the RPI omits. It is implicitly weighted by current expenditure on individual goods and services relative to total spending. The coverage of the RPI is therefore slightly less exhaustive than that of the CPI. Consequently, the relative weights attached to expenditure on individual products differs between each index. The respective weights currently applied to tobacco, spirits, beer, wine and petrol in the construction of the consumer and retail price indices are shown in Table 2. While the weights applied to beer, spirits and wine in the RPI have not changed significantly in recent years, the weight on tobacco products has declined 0.8 percentage points (18%) and the weight on petrol has increased 1.5 percentage points (45%) since 1979.

Table 2

Excise Commodity Weights in the RPI and CPI

%

	RPI	CPI[1]
Tobacco	3.6	2.7
Spirits	1.54	0.7
Beer	4.7	2.7
Wine	1.12	0.7
Petrol	4.8[2]	4.0

3.5 In this paper, only the effects of higher indirect taxation on the Retail Price Index are considered. The reasons for this are twofold:

(i) The government has always used the RPI to index welfare payments and personal tax allowances. In theory, they may use the CPI as an alternative deflator, but this is unlikely to occur in practice.

(ii) The RPI is the most widely understood and commonly used price index, particularly in wage bargaining.

3.6 In the following analysis, as a likely proxy for any increase in excise duties following indexation, a universal 5% increase in duties on tobacco, spirits, beer, wine and petrol is assumed. After the interaction of VAT, the net change in taxation would be less than the gross increase of 5% and would vary slightly between different goods (Table 3). Coupled with the proportion of tax in the prices of the excise goods in 1982, the respective commodity price increases resulting from the higher rates of taxation are shown in Table 4.

Table 3

Taxation and the Excise Goods

	Change in duty	Change in duty inc. VAT	Proportion of tax in price: Pre-duty increase	Proportion of tax in price: Post-duty increase
Cigarettes	5%	4.13%	74.59%	75.35%
Whisky	5%	4.48%	58.72%	59.78%
Beer	5%	3.8%	38.12%	39.00%
Wine	5%	3.58%	34.40%	35.20%
Petrol	5%	4.4%	54.84%	55.90%

Table 4

Commodity Price Increases

	post-5% increase in excise duty
Cigarettes	3.08%
Whisky	1.79-3.84% (3)
Beer	1.45%
Wine	0.89-1.72% (3)
Petrol	2.40%

3.7 From this, and given the latest product weights derived from the Family Expenditure Survey, the corresponding effects on the RPI from these product price increases can be estimated (Table 5). This illustrates that the effect on the RPI of increasing duty on tobacco is similar to that resulting from the same percentage increase in petrol duty, while it is between nearly two and seven times greater than the impact of such an increase in indirect taxation on the other products considered. This result arises for two reasons:

(i) the higher proportion of duty in the price of tobacco products; and

(ii) the weight attributed to tobacco in the RPI, given (i).

Table 5

Impacts on the Retail Price Index

	post-5% increase in excise duty(4)
Tobacco	0.111%
Spirits	0.0465%(5)
Beer	0.0682%
Wine	0.0156%(5)
Petrol	0.115%

3.8 Comparing tobacco and petrol alone, tobacco products have a greater proportion of tax in their price than is the case with petrol, while petrol is attributed a much larger weight in the RPI. On balance, therefore, their inflationary effects are similar.

Secondary Price Effects

3.9 In the above calculations, price changes and impacts on the RPI are restricted solely to the direct price effects. However, this omits the possibility of additional, indirect price effects occurring if the excise goods are required in the manufacture of other final products.

3.10 The extent to which the prices of indirectly-related products eventually rise will depend on the importance of the excise commodity in their manufacture (whether as a factor of production or as a means of distribution) and how much of the intermediate product price increase is passed on to the final consumer.

3.11 The Treasury recognise that there will be secondary price effects from changes in taxation. In their indirect taxation model, however, only direct price effects are considered. For alcoholic spirits and tobacco, secondary effects are of little significance since only a small proportion of tax revenues accrue from producers (between 1% and 8% of respective total tax revenues). With petrol, however, the secondary price effects may be more significant. It is estimated that 36% of all excise duty revenues from this source are derived from purchases by intermediary users in both the public and private sectors.

3.12 Petrol is not normally used directly in the production of other goods, but is a subsidiary input, necessary for the operation of an enterprise. In the private sector, it may be used in company cars or light vans to facilitate sales, delivery and distribution of final products. Additional excise duties on petrol will therefore add to operating costs of many firms which, we would expect, will eventually be passed on to final consumers. Consumption of petrol by the public sector is unlikely to lead to an increase in the price of a specific good, but may be reflected in increased local or central government taxation.

3.13 The service sector is a significant purchaser of road vehicles (for example, it accounted for 22% of all new cars purchased in the 12 months to July 1983) and, we would therefore expect, a major user of petrol. Most notable sub-sectors in this respect include distributive trades and banking, insurance and finance. In manufacturing industry, however, purchases of motor spirit (which includes derv) amount to only 0.8% of total expenditure, and petrol would only account for 25-30% of this. Transport costs in this sector now account for a very small proportion of overall operating costs and generally amount to less than 3% of turnover.

3.14 An illustration of the declining importance of petrol in production is given by the fact that petrol has a weight of only around 0.15% in the producer's index of requirements for production (which includes distribution). On average, therefore, the effects of an increase in petrol duties on the prices of most manufactured products would be slight.

3.15 Quantifying indirect price effects, following a 5% increase in petrol duties and a corresponding price rise of 2.40%, the indirect RPI effect would amount to a marginal 0.0036%. Direct and indirect effects together therefore indicate arise of 0.1186% in the RPI, following a 5% increase in petrol duties.

3.16 In conclusion, increases in tobacco duty have a much more significant impact on the RPI than three of the four other excise goods considered - spirits, beer and wine. However, the inflationary effects of increasing petrol or tobacco taxation are very similar and amount to approximately one-ninth of a percentage point being added to the Retail Price Index following a 5% increase in duties.

Notes:

(1) Based on 1982 expenditure levels.

(2) This weight applies to petrol and oil together in the RPI and will correspondingly slightly over-estimate the inflationary effect of petrol price rises alone.

(3) This represents the range of product price increases following an increase in excise duty depending on whether sales are through an off-licence or through a public house, restaurant or similar.

(4) Estimates are sensitive to the number of decimal places allowed for in calculations of the price breakdown of excise products. In this paper, such calculations are made to two decimal places.

(5) Given a range of price increases have been derived, the inflationary effect is calculated on the basis of an expenditure-related breakdown of the RPI weights, which are then applied to the different product price rises.

4.0 INDIRECT TAXATION AND TAX REVENUES

4.1 While Section 3 describes the relative inflationary effects of increasing indirect taxation on each of the various excise goods, it side-steps the consequent effects on consumption patterns, through product substitution and income effects, following any price increase. Such changes could have important repercussions on the net marginal tax revenue accruing to the government from any change in taxation on a particular good.

4.2 Adopting a different approach, the revenue-earning potential of each of the excise goods can be analysed, and due consideration afforded the substitution and inflationary effects that will result. In the following scenario, it is assumed that the government wish to raise a standard sum in tax revenue (taken to be £50m) from each of the excise sources. The consequent effects on inflation, excise duties and consumption are noted.

4.3 The extent of changes in consumption patterns, following an increase in the price of a product, will depend on the elasticity, or price responsiveness, of demand for the good in question. Estimates of elasticities applied in this paper are those calculated by the Treasury and updated from the article "The Change in Revenue from an Indirect Tax Change" (Economic Trends, March 1980) (Table 6).

Table 6

Own-price and Income Elasticities

	Own-price elasticities	Income elasticities
Tobacco	-0.5	0.6
Spirits	-1.3	1.75
Beer	-0.2	0.7
Wine	-1.1	2.5
Petrol	-0.2	0.3
VAT	-0.6	1.2

4.4 The estimates of own-price elasticities suggest that demand for both beer and petrol is highly inelastic i.e. quantities consumed vary only marginally following changes in their prices, while the demand for spirits and wines is highly elastic and will therefore be very sensitive to price changes.

4.5 Required increases in the respective excise duties on tobacco, spirits, beer, wine and petrol to produce a net amount of £50m in additional tax revenues, with the corresponding effects of each on the RPI, are given in Table 7.

Table 7

Effects on excise duties and the RPI
(£50m increase in tax revenues)

	Change in duty %	Change in RPI %
Tobacco	2.883[1]	0.0638
Spirits	11.726	0.1090
Beer	3.780	0.0513
Wine	14.304	0.0443
Petrol	1.160	0.0268

4.6 In Table 7, the RPI effects include only first round product price changes i.e. the impact from the change in the prices of the excise good themselves. This then omits subsequent increases in the prices of goods dependent on the excise goods, whether in production, distribution or retailing. To calculate 'secondary inflationary effects' would require detailed, uncollated information on the importance of the excise commodities in the production of other final goods and services and the individual weights of the same used in the construction of the RPI.

4.7 Raising £50m from the excise goods could apparently have very mixed effects. To minimise the impact on both the RPI and excise duties while raising the necessary tax revenues, increasing petrol duties by 1.16% would appear to best serve this purpose. This is a result of petrol accounting for a larger proportion of consumers' expenditure than the other products. This then presents a larger taxable base for the government.

4.8 While the RPI effects are fairly non-controversial, any potential percentage change in excise duty should be considered in relation to the current tax position of the individual products in question, rather than in absolute terms or in isolation. For example, the required increase in wine duties is significantly greater than the necessary increases in any of the other revenue-earning sources to raise £50m. However, as

Table 3 illustrated, wine is currently more lightly taxed than any of the other excise goods considered. Similarly, any increase in beer duties would be from a low base.

4.9 Corresponding to the individual product price increases, there would also be changes in quantities consumed of the respective goods. Table 8 shows that while the effects on consumption of petrol and beer would be fairly insignificant, the price elasticities of spirit and wine consumption indicate that the suggested increases in excise duties would cause demand to fall sharply.

Table 8

Changes in Consumption

	Change in Quantity consumed
Tobacco	-0.9%
Spirits	-7.63%
Beer	-0.25%
Wine	-3.82%
Petrol	-0.12%

4.10 From the foregoing analysis, therefore, to raise an additional £50m in tax revenues, the impacts on the respective excise goods can be summarised as follows:

(i) Petrol duties would need to rise by 1.16% causing consumption to decline only marginally (0.12%) and overall price inflation to rise by a negligible 0.0268%. This would appear to be the most effective means of raising £50m in additional tax revenues, from the options considered.

(ii) The impacts on the RPI of raising £50m from increased beer or tobacco duties are very similar, at 0.0513% and 0.0638% respectively. Beer duties would rise by 3.78% and consumption would correspondingly fall by 0.25%. The specific element of tobacco duties, on the other hand, would have to necessarily rise by a smaller amount (2.883%), but this would correspond to a greater fall in consumption of 0.9%

(iii) Very large percentage increases in spirit or wine duties, amounting to 14.304% and 11.726%, would have to be incurred to raise an additional £50m in tax revenues. The extent of the corresponding increases in product prices would then lead to a substantial fall in consumption and fairly significant increases in the rate of price inflation.

Government Revenues and VAT

4.11 A subsidiary objective of this paper is to examine the likely effect on the rate of VAT that is levied (and subsequent effects on the RPI) following an attempt to raise an equivalent sum in tax revenue to that gained from each of the excise goods above.

4.12 Value Added Tax is a general sales tax levied on a wide range of consumer products. Any increase in VAT will therefore affect the prices of a number of products, each of which will, in turn, increase the rate of general price inflation. The estimated weight of goods subject to VAT in the construction of the RPI in 1984 is 57.2%.

4.13 Total receipts from VAT in 1983-84 are estimated to amount to £15.5 billion. It is important to realise, therefore, that an increase in receipts of £50m is very small in relation to the overall earnings. This is likely to have repercussions on the margin of error that will be built into our calculations.

4.14 However, it is estimated that to raise an additional £50m in VAT receipts, this is likely to require an increase in the sales tax of 0.4%, bringing the rate at which VAT is levied to 15.06% from the 1984 levels.

4.15 The corresponding increase in the RPI will be approximately 0.031%. This result is very similar to the increase in inflation expected to result from the increase in petrol duties required to raise an additional £50m. In comparison, the effects on the RPI from the other excise goods were between around twice and three times this figure (Table 9).

Table 9

RPI effects of raising
£50m additional tax revenues

	Estimated RPI increase
Tobacco	0.0638%
Spirits	0.1090%
Beer	0.0513%
Wine	0.0443%
Petrol	0.0268%
VAT	0.031%

Notes:

(1) The change in duty relates to the specific duty component of tobacco taxation.

5.0 INDIRECT TAXATION AND ITS EFFECT ON GOVERNMENT EXPENDITURE AND REVENUE

5.1 The impact of any fiscal change that has repercussions on the rate of inflation cannot be seen in isolation. The government have several social and welfare payment commitments, the cost of which would increase if inflation were to rise. Additional costs to the government in this respect must therefore be deducted from any marginal revenue gain that follows an increase in indirect taxation on the excise goods. In this section, the true net revenue gain to the government from increasing respective levels of indirect taxation, either at a rate equivalent to the general increase in prices or by an amount that stands to accrue £50m in marginal revenue, is calculated for each of the excise goods.

5.2 An increase in the RPI would affect both government expenditure levels and government revenues. Firstly, there would be direct costs to the government resulting from increased payments on welfare benefits. Secondly, there would be opportunity costs in terms of tax revenues foregone from having to increase pesonal tax allowances.

5.3 Government policies and commitments on various forms of public spending are well-publicised. Longer term benefits, including retirement pensions, are index-linked to the rate of increase of prices. With other social security payments, such as unemployment benefit, supplementary benefit and maternity allowances, there is no such commitment. The Social Security (No. 2) Act 1980 allows the government to increase payments by five percentage points less than the rate of inflation, if so desired. While this right was exercised in 1982, recipients were recompensed in the following year. Given political and social pressures, it would therefore appear likely that future increases in social security payments will generally keep pace with inflation. Similarly, although there is no index-linked commitment from the goverment on child benefit payments, they have been rising steadily since 1979 and are likely to continue to be maintained in real terms.

5.4 As regards personal taxation, rates of personal allowances for married or single people as well as the lowest and highest tax thresholds are indexed such that they cannot be increased by less than the increase in the RPI over the previous year. This followed the Rooker-Wise amendment to the Finance Act 1977. The amendment can be over-ridden, but only with the express consent of Parliament. Although indexation of personal allowances was suspended between 1981 and 1983, these have since been realigned with rates of inflation and the latest Budget confirms the government's intent to continue with indexation of both personal allowances and tax thresholds.

5.5 For our purposes, social benefits paid by the government have been taken to include unemployment benefit, supplementary benefit, child benefit and retirement benefit. The total cost of their provision amounted to £25.548 billion in the financial year 1982-83. With regard to personal allowances, the cost to the government of providing single and married personal tax allowances amounted to £16.1 billion in 1983-84. Following a 0.1% increase in the RPI, therefore, the corresponding cost to the government would be £41.648 million in a full fiscal year. The implication is that there would be significant costs to the public sector, as well as the private sector, of higher inflation rates. In addition, any such estimates in this paper will be under-estimates, given the date of the expenditure statistics, the omission of costs relating to indexation of lower and higher rate tax thresholds, and the possibility of a relationship existing between inflation rates and interest rates, thus increasing the cost of borrowing both to the government and the private investor.

Indexation

5.6 If the rate of change of excise duties was to be indexed to the annual rate of inflation, and consequently (as was assumed in Section 3) a flat rate increase on duties of 5% was to be invoked in the forthcoming Budget, an estimate of the indirect costs to the Exchequer is given in Table 10.

Table 10

Costs incurred by the Goverment following a 5% increase in excise duties

	£m	
	first year	full fiscal year
Tobacco	9.71	46.23
Spirit	4.07	19.37
Beer	5.97	28.40
Wine	1.36	6.50
Petrol	10.06 (1)	47.895

PEIDA

5.7 The first year costs of an increase in indirect taxation are much less than in a full fiscal year. Social benefit payments are up-rated in November by the rate of inflation in the 12 months to May of that year. By the month of May, the impact of higher excise duties introduced in the Budget in March is likely to be fully reflected in a higher inflation rate. However, the period over which the increased payments would have to be made amounts to only approximately 34% of a full year. Estimates in Table 10 therefore show costs in the first year of the new fiscal regulations and in a full year, ignoring the likelihood of seasonality in employment opportunities increasing that proportion of annual unemployment benefit and supplementary benefit payments made in the winter months relative to the summer months. Indexation of personal allowances poses no additional costs to the Chancellor in the first year of the change in tax structure.

5.8 Given the gross tax revenue expected to accrue directly from the 5% increase in duties on the excise goods, the net revenues gained by the government in the first year and in a full fiscal year, after offsetting the indirect costs, are shown in Table 11. While tobacco and beer appear to have very similar revenue-earning capabilities, for the reasons given earlier, increasing petrol duties by the same amount produces over four times their net revenue. Similarly, spirits and wine would appear to have very low net revenue-earning capabilities.

Table 11

Net marginal tax revenues following a 5% increase in excise duties

	first year	full fiscal year
	£m	
Tobacco	71.84 (2)	40.32
Spirits	21.93	6.63
Beer	55.53 (2)	38.10
Wine	16.64	11.50
Petrol	204.94	167.105

Raising a standard sum

5.9 An alternative possibility with regard to increasing revenues from indirect taxation would be to raise a specific sum in tax revenue from each of the excise sources. The inflationary consequences of this policy (taken to be a standard sum of £50m from each) were studied in Section 4.

5.10 Under the same conditions and assumptions that applied in the above estimation of indirect costs and net revenues, Table 12 presents the possible first and full year costs involved in attempting to raise such a sum from the five excise goods and VAT. Table 13 shows the corresponding net tax revenues that would then accrue to the government.

Table 12

Costs of raising an additional £50m from each revenue source

	£m first year	£m full fiscal year
Tobacco	5.58	26.57
Spirits	9.53	45.40
Beer	4.49	21.365
Wine	3.88	18.45
Petrol	2.34	11.16
VAT	2.71	12.91

Table 13

Net revenues from an attempt to raise £50m from each revenue source

	£m first year	£m full fiscal year
Tobacco	39.42 (2)	23.43
Spirits	40.47	4.60
Beer	45.51	28.635
Wine	46.12	31.55
Petrol	47.66	38.84
VAT	47.29	37.09

5.11 The results highlight a consequence of increasing indirect taxation easily overlooked in the example of indexation of excise duties. The offsetting costs of increasing indirect taxation, in terms of increased government expenditure and foregone government revenues, appear to vary significantly between different sources of tax revenues. The least inflationary, and therefore the most 'cost effective' means of raising additional tax revenues would appear to be by increasing petrol duties or the rate at which VAT is levied in preference to increasing taxation on wine, tobacco, beer or spirits. While the offsetting costs would amount to 22% of the revenue gain from petrol and 26% from VAT the clawback amounts to 37% from wine, 43% from beer, 53% from tobacco and 91% from spirits. This is a reflection of the current tax position of the individual products and the sizes of their taxable bases.

Notes:

(1) The inflationary effect is based on the direct price effect alone.

(2) Due to procedural arrangements regarding receipt of excise duties, there is an estimated shortfall of £5m in first year revenues from increased tobacco and beer duties relative to normal full year benefits.

6.0 THE EFFECT OF THE RPI ON WAGE SETTLEMENTS

6.1 Steadily rising standards of living, changing attitudes and increasing organisation of labour in the past few decades have all contributed to growing resistance, not only to cuts in money wages, but possibilities of cuts in real wages.

6.2 Monetarists suggest that employees do not suffer from the 'money illusion', recognising the full effects of inflation on their earnings. Consequently, any increase in the price level will be incorporated into wage claims. The transitional period during which wage expectations are revised in light of such price changes is assumed to be a very short period of time.

6.3 Keynesians believe that in addition to keeping real wages constant, unions have aspirations for real growth in earnings. They are assumed to form some target real wage on the basis of the behaviour of real wages and rate of growth of productivity and output in the recent past.

6.4 From the above, a model of the effects of prices on wage settlements is likely to include variables on the following:

(a) past prices
(b) expected future prices
(c) real earnings
(d) taxes (possibly)
(e) unemployment.

6.5 One example of such a model is that used by the NIESR. Their Keynesian-based model finds that the variables (a)-(e) are of significance to ultimate wage settlements in the following ways:

(i) recent trends in inflation are assumed to have significant effects on wage settlements over four time periods;

(ii) the coefficient on expected future prices, implying the first round effect of inflation on wage settlements is 0.759. The lag to this initial impact is about six months. In addition, they estimate that the full effect of any price change is apparent in wage settlements within two years;

(iii) the real wage target is presently taken to be 2%;

(iv) taxes, when tested in their model, were found to be of little significance to overall wage settlements; and

(v) the effect of unemployment is included in the coefficient of the real wage target, which is moderated in light of both the level of and movements in unemployment.

6.6 Applying the assumptions of this model to the aggregate increase in the RPI found from a 5% rise in excise duties, we would expect an almost immediate increase (within six months) of around 0.27% in wage settlements. (The individual effects would vary from 0.012% for wine to over 0.08% following the petrol and tobacco increases). In addition, this would only account for part of the impact on earnings. Any such increase in the RPI will have a lasting effect of up to five years in total - one year presently and four years retrospectively. Beyond the second year, however, the impact may be slight. Within the first two years of a rise in taxation, the NIESR model estimates that wage settlements will fully reflect the consequent increase in prices brought about by the tax increase i.e. wage settlements would rise by the full 0.3563% increase in the RPI.

6.7 These results differ from a monetarist analysis only in the length of the lag before a change in prices is fully reflected in higher wage settlements. Monetarists would also treat unemployment as an independent variable and there would be no assumption of a real wage target. Thus, the effect of a change in prices would be more direct and more instantaneous in their model.

6.8 In conclusion, there appears to be a broad consensus between both schools suggesting that wage bargaining is extremely sensitive to changes in prices and that, usually over a fairly short period of time, increased prices are fully reflected in changes in money wages. Moreover, these effects will be perpetuating, as expectations are revised upwards and a wage-price inflationary spiral is set in motion, inhibited, but perhaps only marginally, by the possibility of growing unemployment.

7.0 CONCLUSIONS

7.1 The impact on the RPI of increasing indirect taxes can be significant and varies considerably between different excise goods. This is a result of two factors:

(a) the extent to which such goods are currently taxed; and

(b) the weight each is attributed in the RPI (which, in theory, should provide a proxy for the product's importance in consumer spending patterns).

7.2 Correspondingly, it would appear that those excise goods whose prices presently have the most sensitive relationship with the RPI are petrol and tobacco. Inconsequently, these products also offer the largest taxable bases to the government of the five excise goods considered. As a result, petrol and tobacco duties are substantial and tempting components of the government's fiscal armoury. However, as well as the positive pecuniary advantages to the government of any increase in taxation, factors that may negate, or at least reduce, these advantages must also be taken into consideration. From a purely fiscal viewpoint, this paper has shown that the magnitude of the indirect costs incurred as a result of a change in taxation may call into question the intuitive 'cost effectiveness' of such a measure.

BP/009

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RECORD OF A MEETING HELD AT 2.30 PM ON 12 FEBRUARY 1986
IN HM TREASURY

Those present:

Chancellor of the Exchequer
Minister of State
Mr Romanski
Mr H Davies
Mr Jefferson Smith - Customs & Excise

Mr Cameron - Chairman, Tobacco Advisory Council (TAC)
Mr Reid - Chairman, Imperial Tobacco
Mr Simpson - Chief Executive, TAC

Mr Reid thanked the Chancellor for meeting the TAC. As Chairman of Imperial Tobacco he hoped the Chancellor would understand why he was so unhappy, following the Secretary of State for Trade & Industry's announcement that day on the Hanson bid for Imperial and Imperial's bid for United Biscuits. The Chancellor said it would not be proper for him to comment on this matter, which fell to the Secretary of State for Trade & Industry.

2. Mr Cameron said duty increases on cigarettes over the past few years had been well in excess of the RPI. UK demand was the most depressed in the developed world. The industry was subject to unceasing attacks by the GMC and the increasingly political BMA. The smoker was discriminated against. Though the Chancellor had been even-handed in 1985, the increase had still been between 1¾ and 2 times inflation. Simple revalorisation would give the industry a chance to defend itself against low cost, marginal producers, like the Germans who spread their overheads to relieve their problem of chronic over-capacity. Imports now took around 8 per cent of the market. Higher prices would drive customers to commodity cigarettes.

3. Mr Simpson said the industry felt beleaguered. If the duty increase was over-stretched it would take several years to recover. It took a long time to recover from the 1981 increase. Tobacco companies now owned companies in many other sectors. They all relied on the cash-flow from the total business.

4. The Minister of State asked about the age profile of cigarette smokers. The Chancellor said recent figures suggested the incidence amongst the young was quite high and rising. Mr Reid said this confirmed the TAC's view. It was a strange quirk in the current situation and DHSS had belaboured the TAC with these recent figures. The 16-20 year old age group showed a marginal increase against the trend. He thought the reason was the young increasingly wanted to show their independence. Mr Cameron said the young only formed 1 per cent of the market. It was hard to see the figure getting much lower. The peak area for smokers was 25-39 years old. They tailed off after 60. The UK was no longer a high-smoking country, with only 34 per cent of the population smoking. Most countries had 44 cent smoking and the Belgians had 50 per cent. So there had been a startling reduction in the UK.

5. The Chancellor said the TAC rightly attributed the decline to a combination of large duty increases and an effective progaganda campaign against smoking. It might be that youngsters were less influenced by propaganda. Mr Reid said for youngsters death was only something on television.

6. Mr Reid said the TAC had had a little work done by PEIDA. In obtaining £50 million extra excise duty from tobacco, the RPI effect raised public expenditure by £26.6 million, leaving net revenue of £24.4 million. The comparable net revenue for beer was £28.6 million, for petrol £38.8 million and for VAT £37.1 million. So raising tobacco revenue was not such an efficient means of revenue-raising as beer, petrol or VAT.

7. The Chancellor said the impact effect of cigarette duty on the RPI was a bit on the high side. But he would be interested

to see the figures Mr Reid had produced. Petrol was clearly lower because large amounts were bought by companies, whose expenditure did not figure in calculating the RPI.

8. Mr Cameron said 60,000 jobs had been lost in the tobacco industry over the past 5 years. Most factories had 3,000-4,000 employees, but in Ballymena, for example, 25,000-30,000 people worked in cigarettes and the town would die if they closed. The decline had passed the stage at which further blows could be borne without closure. BAT exported £400 million worth of tobacco products each year. Patriotism led BAT to produce in the UK, but they could just as easily produce in Germany or Holland if the UK climate became very hostile. The constant propaganda against smoking exerted undue influence and repeated the same diet, though he did not wish to denigrate in any way the many respected figures and bodies involved. He simply hoped they did not have undue influence on duty decisions.

9. Mr Jefferson Smith asked about duties on pipe tobacco and cigars. Mr Reid said the TAC had greatly valued the freezing of cigar duty in 1985. This was just beginning to have a favourable impact on consumption and had arrested the declining trend. He had seen Mr Rifkind the previous day, as Chairman of Imperial Tobacco, to discuss their major investment in a cigar factory in Glasgow. They were planning another, but the whole future of the operation depended on a viable industry.

10. The Chancellor said constructing a Budget was an especially difficult task, all the more so given current oil price movements. But he would take the TAC's points carefully into account.

PWO.

P WYNN OWEN
14/2/86.

Copies to:
PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
Mr Monger
Mr Romanski
Mr Murray
Mr Cropper
PS/Customs & Excise
Mr Jefferson Smith - Customs & Excise

13 February 1986

ANNEX A
BEER DUTY

Annex A.

THE BREWERS' SOCIETY

BEER DUTY

Duty and Volume

1. Between May 1979 and March 1985, beer duty increased by 142%, which is over twice the increase in the RPI (70%). This is on top of the general increase in the rate of VAT from 8% to 15% in June 1979. The duty increase in March 1985 was for the sixth year in succession, a sequence unparalleled in our history.

2. These tax increases have had most impact on the least affluent members of the community, who have a greater propensity than others to drink beer instead of wines or spirits, and who have been hit hardest by the recession.

3. These increases have also had a demonstrable effect on the level of beer consumption, which started to decline within months of the 1980 budget. Although the rate of decline has now slowed down, the beer market shows no sign of participating in the general economic recovery.

4. In contrast, the duties on wines and spirits have been increased by considerably less than the RPI (as shown in Annex A). In the case of table wine, this took place against the background of a rapidly increasing market, but we appreciate the constraints imposed on the UK by the E.C.J. decision.

5. The duty on spirits, however, has been increased by only 51% over the same period as is mentioned in paragraph 1.1.

6. The purpose of this action is believed to have been to help Scotch Whisky sales and hence production, but the trends in the table below suggest that the

principal effect has been to encourage imported spirits. This growth in imported spirits clearly implies that jobs have been exported. Moreover, the relative cheapening of spirits as against beer must have had a depressive effect on the consumption of beer.

Consumption of Spirits

(Percentage change on previous year)

Calendar Year	Scotch Whisky	Imported Spirits	Total Spirits
1980	-4.5	-9.7	-5.6
1981	-4.9	-6.0	-5.2
1982	-6.2	-1.7	-5.7
1983	-0.6	+4.5	+2.8
1984	-2.5	~~+9.2~~ +4.4	~~+0.6~~ -0.5

Effect on the Brewing Industry

7. Over 95% of beer sold in this country is UK produced, utilising UK produced raw materials and containers. In comparison 8% of wine (including fortified and made wine) and ~~75%~~ 76% of spirits are home produced.

8. The Society has previously observed that the decline in the beer market from its peak in 1980 - the annual loss now stands at over 4.5 million barrels (or 11%) - is equivalent to the total production of one of the national brewers. Well over a dozen breweries have in fact been closed, with a loss of some 13,000 jobs.

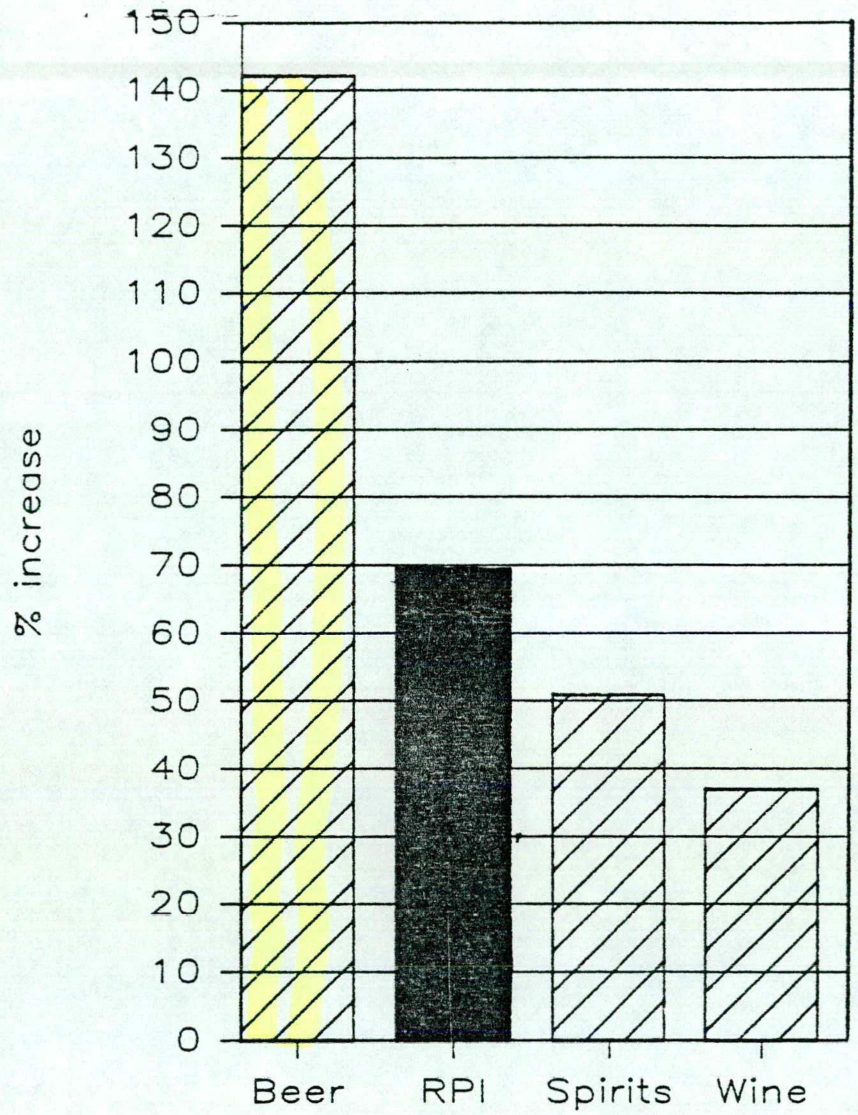
9. Pubs and clubs such as working mens' clubs - which employ 400,000 people - are largely beer orientated and their viability depends to a substantial extent on the sale of beer, rather than of other drinks and products. The high price of beer and the decline in its consumption has been particularly relevant to establishments such as these.

The decline in beer sales is confined to the kinds of beer they sell - that is draught beer and beer in returnable bottles, as against the kinds of packaged beer sold in supermarkets and similar outlets - and for these former kinds of beer the decline in the market since 1980 stands at 15%.

October, 1985.

Increases in excise duties and RPI

Between May 1979 and March 1985



Annex B

ANNEX B
ACTUAL + REAL VALUES OF BEER DUTY 1966-1985

TABLE OF ACTUAL AND REAL VALUES OF BEER DUTY, 1966 - 1985

p per pint at 1037°

Date of change	Actual	Real at April 1985 prices (1)
July 1966	4.25	26.1
Nov 1968 (3)	4.7	26.3
April 1973 (2)	3.1	12.6
March 1974	4.0	14.1
April 1975	5.9	16.4
April 1976	6.8	16.6
Jan 1977 (3)	7.5	16.3
March 1980	9.1	13.0
March 1981	12.6	16.6
March 1982	14.3	17.1
March 1983	15.1	17.0
March 1984	16.8	18.0
March 1985 (4)	18.1	18.1

(1) Based on first month in which the RPI reflected the duty change.

(2) Duty reduced when VAT introduced.

(3) Regulator used and consolidated next Budget.

(4) Although the duty was increased significantly more than revalorisation in 1985, the real level of duty did not rise significantly when measured in April because of the sharp rise in the rate of inflation between December 1984 and April 1985.

FROM: H J DAVIES
DATE: 14 FEBRUARY 1986

CHANCELLOR'S MORNING MEETING - **47TH MEETING**

NOTE FOR THE RECORD

Present: Chancellor of the Exchequer
Financial Secretary
Minister of State
Economic Secretary
Mr Cropper
Mr Lord
Mr Davies

1– ~~R~~
2– ~~JK~~
3– [illegible]

1. PETROL TAX

Ministers discussed the political implications of raising petrol duty.

The Chancellor noted that there was a significant difference of opinion among backbenchers about the political wisdom of raising petrol duties at the present time. It was clearly acceptable to do something additional on petrol in order to leave Vehicle Excise Duty unchanged, but the question was whether we should do, as presently planned, rather more and not revalorise drinks duties.

The Financial Secretary thought that the politics argued for an increase in petrol duty if we could have nothing on beer as a result. The Economic Secretary agreed. As long as we were not too greedy we could afford some increase in petrol duty. He favoured the current proposal. Similarly, the Minister of State thought we should go ahead.

In further discussion it was noted that there was no certainty of a pump price increase of the same size as the duty change if the oil companies had maintained thick margins ahead of the Budget. The Budget Speech could refer to the oil price fall and lack of forecourt adjustment, if that was correct. And perhaps not refer to a pence per gallon increase except to say that the Chancellor presumed the oil companies would absorb the rise in duty.

HJD

H J DAVIES

Chancellor

b/f 21/2

PA

covering CONFIDENTIAL

FROM: R P SHORT

DATE: 4 February 1986

cc As attached list

MANUAL OF ILLUSTRATIVE TAX CHANGES

I attach a revised version of the 1986 tax and national insurance ready reckoner. This now shows the effects of indexation and revalorisation based on the December 1985 RPI increase ie 5.7 per cent over the previous year.

R P Short

R P SHORT
ETS Division

191/17

MANUAL OF ILLUSTRATIVE TAX CHANGES

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MANUAL OF ILLUSTRATIVE TAX CHANGES

CONTENTS

Inland Revenue Taxes

Customs and Excise Taxes

National Insurance Fund

HM TREASURY
ETS Division
February 1986

1. INCOME TAX

INDEXED LEVELS OF INCOME TAX ALLOWANCES AND THRESHOLDS

Allowances	1985-86 Current Levels £	1986-7 Indexed Levels (1) £
Single and wife's earned income allowances	2,205	2,335
Married allowance	3,455	3,655
Additional personal and widow's bereavement allowance	1,250	1,320
Single age allowance	2,690	2,850
Married age allowance	4,255	4,505
Aged income limit	8,800	9,400

Rates per cent	Bands of taxable income 1985-86 Current Levels £	1986-87 Indexed Levels (1) £
30	0 - 16,200	0 - 17,200
40	16,201 - 19,200	17,201 - 20,400
45	19,201 - 24,400	20,401 - 25,900
50	24,401 - 32,300	25,901 - 34,300
55	32,301 - 40,200	34,301 - 42,700
60	over 40,200	over 42,700

(1) Based on the 5.7 per cent year-on-year increase in the Retail Prices Index to December 1985, and rounded up as laid down in the Finance Act 1980.

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Cost of 5.5 per cent indexation at 1986-87 income levels

	Full Year	1986-87 Revenue effect
	£m	£m
£130 increase in the single person's and wife's earned income allowance	505	405
£200 increase in the married man's allowance	615	490
£70 increase in the additional personal and widow's bereavement allowance	10	8
£160 increase in the Single Age allowance	55	43
£250 increase in the Married Age allowance	70	57
£600 increase in the Aged Income Limit	15	12
£1000 increase in the Basic Rate Limit	125	70
Increase in the further higher rate thresholds	95	50
Total cost of indexation	1490	1135

GENERAL NOTE: The costs are based on the levels of allowances etc shown in the preceding table, and are estimated on the basis of the NIF, Holly 47. The changes are cumulative, eg the cost of the increase in the aged income limit is on top of the increase in both the ordinary and age allowance immediately above.

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INDEPENDENT CHANGES	Full Year	1986-87 Revenue effect
Rates		
Change basic rate by 1p (1)	1175	975
Change all higher rates by 1p	115	55
Allowances(2)		
Change single and wife's earned income allowance by £100	365	290
Change married allowance by £100	320	250
Change single age allowance by £100	35	27
Change married age allowance by £100	27	22
Change aged income limit by £200	4	3
Higher Rate Bands		
Change all higher rate thresholds by 1% of basic rate band:		
increase (cost)	28	15
decrease (yield)	29	16
Change all higher rate threshold by 1%:		
increase (cost)	33	18
decrease (yield)	34	18
Change all higher rate thresholds by 10% of basic rate band:		
increase (cost)	260	140
decrease (yield)	310	165
Change all higher rate thresholds by 10%:		
increase (cost)	300	160
decrease (yield)	375	200

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Costs of tax changes over and above indexation at 1986-87 income levels

	Full Year	1986-87 Revenue effect
PACKAGES	£m	£m
1% above indexation on all statutory allowances	215	175
1% above indexation on all statutory allowances and thresholds	250	190
10% above indexation on all statutory allowances	2100	1700
10% above indexation on all statutory allowances and thresholds	2400	1850

GENERAL NOTES: All absolute changes are calculated on top of the indexed levels of allowances and thresholds shown in table 1.1. Percentage changes unless otherwise stated are based on 1985-86 levels. Costs are based on the NIF, Holly 47. Please refer to Inland Revenue for exact costs of packages and information on taxpayer numbers and staffing effects.

(1) The effect would be smaller if introduced at the same time as an increase in one or more thresholds, but these amounts are broadly correct for rate changes on top of allowance increases up to 5 per cent above indexation. The costs include the effect of the change of receipts of Advance Corporation Tax and on consequent liability of Mainstream Corporation Tax; this effect is £13 million in a full year and £130 million in 1986-87.

(2) The estimated effects for allowance changes are shown to the nearest £5 million (to avoid undue magnification of rounding errors when considering large changes), but the figures should not be assumed to be accurate to this degree.

G A KEENAY
Inland Revenue
Ext 7390

2. CORPORATION TAX

The 1984-85 Finance Act set a rate of 40 per cent for profits arising in the year 1985-86.

Advance corporation tax under the imputation system is due at the rate of 30/70 in respect of distributions made by companies during the year to 31 March 1986.

The estimated yield for 1985-86 is £10600 million (including £550 million on gains and £3800 million ACT).

The effect on corporation tax receipts of a reduction in the rates by 2 per cent to apply to profits arising in the 1985-86 financial year is estimated as:

£ million

	First Year 1986-87	**Full Year assuming income levels of 1985-86**
Main corporation tax rate	370	610
Small companies rate	32	60

Most of this change would affect tax payable on 1 January 1987 and paid for the most part in the following two months.

For the effect of a change in the rate of ACT see Section 1 (page 1.4).

The quarterly path of a 2 per cent change in the planned rate of Corporation Tax (including small companies rate)(1) from 1 April 1985 is estimated to be:

£ million

	Q2	**Q3**	**Q4**	**Q1**	**Total**
1986-87	5	17	120	260	402
1987-88	57	68	164	423	712
1988-89	68	79	176	487	810

A GREENSLADE
Inland Revenue
Ext 7423

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(1) These figures ignore any possible associated change in the imputation system.

3. CAPITAL GAINS TAX

There is a liability to tax, under CGTA 1979 and subsequent Finance Acts, on capital gains realised on the disposal of assets. Tax payable by companies is accounted for within corporation tax. Capital Gains Tax only comprises payments for individuals and trusts.

2. There are various types of exemptions and reliefs from the tax. Examples are:

Exemption of gains arising on the disposal of

- a person's only or main residence;
- gilt edged securities and qualifying corporate bonds;
- National Savings Certificates and such like;
- Chattels which are wasting assets, or whose value is less than £3,000 on disposal;
- life assurance policies.

Exemption of:

- gains accrued but unrealised on death;
- compensation or damages for wrong or injury;
- gains of approved pension schemes, charities, authorised unit trusts and investment trusts, other specified types of organisations.

Reliefs include:

- "rollover" reliefs eg on reorganisation of share capital, where gains are used to replace business assets, for various gifts (including transfers out of trust);
- deduction of up to £100,000 on disposal of a family business on retirement.

Capital losses (including such losses brought forward) can be offset against realised gains. Companies can offset trading losses against capital gains.

In calculating chargeable gains, acquisition costs are indexed (using the Retail Prices Index) from March 1982, or from the date of aquisition if later.

4. The rate of tax on net chargeable gains is 30 per cent.

5. For individuals and trusts, tax is calculated on the extent to which the net chargeable gains in any financial year exceed an indexed annual exemption - as follows:

Gains realised in	**Exemption for**	
	Individuals	**Trusts**
1984-85	£5600	£2800
1985-86	£5900	£2950
1986-87 (if fully indexed)	£6300	£3150

6. Estimated yields in 1986-87 are:

	£m
Capital Gains Tax (individuals and trusts)	1000 [1]
Company gains (within corporation tax)	775 [1]

7. For Capital Gains Tax (ie on individuals and trusts) the liability on gains realised during any financial year becomes payable, at the earliest, on 1st December of the following year. For practical reasons, however, assessments in respect of any year are finalised only over several subsequent years so that receipts "for" a particular year are slow (and receipts "in" a year are in respect of gains made in several preceding years).

8. In estimating the "full year" effects of changing CGT rules, the FSBR convention (see FSBR 1981-82, page 9, note 2) is to apply an estimated proportionate cost (derived from estimates of the eventual yield for the first year to which the change applies fully) to the forecast yield in the year in which the Finance Act containing the change is enacted. On this basis, if selected changes were enacted during 1986-87, revenue effects would be:

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(1) Not for publication at this stage.

Change	**Estimated "full year" effect**			**Effect in 86-87**	**Effect in 87-88**	
Annual exemption increased to £7,000 (from £6,300)	CGT cost		£30m	nil		£12m cost
There is no annual exemption for companies						
Rate changed ±5 per cent (ie to 35 per cent or 25 per cent)	CGT yield	±	£170m	nil	±	£70m
	CT yield	±	£130m	nil	±	£50m

R V S QUINN
Inland Revenue
Ext 6314

4. STAMP DUTIES

Stamp Duty is charged under numerous heads. The most important covers the ad valorem duty on conveyances of real property and transfers of stocks and shares which is a straight 1 per cent for all transfers of stocks and shares and conveyances of real property, with low value transfers (up to £30,000) of the latter subject to a nil rate.

2. Estimated yield in 1986-87. £1400 million[1]. The main components are:

		£m
(a)	Conveyances (1 per cent) of which duty on residential property £420 million	555
(b)	Transfers of stocks and shares (1 per cent)	570
(c)	Leases (various rates)	45
(d)	Companies' Share Capital Duty (1 per cent)	150
(e)	Other	90

3. Because of the effect on demand, doubling the duties itemised in paragraph (2) would in general, less than double the yield shown in a full year; similarly halving the rates would not reduce the yield by as much as a half.

The cost of raising by £5,000 the thresholds for exemption from duty for small conveyances, would be £80 million in a full year. If the new thresholds took effect from March 1986 the cost in 1986-87 would be £75 million.

4. Any increase in stamp duties on conveyances of property or transfers of shares will lead to some reduction in yield of capital gains tax partly since stamp duties are an allowance expense against capital gains tax but also because of the demand effects.

G A PAPE
Inland Revenue
Ext 6236

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(1) Not for publication.

5. CAPITAL TRANSFER TAX

Capital transfer tax is charged, broadly, on transfers which reduce the value of the transferor's estate. The main occasions of charge are on death, on distribution from trusts, and on gifts made during a person's lifetime. The rate of tax on any transfer depends on the cumulative total of chargeable transfers made within the preceding 10 years. There are two scales of rates - one for transfers on death or within 3 years of death and another for lifetime transfers. The scales of rates applicable to chargeable transfers made on or after 13 March 1984 and those scales adjusted in line with statutory indexation are:

Bands of chargeable value			Rate on death	Lifetime rate
1984-85 £'000	1985-86 £'000	Indexation at 5½ per cent inflation	per cent	per cent
0 - 64	0 - 67	0 - 71	Nil	Nil
64 - 85	67 - 89	71 - 95	30	15
85 - 116	89 - 122	94 - 129	35	17½
116 - 148	122 - 155	129 - 164	40	20
148 - 185	155 - 194	164 - 206	45	22½
185 - 232	194 - 243	205 - 257	50	25
232 - 285	243 - 299	257 - 317	55	27½
over 285	over - 299	over 317	60	30

2. The main exemptions are:

(i) all transfers of property between spouses (unless the recipient is not domiciled in the United Kingdom);

(ii) lifetime gifts which represent normal expenditure out of income;

(iii) gifts not exceeding £3,000 in a tax year;

(iv) gifts to any one person in a tax year up to a value of £250;

(v) gifts in consideration of marriage (up to certain limits);

(vi) lifetime gifts for the maintenance of children and dependent relatives;

(vii) gifts and bequests to political parties (up to certain limits);

(viii) gifts and bequests to charities and certain bodies concerned with the national heritage.

3. Relief of 50 per cent is given on business assets except for minority holding unlisted shares and loaned assets for which the relief is 30 per cent. There is also

50 per cent relief on agricultural assets held by working farmers and 30 per cent relief on let agricultural land owned by landlords.

4. Estimated yield in 1986-87 assuming statutory indexation of the scale: £950 million[1]

of which tax on trusts and on lifetime gifts: £55 million [1]

The cost of statutory indexation in a full year is: £60 million (£20 million in 1986-87; £45 million in 1987-88).

Note

(1) Not for publication

C J C BROWN
Inland Revenue
Ext 6794

6. REVALORISATION

Full year revenue effects and price changes[1]

	VAT inclusive price change (p)	1986-87 Full year revenue £m	RPI effect %
Beer			
(1 pint)	1.2	100	0.07
Spirit			
(75cl bottle of whisky)	31.0	45	0.04
Table Wine			
(EEC table wine) per 70cl bottle)	4.5	20	0.02
Fortified Wine			
- (Harvey's Bristol Cream per 70cl bottle)	8.3)		
- (Cockburn's Special Reserve per 70cl bottle)	9.6)	10	0.01
Tobacco - specific duty only			
(20 King sized cigarettes)	4.7	150	0.14
Petrol			
(1 gallon of 4-star)	5.3	260	0.13
Derv			
(1 gallon)	4.5	65	nil
Rebated oil			
(gallon of fuel oil)	0.2[2]	15	neg

Notes

(1) Revalorisation of specific duties for 1986-87 in line with 5.7 per cent inflation for December 1985 on December 1984.

(2) Fuel oil is not liable to VAT.

MRS L HAMILL
HM Customs and Excise
Ext 5044

7. TOBACCO DUTY

Tobacco Products duty is paid at the following rates:

	Present rate
Cigars	£47.05) per kg on manufactured weight of tobacco
Hand-rolling tobacco	£43.73)
Pipe tobacco	£24.95)
Cigarettes	Ad valorem tax: 21 per cent of recommended retail price including VAT. Specific tax: £26.95 per 1000

VAT is also paid at 15 per cent (three twenty-thirds of retail pice).

Effective burden

On a packet of 20 king size cigarettes retailing at 135p the total tax burden is: 99.8p

Estimates

	£m 1985-86	£m 1986-87	£m 1987-88
Duty (excluding revalorisation)	4400	4510	4610
VAT on tobacco	930	965	990

Specimen change

Price Increase	Full year (including VAT) £m 1985-86	£m 1986-87	£m 1987-88
1p on an average packet of cigarettes*	35	35	35

(This increase can be achieved by several combinations of changes in the rates of individual tobacco taxes).

First Year effect of a change

Close to full year effect multiplied by the fraction of the financial year remaining less one-twelfth of full year effect, but for a detailed estimate reference should be made to HM Customs and Excise.

Effct of a change on the Retail Price Index

1p on a packet, 0.03 per cent*.

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* These figures assume equivalent increases on other tobacco products.

Business Costs

The incidence of tobacco duty on businesses is negligible.

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8. BEER AND CIDER DUTIES

Present Rates

Beer - the present duty rate for beer is £25.80 per hectolitre plus 86p for each degree of original gravity in excess of 1030° (the average strength of a pint is approximately 1037°).

Cider - £15.80 per hectolitre on cider of a strength of less than 8.5 per cent of alcohol by volume. Cider of a strength of 8.5 per cent or more is chargeable with made-wine duty.

VAT is also paid at 15 per cent (three twenty-thirds of retail price).

Effective Burden

Beer - Duty 18.1p per pint on beer of average strength. On a pint costing 71p, 9.2p of VAT is also paid.

Cider - Duty 9.1p per pint. On a pint costing 76p, 9.9p of VAT is also paid.

Estimates **Beer**	**£m** **1985-86**	**£m** **1986-87**	**£m** **1987-88**
Duty (excluding revalorisation)	1960	1995	2035
VAT on beer	1050	1100	1150

Cider and perry	**£m** **1985-86**	**£m** **1986-87**	**£m** **1987-88**
Duty (excluding revalorisation)	60	70	75
VAT on cider	85	105	120

Price increase		**Full year (including VAT)**	
	£m **1985-86**	**£m** **1986-87**	**£m** **1987-88**
1p on an average pint	80	80	85

First Year effect of a change

Close to full year effect multiplied by the fraction of the financial year remaining less one-twelth of full year effect, but for a detailed estimate reference should be made to HM Customs and Excise.

Effect ofchange on the Retail Price Index

1p on an average pint 0.05 per cent.

Business Costs

2 per cent of total beer duty receipts are assumed to be paid by businesses.

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9. WINE AND MADE WINE DUTIES

Excise duty rates on wine and made-wine -	Present rate Duty per hectolitre
Less than 15 per cent alcohol by volume	£ 98.00
15 per cent and over but not exceeding 18 per cent	£169.00
Exceeding 18 per cent but not exceeding 22 per cent	£194.00

Customs duty is also paid on non-EEC imported wine. VAT is also paid at 15 per cent (three twenty-thirds of retail price).

Effective burden

	Price (p)	Size (cl)	Strength band	Duty (p)	VAT (p)	Total effective burden (p)
EEC Table Wine "Hirondelle"	225	70	less 15%	68.6	29.3	97.9
"Harvey's Bristol Cream"	380	70	15% - 18%	118.3	49.6	167.8
"Cockburn's Special Reserve"	550	70	18% - 22%	136.4	71.7	208.1

Estimates

	£m 1985-86	£m 1986-87	£m 1987-88
Duty (including made wine but excluding revalorisation)	650	730	800
VAT on wine	400	465	510

Specimen Change
Price increase

	Full year (including VAT) £m 1985-86	£m 1986-87	£m 1987-88
5p on a bottle (70 cl, NE 15^{o}) and equal percentage changes in the other strength bands, including made-wine	30	35	40

About 60 per cent of the extra revenue would come from light wine (ne 15 per cent) of fresh grape.

<u>First year effect of a change</u>

Close to full year effect multiplied by the fraction of the financial year remaining less one twenty-fourth of the full year effect, but for a detailed estimate reference should be made to HM Customs and Excise.

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Effect of a change on the Retail Price Index

5p on a 75 cl bottle (NE 15^{o}) and equal percentage changes in the other rates, 0.04 per cent.

Business Costs

8 per cent of wine duty is assumed to be paid by businesses.

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10. SPIRITS DUTY

Present rate

Excise rate on mature and immature spirits is £15.77 per litre of alcohol. VAT is also paid at 15 per cent (three twenty-thirds of retail price).

Effective burden

£4.73 duty on a 75 cl bottle of domestically produced spirits at 70° (equivalent to 40 per cent alcohol by volume). On a bottle costing £7.60 (off-licence), 98.8p of VAT is also paid so that the total burden is £5.72 per bottle.

Estimates

	£m 1985-86	£m 1986-87	£m 1987-88
Duty (excluding revalorisation)	1460	1485	1575
VAT on spirits	435	535	515

Specimen changes

Price Increase

		Full year (including VAT)	
	£m 1985-86	£m 1986-87	£m 1987-88
30p on a 75 cl, 70° bottle	35	35	40

First year effect of a change

Close to full year effect multiplied by the fraction of the financial year remaining less one twenty-fourth of the full year effect, but for a detailed estimate reference should be made to HM Customs and Excise.

Effect of a change on the Retail Price Index

30p on a bottle 0.04 per cent.

Business costs

8 per cent of spirits duty is assumed to be paid by businesses.

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11. OIL DUTY

(A) PETROL

Present rate

17.94p per litre. VAT is also paid at 15 per cent (three twenty-thirds of retail price). Petroleum substitutes and LPG are taxed at a related rate.

Effective burden

81.6p per gallon.

On a gallon of four-star petrol costing £1.95, VAT of 25.4p is also paid, and the effective burden for the private motorist is 107p. VAT is reclaimed on business use, which accounts for about a third of petrol consumption.

Estimates	**£m 1985-86**	**£m 1986-87**	**£m 1987-88**
Duty (excluding revalorisation)	5020	5310	5545
VAT on petrol*	1120	1210	1285

* Not including VAT reclaimed on business use

Specimen change

Duty increase	**Full year (including VAT)**		
	£m 1985-86	**£m 1986-87**	**£m 1987-88**
2p on a gallon (including VAT)	100	105	110

First year effect of a change

As for spirits (page 10.1)

Effect of change on the Retail Price Index

2p on a gallon: immediate efect 0.05 per cent.

Business costs

About a third of petrol duty is assumed to be paid by businesses.

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cf Petrol @ 17.94 ∴ 2.7? of 2.79 (18.42)

OIL DUTY

(B) DIESEL ENGINED ROAD VEHICLE FUEL (DERV)

Present rate

15.15p per litre. VAT is also paid at 15 per cent (three twenty-thirds of retail price) but this can be reclaimed by registered traders. The use of DERV by private motorists is negligible.

Effective burden

68.9p per gallon (the private motorist pays a further 24.7p in respect of VAT on a gallon of DERV selling at £1.89 (a VAT exclusive price of £1.64)).

Estimates	**£m 1985-86**	**£m 1986-87**	**£m 1987-88**
Duty (excluding revalorisation)	1255	1325	1385

a 2.79 inc (= 18.42) might bring in £240m (cf £440m for HGVs)

Specimen change

Duty increase	**Full year (excluding VAT)***		
	£m 1985-86	**£m 1986-87**	**£m 1987-88**
2p on a gallon (including VAT)*	30	30	35

First year effect of a change

As for spirits (page 10.1).

Effect of change on the Retail Price Index

DERV does not appear directly in the RPI since very little is bought by households.

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* DERV is normally purchased by registered traders who can reclaim any VAT charged as input tax, so the effective price increase to them would be 1.74p.

OIL DUTY

(C) REBATED OILS

Present rate

0.77p per litre. The duty on kerosene used other than as aviation fuel was abolished in the 1984 Budget. All rebated oils are zero-rated except for lubricating oils which are chargeable at the standard rate of VAT.

Effective burden

3.5p on a gallon of fuel oil costing 59p.

Estimates

	£m 1985-86	£m 1986-87	£m 1987-88
Duty (excluding revalorisation)	225	235	245
VAT on lubricating oils	20	25	25

Specimen change

Duty increase

		Full year	
	£m 1985-86	£m 1986-87	£m 1987-88
1.0p on a gallon on all rebated oil	60	65	70

First year effect of a change

As for spirits (see page 10.1).

Effect of a change on the Retail Price Index

1p on a gallon of all rebated oil. Immediate effect negligible.

Business costs

Over 90 per cent of rebated oil duty is assumed to be paid by businesses.

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12. BETTING AND GAMING

Present Rates

General Betting Duty	- Off-course	8 per cent on stakes
	- On-course	4 per cent on stakes
Pool Betting Duty		42½ per cent on stakes ($33^1/_3$ per cent for charity pools)

Taxes are also levied on Bingo Halls, Casinos and Amusement Arcades.

Estimates	**£m 1985-86**	**£m 1986-87**	**£m 1987-88**
General Betting duty	300	345	375
Pool Beting Duty	230	265	290
Gaming Duties	170	190	205
All Betting and Gaming	700	800	870

Specimen Changes

An increase in the general betting duty would give a considerable stimulus to the existing incentive for illegal betting posed by the current combined rates of duty and racing levy. It is not known by how much the revenue gain from increasing the rates would be eroded.

First year effect of a change

This will depend on the date of operation of the change in rate and is complicated by the seasonality of the yield and the payment arrangements. Detailed estimates should be obtained from the Customs and Excise Department.

Effect of change on the Retail Price Index

Negligible.

(No betting activity appears directly in the RPI. The effect of changes in pool betting duty on the price of admissions to football matches is expected to be negligible).

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13. VALUE ADDED TAX

Present rate

15 per cent

Zero-rated Items

Most foods; water supplies; books, newspapers etc; fuel and power (excluding road fuels); some building work; certain services to overseas traders; most commercial ships and aircraft; passenger transport (except taxis); residential caravans and houseboats; certain supplies of gold; bank notes; drugs and medical supplies on prescription; exported goods; certain supplies by certain charities; young children's clothing and footwear.

Exemptions

Land; insurance; postal services; sweepstakes and lotteries; financial services; most educational services; doctors, dentists and opticians; burial and cremation services; sports competitions.

For more detailed information on the zero-rated and exemption schedules see Customs and Excise Notice No 701. ("VAT Scope and Coverage")

Estimates	**£m 1985-86**	**£m 1986-87**	**£m 1987-88**
1. Full year yields (accruals)	19200	20800	22500
2. Receipts	18800	20400	22400

Specimen change

		Full year effect	
	£m 1985-86	**£m 1986-87**	**£m 1987-88**
% change in rate including compounding on tobacco* +1 per cent (15 per cent to 16 per cent)	850	925	1010

(exclusive of Central Government and Local Authorities)

First year effect

This is affected by the pattern of collection. Customs and Excise will provide the estimates for specific times of change.

Effect of a change on the Retail Price Index

$\pm$ 1 per cent change in rate = +0.5 per cent change in the RPI

Business Costs

VAT on inputs, other than cars and business entertainment, can be reclaimed by registered traders.

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* The tobacco products duty on cigarettes has ad valorem and specific elements. The ad valoren duty is levied on the VAT inclusive recommended selling price which will change if the VAT rate is changed.

14. CAR TAX

Present rate

10 per cent on the wholesale price of all new cars and motor cycles.

Effective burden

VAT is also paid at 15 per cent on the retail selling price, so taxes total about 19.7 per cent of the selling price of a new car.

Estimates

	Car tax			VAT on new cars		
	£m 1985-86	£m 1986-87	£m 1987-88	£m 1984-85	£m 1985-86	£m 1986-87
Accruals	850	970	1050	1655	1890	2045
Receipts	830	950	1040	1615	1850	2025

Specimen change

	Full year (including VAT)		
	£m 1984-85	£m 1985-86	£m 1986-87
10 per cent to 12½ per cent	210	240	260

First year effect

This is affected by the pattern of collection. Customs and Excise will provide estimates for specific times of change.

RPI effect

There is no direct effect on the RPI as the price index for all cars is based on the prices of second-hand cars. A change in car tax would be expected to affect the price of second-hand cares indirectly, however, so that there would be some eventual impact on the RPI.

Business Costs

About 45 per cent of car tax duty is assumed to be paid by businesses.

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15. REGULATOR POWERS FULL YEAR REVENUE EFFECTS

EXCISE DUTIES

		Change in price due to 10% Regulator p	Yield from Regulator 1985-86 £m	Yield from Regulator 1986-87 £m	Yield from Regulator 1987-88 £m	Change in Retail Price Index %
Group(1)						
A	Tobacco 137p (20 king size) cigarettes) Full Regulator	12.8	390	400	410	0.33
	10 per cent specific tax regulator only	8.2	250	255	265	0.24
B	Beer 71p (1 pint of beer)	2.1	165	170	175	0.11
	Spirit 775p (bottle of whisky off licence)	54.4	65	70	75	0.08
	Wine 225p (EEC Table wine per 70 cl bottle	7.9)				
	(Harvey's Bristol Cream per bottle) 380p	13.6)	45	55	60	0.06
	(Cockburn's Special Reserve per bottle) 550p	15.7)				
C	Road Fuel (Gallon of 4-star) 195.0p	9.4 (2)	450	460	495	0.23
	(Gallon of Derv) 189.0p	6.9 (3)	115	120	125	nil
C	Rebated Oil (Gallon of fuel oil) 81p	0.35	20	20	20	neg

NOTES

(1) Under the provisions of the 1982 Finance Act the taxes on each of the items in a group may now be changed by different proportions. The maximum changes are illustrated here.

(2) The business user who deducts VAT will in effect pay only 8.2p.

(3) For the business user; that is, excluding VAT. The private motorist would pay an extra 7.9p.

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VAT[1]

Total Revenue Yield from 25 per cent Regulator, Full Year.

1985-86 £m	1986-87 £m	1987-88 £m	Change in RPI %
3095	3380	3685	1.9

NOTE

(1) The figures quoted are exclusive of Central Government and Local Authorities.

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16. MOTOR VEHICLE DUTIES ETC

		UK
		£pa
Present Rates		
Motor Cars and light goods vehicles		100
Illustrative Table		
Goods general taxed according to gross weight and wheel plan		
	Gross Weight (Tonnes)	
Rigid (without trailer):		
2 Axles	13	410
"	16 ¼	1,030
Articulated (excluding concessionary rates)		
2 Axled tractive unit with any semi-trailer	16	590
	23	1,000
	32 ½	2,450
	38	3,100
3 axled tractive unit with any semi-trailer	16	440
	23	620
	32½	2,450
	38	2,730

Estimated Yield - United Kingdom 1986-87
(assumed current tax rates)

	UK £m	GB £m	NI £m
By class of vehicle:			
Private, Light Goods Vehicles (including cycles)	1,975	1,928	47
Heavy Goods Vehicles	447	433.3	13.3
Tractors & Agricultural etc machines	8	8)	
Hackneys	9	9)	1
Trade Licences	4	4)	
Grand Total	2,443	2,382	61
* Other receipts	11		
Driving Licence Receipts	16		

Specimen Changes

	£m
For each £5 Private Light Goods Licence	97.7
For 5 per cent change in Goods licence	22.4
For 5 per cent change in Tractors, etc	0.4
For 5 per cent change in Hackneys	0.4
For 5 per cent change in cycles	1.1

* Includes mitigated penalties and fees for retention of cherished registration numbers, duplicate registration documents and duplicate licences.

DVL ACS

18 December 1985

ESTIMATED VED YIELD AND VEHICLE NUMBERS - UK

1. Breakdown by Vehicle Category

		1985-86 Yield £m	Number of Vehicles Licensed September 1985
Schedule 1:	M/cycles	20	1,215,800
	Tricycles	3	73,200
		23	1,289,000
Schedule 2:	Hackneys	9	122,200
Schedule 3:	Showmen's Haulage	-	200
	General Haulage	2	5,800
	Agric Machines	6	387,100
		8	**393,100**
Schedule 4:	HGV Showmen's	-	900
	HGV Farmers'	5	22,300
	HGV	433	506,200
	All Restricted HGVs	3	27,200
		441	**556,600**
Schedule 5:	Private/Light Goods	1,921	18,462,200
	Light Goods Showmen's	-	500
	Light Goods Farmers'	4	48,500
		1,925	**18,510,700**
	Trade Licences	**4**	**92,300**
	GRAND TOTAL	**£ 2,410m**	**20,963,900**

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DVL ACS

18 December 1985

17. NATIONAL INSURANCE CONTRIBUTIONS

There are four classes of NICs:

Class 1 (Employees) - If an employee earns more than the lower earnings limit (£38 per week in 1986-87) they pay primary Class 1 contributions and their employer pays secondary contributions. The rates of contribution in 1986-87 are at the following percentages of gross weekly earnings up to the upper earnings limit (£285 per week in 1986-87):

Not contracted-out

		Paid by employee	Paid by employer	Total
Normal :	Earnings £38 to £59.99	5%	5%	10%
:	Earnings £60 to £94.99	7%	7%	14%
:	Earnings £95 to £139.99	9%	9%	18%
:	Earnings £140 to £285	9%	10.45%	19.45%
Opted out married women		3.85%	As in normal schedule	
Persons over pensionable age		-	As in normal schedule	

For earnings above the upper earnings limit employer's contributions remain at 10.45 per cent of gross weekly earnings however for employee's there is a maximum contribution of £285 x employee rate (at not contracted-out rates = £285 x 9 per cent = £25.65).

Where the employee is contracted-out the percentage rates are reduced by 2.15 per cent (primary/employee) and 4.1 per cent (secondary/employer) on the slice of earnings between the lower earnings limit and the upper earnings limit.

Class 2 (self-employed) - Flat-rate payment of £3.75 in 1986-87 by all self-employed persons over the age of 16 with earnings above £2,075 per annum.

Class 3 (Voluntary) - Voluntary flat-rate contributions may be paid by persons 16 and over to enable them to qualify for certain benefits. The rate is £3.65 in 1986-87.

Class 4 (Self-employed) - Earnings related contributions for the self-employed. They are paid if earnings are above the lower profits limit of £4,450 (in 1986-87) at the rate of 6.3 per cent of earnings above the LPL. There is no contribution payable on earnings above the upper profits limit of £14,820.

Specimen changes (GB only)

1. Contribution rates in 1987-88

Yield of an additional 1 per cent on contribution rates:

			£m
Standard rate employees:			
	Weekly earnings:	£ 40 - £ 62	38
		£ 62 - £100	91
	(UEL £300)	£100+	1453
Reduced rate employees:			56
	Employers:		
	Weekly earnings:	£ 40 - £ 62	47
		£ 62 - £100	105
		£100 - £145	250
		£145+	1346
Self-employed: (Class 4)			65

Yield of an additional £1 on flat-rate contributions

Self-employed:	(Class 4)	101
Voluntary:	(Class 3)	6

These are contributions due in respect of the tax year+ (full year effect) and exclude Treasury Supplement*.

A 1 per cent increase is assumed for all contributors including those groups (eg HMF) paying at special rates.

2. Earnings ceilings for contributors

The effect on contributions in respect of 1987-88 of abolishing the upper earnings limit for employees (although retaining it for the calculation of contracted-out rebate) and the upper profits limit for the self-employed from their assumed levels of £300 pw and £15600 pa is:

National Insurance Fund

	£m	
	Employees	**Self-employed**
Excluding Treasury Supplement	765	200
Including Treasury Supplement	835	220

3. Rate of SSP[+]

The effect on contributions in respect of 1987-88 of increasing the main rate of SSP by £1, with proportionate changes for the other rates, is to reduce contribution income to the National Insurance Fund by £16.8 million. This excludes the effect of additional contributions payable by employees and the Treasury Supplementary payable thereon, together these would amount to at most £1.5 million.

Notes

+ Class 1 contributions are collected with PAYE income tax. There is an initial delay of some six weeks before changes in contribution rates are reflected in receipts. There are longer delays in the collection of contributions from the self-employed and voluntary contributions.

* There is an automatic Treasury Supplement of 9 per cent of the total contributions paid to the National Insurance Fund. Contributions used are after adding back estimated contracted-out rebates and SSP reimbursement to employers but exclude state scheme premiums.

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18. PROJECTED INCOME OF NATIONAL INSURANCE FUND

GB (£ million)

	April 1986 Rates and Limits		New Limits*	
	1986-87		1987-88	
CONTRIBUTIONS	**Receipts**	**Contributions in respect of tax year**	**Receipts**	**Contributions in respect of tax year**
Employees	9961	10067	10749	10826
Employers	11575	11695	12518	12607
Self-employed	609	642	670	712
Voluntary	21	21	21	22
Premiums[ø]	302	302	329	329
Total	22468	22727	24287	24496
SSP	745	778	809	813
Net Total	21723	21949	23478	23683
Treasury Supplement[+] Fund	2394	2421	2587	2609
Total NI Fund	24117	24370	26065	26292

(1) the figures shown in the table are on the basis of average numbers of employees in employment (including members of HMF) and the average earnings summarised below:

	Average gross earnings of employees in employment (£pa)	GB Employees in employment (000s)
1984-85	7386	21060
1985-86	7977	21197
1986-87	8535	21546
1987-88	9047	21836

It is the movement of these quantities since 1984-85 which is important rather than their absolute magnitudes, since our estimates are normalised on the actual 1984-85 contributions. Class 1 contributions are very nearly proportionate to the number of employees.

(2) The effect on contributions in respect of the tax years shown of average earnings 1 per cent higher or lower than has been assumed, with no effect on numbers, is:

	£m 1986-87
National Insurance Fund	
Excluding Treasury Supplement	220
Including Treasury Supplement	245

Because Class 4 contributions in respect of a tax year depend on earnings in a previous period it is assumed that self-employed contributions are unaffected except for those who have earnings from employment and are affected by the upper limit on contribution liability.

(3) The effect on contributions in respect of the tax year shown of ± 100,000 unemployed in GB, excluding school leavers and students, which would effect the number of employees in employment, is:

	£m 1986-87
National Insurance Fund	
Excluding Treasury Supplement	130
Including Treasury Supplement	145

Notes to the tables

* From April 1987 Class 1 lower and upper earnings limits are assumed to rise to £40 and £300 pw from their 1986-87 values of £38 and £285 pw. The earnings limits which determine the bands on which lower rates are paid are assumed to rise from £60, £95 and £140 pw to £62, £100 and £145 pw. Class 1 contribution rates are assumed to remain unchanged.

Classes 2 and 3 contributions ar eassumed to rise to £3.89 and £3.79pw respectively with the range for Class 4 contributions changing from £4450/£14820 to £4615/£15600pa. The Class 4 rate is assumed to remain unchanged.

The standard rate of SSP is assumed to increase to £48.40pw with proportionate increases for the lower rates.

\+ 9 per cent of contributions excluding state scheme premiums but before deducting contracting-out rebates.

ø for premiums the convention is adopted that contributions in respect of a tax year are the same as the receipt in the same period.

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19. NATIONAL INSURANCE BENEFITS

Present rates of benefit (from 25 November 1985)

	£
1. National insurance flat rate retirement pension:	
single	38.30
married	61.30

Pensioners over 80 receive an extra 25p age addition

Pension is increased for each dependent child by:	8.05

A person who does not retire on reaching pensionable age becomes eligible for increased pension when they do retire. No further increase can accrue after the age of 70 (men) or 65 (women).

Since April 1979 pensions have been in two parts. As well as the flat-rate pension there is an earnings-related additional component (AC) based on contributions on earnings above the basic level in the relevant years. (Widows benefit and invalidity pension similarly attract an additional component).

2. Widow's allowances	53.60
Widowed mother's allowance	38.30
Widow's pension (50+)	38.30
Invalidity pension: single	38.30
Dependency increase for wife of invalidity pensioner:	23.00
Dependency increases for children:	8.05

Invalidity allowance is payable if age of onset of illness is less than 60 (55 for women). The rate of invalidity allowance depends on the age of onset of illness.

3. Sickness, and maternity benefit: single	29.15
Dependency increases for wife:	18.00

4. Unemployment benefit: single	30.45
Dependency increase for wife:	18.80

Earnings related supplement was abolished in January 1982

COST IN 1987-88 OF A 1 PER CENT UPRATING IN JULY 1986

GREAT BRITAIN

£ MILLION

Benefits uprated	NI Fund	Non means tested Non NI fund benefits	Supplementary Benefit	Housing Benefit (Rents only)	Net Cost
Retirement pensions only	178		-28	-11	139
Retirement pensions, supplementary pension and housing benefit for pensioners	178		9	negligible	187
Long term benefits +(1)	214	17	28	-14	245
Short term benefits +(2)	20	5	44	-1	69
Additional component (3)	5.3				5.3
All benefits except child benefit, FIS, supplementary benefit and housing benefit	239	24	-30	-12	221
All benefits except child benefit and FIS	239	24	80	4	347

Effect of a £1 increase in Child Benefit in July 1986+

GREAT BRITAIN

£ MILLION

		1986-87	1987-88
Cost	Child Benefit	420	620
	One parent benefit	21	33
Savings	Child Dependency Additions		
	- retirement pension only	1	2
	- long term benefits - NI fund (1)	14	22
	Non-fund	0.5	1
	Supplementary Benefits	70	106

\+ Excludes housing benefit

(1) Comprising: NI Fund: (RP (excluding AC), WB (excluding AC), IVB (excluding AC), Dis Ben, IDB,II old cases.
Non means tested, non NI Fund benefits: NCRP, AA, ICA, SDA, War Pensions Supplementary benefit: Supplementary pensions and long term allowances

(2) Comprising: NI Fund: UB, SB, MA
Non means tested, non NI Fund: Mob A
Supplementary benefit: Supplementary allowance - basic scale

(3) AC payable with RP IVB and WB

Effect of change in the number of wholly unemployed (GB)

	£ million			
	November 1985 rates		July 1986 rates 1 per cent upgrading	
	1986-87	**1987-88**	**1986-87**	**1987-88**
± 100,000 in 1986-87 and 1987-88				
Supplementary benefit/housing benefit	120	160	120	165
Unemployment benefit	90	43	91	43
± 100,000 in 1987-88 only				
Supplementary benefit/housing benefit		120		120
Unemployment benefit		90		91

P H HAMSHARE
DHSS
Ext 4202 (Friars House: GTN 2916)

CAR AND CAR FUEL BENEFITS

A Car Benefit Scale Charges

1. The AA may argue that the scale charges are too high, and should not be increased.

Line to Take

2. Current car benefit scale charges (£410 for 1600cc car) nowhere near realistic value of company car. Independently estimated (Regional Reward Surveys) that employee would have to earn extra £3,300 to run privately similar car.

3. Increase in tax from 1984/85 to 1985/86 for typical 1600cc company car user only 26p a week.

Background

4. 1985/86 Main Car Benefit Scale Charges

Size of Car	Scale Charge £	Tax Per Week £	Weekly Increase Over 1984/85
0-1300cc	410	2.36	20p
1301-1800cc	525	3.02	26p
Over 1800 cc	825	4.76	43p

Note Tax at basic rate; figures double if free fuel provided.

5. Company cars only taxed in the hands of directors and those employees earning, including the value of the benefit, at a rate of £8,500 a year or more.

6. Estimated number of company cars subject to tax 1 million. Revenue yield (including car fuel benefit) about £380m (1986/87).

7. Imbucon (remuneration specialists) report increased provision of company cars among jobs surveyed: 79.7 per cent (1985) compared to 77.9 (1984).

B Car Fuel Benefit Scale Charges Too High

8. The AA may argue that because car fuel benefit scale charges have followed the car benefit figures they now bear no relationship to the real value of this benefit.

Line to Take

9. While company car may be necessary to carry out some jobs, free fuel for private motoring is a pure perk. If the user considers the tax charged outweighs the value of the beneift, then he can avoid the charge simply by making good to the employer the cost of providing the fuel.

CAR AND CAR FUEL BENEFITS

Background

10. Car fuel benefit scale charges are the same as car benefit scale charges (see paragraph 4). About 50 per cent of all company cars receive free fuel for private motoring. Tax yield (1986/87: £130m).

11. Although the real worth of the benefit (assuming 8,000 miles private motoring as indicated by the National Travel Survey) may now be equal to or exceed the scale charge, it will still pay most company car users (all those covering 2,500 + private miles) to pay the tax rather than make good. The possiblity of decoupling the car fuel from the car benefit scale charge is covered in our paper of 22 November.

2652/16

VEHICLE EXCISE DUTY RATES

A. **AA'S VIEWS**

The AA consider that VED is less unpopular than petrol duty. Last year, Lord Erroll emphasised that "there is no statutory need to revalorise all the excise duties each year".

B. **BACKGROUND**

In the 1985 Budget VED was raised from £90 to £100 for cars and light vans, i.e. by 11.1 per cent, more than twice the rate of inflation. This will yield an extra £200 million in 1985/86 and in a full year; an increase in line with inflation would have yielded an extra £80 million.

C. **LINE TO TAKE**

The Government is not anti-motorist. Taking both VED and petrol duty together, the increase in motoring taxes in 1985 Budget was about 1½ times the rate of inflation - in line with the increases for most other excise duties. These increases progress the stated aim of switching the burden of personal taxation from earnings to spending. VED is still slightly lower in real terms than level set by previous Labour Government in 1975. If the duty had been increased in line with inflation since 1977 (the last time the Labour Government increased the rate - to £50), it would now stand at about £103.

VEHICLE EXCISE DUTY RATES

CONCLUSION

The RAC's case for abolition of the esturial toll charges can be summarised as follows:-

It is nonsensical to charge ever-increasing tolls, whilst the debts continue to expand.

It is unreasonable to make road transport users pay for immense and unexpected costs – such as the £33 million repairs to the Severn Bridge now commencing.

It is wrong to charge the users for the construction and maintenance of 25 miles of Britain's national road network – while the motoring taxpayers contribute immensely more than the expenditure on the other huge mileage.

It is discriminatory and unfair – especially for many who use the crossings for daily journeys to and from work and have to pay as much as £10 a week.

It is anomalous that some bridges and tunnels have been selected for toll charges whilst road transport users elsewhere make no payments at other river crossings.

The information provided concerning the financial situation demonstrates why continuance of the toll charges system makes no sense. Motorists pay more – deficits increase!

The RAC confidently hopes that the Transport Committee will soon make recommendations for a concession to remove these objectionable costs incurred by road transport – necessitating a payment once and for all of a relatively small sum compared with the ever-widening gap between motoring taxation income and the national road expenditure.

March 1985

RAC

If any further information is required, enquiries should be submitted to the Public Affairs Division of the Royal Automobile Club, 49 Pall Mall, London SW1Y 5JG. Tel: 01-839 7050.

CONFIDENTIAL

FROM: A M W BATTISHILL

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

18 February 1986

FINANCIAL SECRETARY

NORTH SEA OIL COMPANIES: ACT AND RING-FENCE PROFITS

This is a particularly difficult issue to come up against at this late stage; and I apologise for that.

Mrs Hubbard's note deals very fully with the problem and with possible solutions to it. We are persuaded that the companies do have an equitable case for relief and that the formula at the end of paragraph 11 should produce a fair result. If we were talking only of £10-£15 million for the smaller companies caught with stranded ACT I would have no hesitation in recommending inclusion in the 1986 Bill. But the risk of a potential £50-£100 million cost (even though a very tentative figure) arising from the majors makes it an altogether different matter. We have explored various ways of restricting the extent of the relief, but so far no entirely acceptable solution has been found.

That said, if we do nothing, we cannot exclude the possibility that at least some companies will try to exploit the newly found loophole (even though it involves some pretty artificial arrangements), and that could cost a lot of money too. I think we must close it.

We should be happy to discuss this with you.

AMWB

A M W BATTISHILL

~~cc~~ PS/Chancellor	Mr Battishill
PS/Chief Secretary	Mr Pollard
PS/Economic Secretary	Mr Beighton
PS/Minister of State	Mr Painter
Mr Robson	Mr Pitts
Miss Sinclair	Mr Elliss
Ms Leahy	Mr Beauchamp
Mr Cropper	Miss Hill
Mr Wilson	Mrs Hubbard
Mr Graham - Parly Counsel	Mr Cleave
	Mr Reed
	MrWhitear
	Mr Pang
	Mr I Stewart
	PS/IR

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

FROM: MRS C B HUBBARD

DATE: 17 FEBRUARY 1986

1. MR PITTS Please see my note at the end.
EP. 17/2

2. MR BATTISHILL

3. FINANCIAL SECRETARY

S. 16 OTA 1975: RESTRICTION ON SETTING ACT AGAINST RING FENCE PROFITS

1. This note is about a possible late addition to this year's starters list and concerns two problems relating to S.16, OTA 1975, which is designed to protect the ring fence by restrictions on the set-off of ACT. One of these problems has been the subject of past and current budget representations by the oil industry; two BRINDEX companies are now claiming that they will suffer unintended hardship in respect of 1986 distributions due to S.16. One of them (LASMO) has now written to you directly (letter of 11 February). The representations are therefore now urging that a solution be found as a matter of urgency, in the 1986 Finance Bill. The other problem has been brought to light by those companies' considerations of how to avoid this hardship, which in turn have exposed a potential loophole in the existing legislation, which could have very significant costs if ever exploited.

---

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Mr Robson
Miss Sinclair
Ms Leahy
Mr Cropper
Mr Wilson
Mr Graham - Parlia. Counsel
Mr Battishill
Mr Pollard
Mr Beighton
Mr Painter
Mr Pitts
Mr Elliss
Mr Beauchamp
Mrs Hubbard
Miss Hill
Mr Cleave
Mr Reed
Mr Whitear
Mr Pang
Mr I Stewart
PS/IR

Background and problem

2. Under the normal rules a UK resident company makes a payment of ACT when it pays a dividend. This ACT may then be set against its mainstream CT liability, or if this is insufficient any surplus may be either carried back up to six years or carried forward indefinitely. If the dividend is paid to another company which has a trading loss it can (under Section 254 ICTA) set the loss against the dividend and reclaim the tax credit on that dividend.

3. It was recognised that these rules could permit the ring fence to be breached, by allowing a a ring fence company to pay ACT on a distribution to its parent (and get the ACT credited against its North Sea CT bill), while its parent - if it had losses - could claim to be paid the tax credit attached to the distribution. Effectively the "ring fence" tax would be reduced by a non-ring fence loss. Section 16 was therefore specifically introduced to prevent ACT on a dividend paid within a group being set against ring fence corporation tax on oil profits. (It was thought that alternative ways of protecting the ring fence by denying repayment of the tax credit where the income out of which the dividend had been paid was ring fence income would involve difficulties of tracing income which could pass through a chain of related companies.) But there is no restriction where the dividend is paid to outside shareholders (including a non-resident parent company) - there the possibility of ring fence leakage does not arise.

4. These rules do not completely - and are not designed to - prevent a ring fence company from setting ACT against its ring fence CT. Under the normal rules, a company may surrender its ACT to another member of the group which can set this against its own current CT liability or carry it forward against its future CT liability. This means that the parent company which pays a dividend to outside shareholders can elect to surrender the ACT on this to a subsidiary which can then set it off against its ring fence CT. The important thing is that the ACT on the dividends will have been retained by the Revenue.

5. Faced with this position a North Sea subsidiary will pay its dividends without accounting for ACT (as it can elect to do under s.256 ICTA 1970) to its parents. The parent declares a dividend in turn (to outside shareholders or to its overseas parent) and pays ACT. It then surrenders the ACT (s.92 FA 1972) to the North Sea subsidiary. The ACT can then be credited against CT on the ring fence profits.

The Companies' Problem

6. However, as explained above, surplus surrendered ACT cannot be carried back, only forward. In this respect, therefore, the rule - as what was thought an unavoidable side-effect - leaves the ring fence company at a disadvantage in comparison with the non-ring fence company. Under the normal rules, a company sets its ACT against its CT liability up to the normal limit, and any surplus can be carried back against its CT liability in the preceding six years. But this is not allowed where ACT has been surrendered to the company - in that case any surplus may only be carried forward. Normally there is flexibility in these arrangements as a non-ring fence subsidiary can set off surrendered ACT against its current liability, so releasing any ACT it has paid itself as surplus for carry back. As the ring fence company cannot credit its own ACT against its CT liablility, it is forced to pay dividends without accounting for ACT. It can only, therefore, have surrendered ACT, which cannot be carried back.

7. The oil industry has always complained that the structure of S.16 created a problem of dividend flexibility (because of the rules described in paras 3-6, the parent will need to pay dividends geared as precisely as possible to the North Sea subsidiary's current taxable profits to avoid creating surplus ACT, which could remain stranded for a good many years) and has regularly featured its repeal or amendment on its Finance Bill shopping list. Our response has always been fairly sympathetic, but that it was not easy to find a workable alternative solution which protected the ring fence; we were not, however aware that

any company had suffered actual, as opposed to theoretical, hardship as a result of S.16. We invited them to let us have evidence of any actual problems, as this would strengthen their case for a change if a viable solution could be found.

8. Such evidence is now beginning to appear. Two companies have been to see us in the last two months to show problems of stranded ACT (and LASMO wrote to you on 11 February), and BRINDEX and UKOITC have returned to the attack on this front, arguing that the present collapse in oil prices is exacerbating matters. (We saw BRINDEX in December and again on 4 February; UKOITC have written again on 3 February.) They claim that it is not always possible to match dividends to taxable profits; they point out that the profile of taxable profits tends to be fairly lumpy in the ring fence, given the long lead times with heavy capital investment in developing new sources as current income streams decline. This creates difficulties, especially for the smaller independent groups at this time, as they are particularly vulnerable to takeover. Their share prices are already lower than at any time in recent years, and they would be at even greater risk of falling to predators if they fall any lower. Thus they need to maintain the level of dividends, even though profits may be falling off. This creates a cash-flow problem. Although stranded ACT can be carried forward indefinitely, it has to be written off in their balance sheets if it cannot be recovered within the next 12 months. This in turn has an adverse effect on their market rating.

Possible Solutions

9. The industry's preferred solution would be the repeal of S.16, and amendment to S.254 to prevent losses being set against dividends from a ring fence company. But such a solution involves problems of keeping track and identifying distributions from North Sea profits which might pass along a chain of companies within a group. The industry reluctantly accepts that there are difficulties with this approach, and their fall-back position is the removal of the prohibition of the carry-back of surrendered ACT contained in S.92(3A) FA 1972. But allowing

surrendered ACT to be carried back would give the group an advantage as compared with the single company, as groups can surrender any ACT, whereas the single company can carry back only surplus ACT. Under the ACT rules as originally enacted, carry-back and surrender were both available only for surplus ACT. If we were to consider allowing any surrendered ACT to be carried back, it would, we feel, be appropriate to re-introduce the restriction that only surplus ACT could be surrendered. Otherwise the companies would have the best of all worlds, and their planning opportunities would be maximised at a considerable exchequer cost. Now that the order of set-off of ACT and double taxation relief has been reversed, the reason for allowing surrender of all, and not just surplus, ACT no longer applies.

10. But the question arises whether such a change should be made across the board to meet what is a specifically oily problem. Although CBI, Institute of Chartered Accountants and Institute of Directors have, in their budget representations, frequently asked for the carry-back of surrendered ACT, they have not offered the quid pro quo of restricting surrender to surplus ACT. They might see such a change as restricting their planning opportunities, and for that reason, we would prefer any solution to be specifically targetted to carry-back of surrendered ACT attributable to ring fence income for set-off against CT on those profits. This could be defended on the grounds that the solution was designed to meet a particular problem caused by S.16. If, in the event, there were to be a demand for the solution to be applied across the board, we would see no difficulties in extending it.

10. There are two possible ways of providing an oily only solution. One would be a general rule, as mentioned above, of restricting within groups containing a company with ring fence income surrender to surplus ACT and allowing it to be carried back for set-off against CT on ring-fence income. (Both UKOITC and BRINDEX have indicated that they would be prepared to swallow this.) But this might be unduly restrictive, and therefore unwelcome, eg for those groups which are not currently experiencing any difficulties with S.16. An

alternative, which we would prefer, because it is more precisely targetted to the problem in hand, would be to allow surrender of any ACT as now, but overcome the S.16 problem by allowing the receiving company to carry back only so much as is attributable to a distribution actually made of ring fence income, and then, possibly, only for set off against CT on ring fence income. This would ensure that a ring-fence company could never be in a better position than a non-ring fence company. We think that a solution along these lines would be relatively straightforward both to legislate and to operate.

The Revenue Problem

12. As we mentioned at the beginning of this note, in discussions with the companies affected by S.16, one group has been exploring the possibility of a reconstruction which could get round S.16. This is because the definition of associated company in S.16 is not sufficiently tight. This has exposed a possible breach in the ring fence, which we feel should be stopped. This would be relatively simple, by replacing the definition of associated company with a suitably tight definition as found in other provisions, eg S.115 FA 1984 or S.302 ICTA. The legislation would therefore be very short and straightforward to draft.

Timing

13. For the Revenue problem, we feel that it is desirable to tighten up S.16 as soon as possible, now that the potential loophole has been exposed, but we feel that it might be difficult to do it in isolation. We would expect there to be considerable pressure for the industry problem to be solved at the same time, unless the changes were both proposed in the same package. For their problem, the oil industry are urging that a solution be found as soon as possible, as the problem is a live one affecting their 1986 dividends. Ideally, they would welcome an announcement in the 1986 Budget, with legislation in the 1986 Finance Bill. By extending their accounting periods, or deferring dividends to the next accounting period, they may be

able to stave off the impact of S.16 in the short term, but it is essentially an interim solution. If they are to avoid difficulties in relation to their balance sheets and market ratings, remedial legislation is necessary.

Cost

14. The cost of any solution, along the lines set out in para 11, arises because of an acceleration of relief which would ultimately be available if the ACT was carried forward. We would envisage such a solution applying to dividends paid in accounting periods ending on or after Budget day. On that basis and of submissions made by the two companies concerned, we would expect that the releasing of stranded ACT would benefit them by £m5-10 in 1986/87. But this change in law would be equally open to some of the major oil companies, although none has made a specific representation to us, other than the general representation by UKOITC. This may suggest that they do not see it as so urgent a problem as the two BRINDEX companies above. It is always very difficult to estimate the extent to which they might be affected by S.16, as so much depends on other factors, and notably oil prices; future development plans which might be affected thereby, but which in turn will affect the amount of their mainstream liabilities; their non-ring fence liabilities, which are also greatly affected by price movements which determine the margins on their downstream activities; and of course their distributions policies. In trying to help the small companies, the solution envisaged inevitably opens up the possibility of extending the benefit to the big ones. The proposal could therefore have significantly greater costs, perhaps of the order of £50-100m in 1986/87. We have spent a long time considering how we might restrict that potential cost, but have not, as yet, been able to find a solution which could be justified, once the point of principle has been conceded.

Conclusion

15. Now that a potential loophole in the ring fence has been exposed, even though perhaps not many groups would wish to or

even be able to reconstruct in an artificial way in order to exploit it, we are concerned that it might be used, especially if nothing is done to remedy the impact of S.16. Certainly, one of the groups affected has been exploring this possibility. It might therefore be prudent to tighten up here in any event. However, to do this and not to do anything to mitigate the unintended effect of S.16 OTA 1975 would, we feel, be rather difficult. The problem would be bound to be aired at length during any debate of such an amendment, and it might be difficult to resist any concession.

16. I am sorry this has come up so late in the day but it is only recently that the companies have come to us with convincing evidence that this is likely to be a real problem this year, and have, in the process, made us aware of the potential loophole. Given the potential costs - albeit surrounded by great uncertainty - you will doubtless wish to consider whether you are prepared to meet the industry's representations. If you decide against, we think there is certain to be further pressure for remedial legislation during the Finance Bill debates, which may be difficult to resist. You may feel that a meeting would be helpful to discuss this complex issue.

CH

MRS C B HUBBARD

Although a late starter, this must be a serious contender for legislation this year. There are three options:

a. to block the loophole:

b. to do that and also meet the companies' problem:

c. to do nothing.

a. would be difficult on its own since there is such a strong case for resolving the companies' problem. But there is a major problem with either b. or c. -the possible cost. As Mrs Hubbard suggests, you may wish to discuss.

DP.

D Y PITTS

Whisky exports up by 7 p c to record £994m

By JOHN PETTY

RECORD exports of scotch whisky, up 7 p.c. at £994 million, are reported for 1985 by the Scotch Whisky Association. But volume was down by 2 p.c. on 1984 at just under 226 million litres of pure alcohol.

The drop in volume was largely due to Japan reducing imports of bulk malt, which it uses to enhance the flavour of its own whiskies.

Many in the industry think exports of bulk malt should be banned. But with huge over stocking in the Highlands, the temptation to take a quick profit is alluring.

Shipments in bottle, representing 70 p.c. of exports, were up 2.5 p.c. and had their best year since 1982. Sales of bottled blends rose by 2 p.c. at more than 156 million litres of pure alcohol, while bottled malts were up 27 p.c. at 5.75 million litres.

Blended scotch for bottling abroad was 50.3 million litres and showed virtually no change.

The export trade is dominated by Distillers Company, currently seeking a bid by Guinness worth £2.2 billion to thwart an offer of about £1.98 million from Argyll Group.

Meanwhile the war of words over the future of Distillers continued unabated yesterday with Distillers spokesman David Connel rebutting claims by Argyll that the Guinness Distillers merger would mean job losses.

"Argyll's record in the whisky industry in Scotland is not impressive" said Mr Connel "they have bought in and out of distilleries and bottling plants, treating them as commodities, and there has been no attempt at constructive investment in the industry. This has meant scores of lost jobs. Argyll even closed the local Glen Scotia distillery in Mr Gulliverer's home town of Campbeltown."

Guinness chief executive Ernest Saunders also last night denied the Argyll suggestions that up to a thousand jobs might be lost in the merger.

DAILY TELEGRAPH
3 FEBRUARY 1986

BUDGET SECRET

TO BE DESTROYED

BR/41

REF No 10 J
COPY No 16 A OF 17

Treasury Chambers. Parliament Street. SW1P 3AG
01-233 3000

R A Allan Esq
Private Secretary
to the Secretary of State
Department of Transport
2 Marsham Street
LONDON SW1P 3EB

20 February 1986

PS/CST
PS/FST
PS/MST
PS/EST
Sir P Middleton
Mr Monger
Mr Scholar
Miss Sinclair
Mr Pratt
Mr Murray
Mr Romanski

Mr Wilmott - C&E
PS/C&E
PS/IR

Dear Richard

VEHICLE EXCISE DUTY

You wrote on 12 February about the timing of decisions on VED. This reply confirms what our officials have already told yours.

The Chancellor would like to keep open two options for car VED: no change and an increase to £105. We understand that the deadline for choosing between these two is 4 March. On lorry VED, the Chancellor has decided that the main rates should remain unaltered this year.

I should also record the decisions reached on the minor VED rates, which are in line with your Secretary of State's proposals:

- Pre-1947 cars - keep at 60% of the car VED rate;

- Motor cycles - keep as existing proportions of car VED rates;

- Taxis, buses and coaches - increase by 5% whatever decision is reached on car VED;

- Haulage vehicles and agricultural machines - unchanged;

- Trade licences - increase to £70 (£14 for motor cycles) from the date the Finance Bill starter simplifying the arrangements is implemented;

- Farmers' HGVs - move to mid-point between current rate and 60% of main HGV rates;

- Showmen's HGVs - unchanged.

Yours ever
Rachel

RACHEL LOMAX

NOTE OF A MEETING IN NO.11 DOWNING STREET ON FRIDAY 21 FEBRUARY 1986 AT 2.30 PM

Present Chancellor
Financial Secretary
Mr Wilson
Mr Monger
Miss Noble
Mr Cropper

Mr Corlett - IR
Mr Hinton - IR

Mr Johnston - Government Actuary
Mr Loades - GAD

PENSION FUND SURPLUSES

The meeting discussed Mr Monger's minute of 20 February setting out the reasons for the proposed increase in the lower trigger point to 10 per cent. The Government Actuary's minute of 20 February on actuarial assumptions was also relevant.

2. The Chancellor noted that, at the overview on 3 February, the Government Actuary had suggested a lower trigger point of 3 to 5 per cent, on the assumption that the guidelines used for estimating surpluses would specify the projected unit credit method of valuation and "strong" actuarial assumptions. He asked why he was now recommending a trigger point of 10 per cent; and whether he had any other worries about the proposed scheme.

3. The Government Actuary explained that a higher trigger point was needed to ensure consistency with the rules for determining the SERPS contracting-out rebate. The problem was that the contracting-out rebate was higher than actuarially necessary to recompense schemes for taking over the obligation to provide a

guaranteed minimum pension (GMP). With the current rebate (6¼ per cent) the bonus is 7½ per cent; and the rebate for the next quinquennium is likely to include a similar bonus, although its size would not be decided until the summer at the earliest. Schemes funded by the rebate and providing only the GMP should be in surplus to the extent to the bonus. Arguably, therefore, the trigger for tax purposes should be no lower than the bonus implicit in the contracting-out rebate.

4. The timing of the new Inland Revenue scheme was rather awkward. Mr Fowler would shortly be negotiating with the pensions industry about the size of the bonus after 1988. There was a risk that a trigger point different from 7½ per cent would appear to compromise his position, depending on whether he wanted a higher or lower bonus.

5. Miss Noble commented that Mr Fowler's starting point was a contracted-out rebate of 5½ per cent which implied a bonus of slightly above 7½ per cent. His inclination would be to go for a higher rather than a lower figure, because the size of rebate would determine the minimum amount going to personal pensions. He could afford to concede a higher figure - a contracted-out rebate of 5¾ to 6 per cent; and the indications were that he wanted to settle at 5¾ per cent, which would be consistent with a bonus of at least 10 per cent. The Government Actuary added that a 5¾ per cent rebate could yield a surplus of 12 or 13 per cent using the projected unit credit basis of valuation and SERPS actuarial assumptions.

6. The Chancellor queried whether it was right to link the trigger point used by Inland Revenue for tax purposes with the bonus implicit in the SERPS contracting-out arrangements. In reality the bonus was there to encourage contracting-out. In the past it had been the outcome of a negotiation with the pensions industry, not an objective assessment of what was necessary for

prudential purposes. In addition, as Mr Monger had pointed out, the vast majority of private sector funds paid benefits in excess of the GMP and used the contracted-out bonus to reduce the size of the additional contributions needed to fund these benefits. In practice, therefore, funds would not be in surplus for the purposes of the new Inland Revenue scheme simply as a result of the working of the contracting-out arrangements.

7. The Government Actuary accepted that there was an element of incentive in the present contracted-out rebate. But Ministers had never publically justified the bonus in these terms. It had been related to quasi - actuarial considerations - such as the unfavourable age profile of some schemes, and unquantifiable risks. Purely from the prudential point of view, however, a surplus of 7½ per cent was probably higher than necessary; using the projected unit credit method of valuation and reasonable assumptions, a surplus of 5 per cent should be very satisfactory.

8. There were however possible practical problems in setting the trigger below the bonus. In principle an employer might be able to benefit himself by setting up a minimum GMP-only scheme, using a very secure funding and assumptions basis, collecting the contracted-out rebate, and taking a refund. Alternatively, to minimise tax liabilities under the new scheme, he might retain a proportion of the contributions for his own use. This was not an immediate problem since GMP-only schemes were not permitted until 1988 and, in any case, the administrative difficulties and formalities involved in setting up a contracted-out scheme might well mean that this possibility was largely theoretical. But it was possible that a trigger point of less than 7½ per cent could prove inconsistent with the OPB's standard which was defined in an entirely different way. He would therefore like to reflect further on the choice between 5 and 7½ per cent.

9. The Chancellor asked for early advice on this point. In principle he would prefer to avoid a linkage between the trigger point and the bonus; and ideally he would like a trigger of 5 per cent. But it would be important to consider the implications for Mr Fowler's forthcoming negotiations. While he was reluctant to modifiy the pension scheme in the light of the arrangements for contracting-out, it was not his intention to limit Mr Fowler's freedom for manoeuvre. The two should be kept separate; Mr Fowler was aiming to secure a large take up for private pensions, whilst the Inland Revenue proposals were intended to prevent abuse of tax relief, consistent with sound funding principles.

Presentation

10. The Chancellor asked how a 5 per cent trigger could be defended, assuming that was the Government Actuary's recommendation. In particular, how could charges of apparent inconsistency with the contracting-out arrangements be answered, bearing in mind the need to avoid compromising Mr Fowler's position.

11. In discussion the following point were made:-

(i) It would be important to establish from the outset that there was a difference of principle between the trigger point and the bonus implicit in contracting-out arrangements. Ministers would need to admit that the bonus contained an incentive for private pension provision. It was not a prudential requirement.

(ii) Whether the bonus implied an equivalent surplus would depend on the method used to value the fund. A feature of the Inland Revenue proposals was that they specified a particular valuation method - the projected unit credit basis and secure actuarial assumptions. Funds were not required to use this method for contracting-out purposes. Many used a less conservative method, and, to this extent, they would not be in surplus for the purpose of the new rules. (It would be helpful to know what proportion of funds did in practice use this method.)

(iii) Refunds - and the associated tax charge - were to a considerable extent voluntary. It was alway open to trustees to improve benefits above the GMP; it was only if they failed to do so - or to reduce contributions sufficiently - that they would have a surplus that would be judged excessive by the Inland Revenue.

12. The Chancellor said he would be grateful for the Government Actuary's assistance in working up a convincing presentation.

Other issues

13. In response to a question from the Chancellor, the Government Actuary said his only other concern about the proposed scheme was the administrative burden on the actuarial profession, given the number of other Government requirements that were being imposed on them at the same time. But he was reassured by Inland Revenue's view that it should be possible to restrict the requirement on funds below the trigger point to provision of an actuarial certificate. In a large number of cases this would remove the need for second valuations. Mr Corlett confirmed that while Revenue would need to have full valuations on the prescribed basis for cases where the surplus exceeded the trigger, and in some marginal cases which needed to be checked, the valuation done for internal purposes would normally be sufficient to indicate that funds were well below the trigger point on the GAD standardised assumptions. This issue had been covered in his paper for the overview meeting on 24 February.

Rh.

Distribution

Those present
Sir P Middleton
Mr Cassell
Mr Isaac - IR
PS/IR
Mr Scholar

RACHEL LOMAX

24 February 1986

LP6.88

BUDGET CONFIDENTIAL

FROM: P WYNN OWEN
DATE: 24 February 1986

MR MONGER

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Lord
Mr H Davies

PS/IR
Mr Prescott (IR)

PS/C&E
Mr Jefferson Smith (C&E)

CAR BENEFITS

The Chancellor has seen and was grateful for your minute of 20 February and Miss Frankis' and Mr Williams' minutes of 21 February. He agrees with your recommendations.

Rs.

P WYNN OWEN

covering BUDGET SECRET

H.M. CUSTOMS AND EXCISE
KING'S BEAM HOUSE, MARK LANE
LONDON EC3R 7HE

Please Dial my Extension Direct:
Use Code (01)-382 followed by
Extension Number 5..023...

pwp

Copy No 1 of 27

From: P G WILMOTT

Date: 25 February 1986

CHANCELLOR

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Cassell
Mr Monck
Mr A Wilson
Mr Evans
Mr Monger
Mr Odling-Smee
Mr Scholar
Mr Pratt
Mr Cropper
Mr Lord
Mr H Davies
PS/IR

EXCISE DUTIES: A BALANCED PACKAGE

I regret that the table attached to Mr Knox's minute of today's date contained three small errors: I attach a revised version to replace it.

P G WILMOTT

Internal circulation: CPS, Mr Knox, Mr Jefferson Smith, Mr Bone, Mrs Hamill

BUDGET SECRET

Duty	Price change	Revenue scorecard basis, £m 1986-87	1987-88
Alcoholic drinks	nil	- 175	- 190
Pipe tobacco/cigars	nil	- 5	- 5
Cigarettes/HRT	+ 11.1p /20ks	+ 180	+ 185
VED (cars)	nil	- 110	- 115
Petrol	+ 7.5p /gal	+ 110	+ 120
VED (lorries)	nil	- 25	- 25
Derv	+ 6.5p /gal	+ 30	+ 30
Bus fuel grants	-	- 5	- 5
Fuel oil	nil	- 5	- 5
AVTUR, lubricating oils, other rebated oils	-	- 20	- 20
Gas oil	+ 1.5p /gal	+ 25	+ 25
Total		0	- 5

Notes

1. If AVGAS and LPG duties abolished (cost - £10m), Gas oil increase becomes 2p a gallon.

2. RPI impact effect of package as a whole comes to 0.06% more than revalorisation.

Copy. 1 . of 16

1 Tony
2 Rhodes

BUDGET SECRET

FROM: H J DAVIES
DATE: 26 FEBRUARY 1986

CHANCELLOR'S MORNING MEETING   **51st MEETING**

NOTE FOR THE RECORD

Present: Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Mr Cropper
Mr Lord
Mr Davies

1. **THE FORECAST**

There was discussion of the forecast circulated under Mr Evans' note of 25 February, which appeared to have discovered £¾billion of additional revenue.

2. **MARINE DIESEL**

The Secretary of State for Transport had pointed out that marine diesel oil was not currently taxed at all. Mr Ridley did not wish to impose taxation for working vessels, but thought that users of pleasurecraft should be taxed. An additional reason for doing so was that there was evidence of abuse of the present position, with boat owners using untaxed diesel in land vehicles.

It was agreed that the late submission of the interdepartmental report on minor oil duties was most unfortunate, since it made it difficult to do anything on this type of point in this year's Budget. But the Minister of State would look into the position quickly.

3. SHIPPING

The Secretary of State for Transport had reiterated his extreme worry about the state of the British shipping industry. The Chancellor remained attracted by the strategic ringfence idea. There was also an issue involving lighthouse dues. In spite of Adam Smith's recommendation the UK imposed a charge on ships for lighthouses, and it fell mainly on large vessels which in point of fact did not use them. One possibility, to avoid removing the charge on foreign vessels (and revenue, at around £60 million, is significant) might be to add an exemption from lighthouse dues to the "strategic ringfence" package. The Financial Secretary had discussed these ideas with officials in a preliminary way. The Chief Secretary should look urgently at the papers and advise.

4. ENTERPRISE ALLOWANCE

The Financial Secretary had reported that a change in the tax treatment of the Enterprise Allowance Scheme to put it into Class 6 would not be widely welcomed, even though it was a concession. But it was agreed again that exemption was not on. The Financial Secretary should make it clear to Lord Young that it was Class 6 or the status quo.

5. GREEN PAPER ON PERSONAL TAXATION

The Financial Secretary reported on his discussions with members of the Cabinet. Most of them had not focused on the issue in detail, but seemed likely to be supportive. The Secretary of State for Energy was more critical. And Mr Fowler would be putting in the same paper to Cabinet arguing for family tax allowances.

6. AGRICULTURAL SUPPORT

The Chancellor would be talking to the Foreign Secretary about our approach to European negotiations. The Chief Secretary believed that a sea change of opinion was under way in the British Farming community. They were prepared now to think radically about the future, and ,in particular ,about a quota system on cereals, which had previously been unthinkable. He believed that our present policy in the community would not ultimately work, since the Germans would not be prepared to support us. We therefore needed, over time, to rethink our approach. Resting on pure price restraint was not, in the long term, a sustainable policy.

HJD

H J DAVIES

2812/24

CONFIDENTIAL

anything else this? r

FINANCIAL SECRETARY TO THE TREASURY

FROM: VIVIEN LIFE
DATE: 26 February 1986

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Mr Robson
Miss Sinclair
Miss Leahy
Mr Cropper
Mr Graham OPC
Mr Battishill IR
PS/IR

Ch
See first Carolyn Hubbard's minute of 17 February, and comments by David Pitts and Tony Battishill (18/2). Rather opaque stuff, but FST's recommendation seems right. Content?
AWK 28/2

Which oil companies will suffer from the FST's recommendations? & how much? & how do D.En know

NORTH SEA OIL COMPANIES: ACT AND RING-FENCE PROFITS

1. The Financial Secretary has read Mr Battishill's minute of 18 February covering Mrs Hubbard's minute of 17 February. He has discussed the proposals with officials. He was particularly concerned at the very high potential cost - £50-100 million - associated with taking steps to help the small companies who have major problems with stranded ACT. However, the only alternative solution appeared to be that identified in Mrs Hubbard's para 9. That is not currently thought to be workable, and even if a means of operating it were found, it would have a similar potential cost.

2. He has therefore concluded that any action to help the oil companies must be ruled out on grounds of cost.

3. However, he agrees it is necessary to close the newly found loophole and recommends that legislation to bring that about should be included in the 1986 Finance Bill.

4. He would be grateful to know whether the Chancellor agrees with these recommendations.

VL

VIVIEN LIFE

CONFIDENTIAL

BUDGET CONFIDENTIAL

pmf

10 DOWNING STREET

From the Private Secretary

26 February 1986

Dear Rachel,

BUDGET: INDIRECT TAXES

The Prime Minister is content with the proposed changes to the indirect taxes set out in the Chancellor's minute to her of today.

/27/2

CH/EXCHEQUER
REC. 27 FEB 1986
~~ACTION~~
COPIES TO
MST
SIR P MIDDLETON
MR CASSELL
MR SCHOLAR
MRS SINCLAIR
MR ROMANSKI
PS/C+E
MR KNOX - C+E
MR WILMOTT - C+E

Yours ever

David.

(David Norgrove)

Mrs. Rachel Lomax,
HM Treasury

BUDGET CONFIDENTIAL

SIFT OF BUDGET STARTERS

773/51

BUDGET CONFIDENTIAL

FROM: G W MONGER
DATE: 28 February 1986

FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Cassell
Mr Monck
Mr A Wilson
Mr Evans
Mr Odling-Smee
Mr Scholar
Mr Culpin
Mr Pratt
Mr Cropper
Mr Lord
Mr H Davies

Sir L Airey
Mr Isaac - IR
Mr Battishill

Sir Angus Fraser - C&E
Mr Knox

Ch. FST hasn't had time to comment in writing, but will give his views at the meeting

Rh.
28/2

SIFT OF BUDGET STARTERS

You asked us to sift again through the list of minor starters not included in the Bill to see if there are any that should be reconsidered.

2. The most interesting possibility thrown up by the sift was not an original starter: the imposition of a withholding tax on entertainers and sportsmen visiting the UK. It had been thought that this would not be practical before 1987 but I understood that the Revenue are sending you a note saying that it might be possible to do it in 1986. It would raise £100m or more in a full year, but has obvious political implications. Even if it is now possible for 1986, I doubt if it would be wise to try to do it in a rush. Miss Sinclair is submitting a separate note to you today on the implications (as commissioned at your meeting on 21 January).

(in separate folder

3. Otherwise, we have again been through the list of rejected starters. The attached annex picks out a few of the more plausible, but I am not arguing for any of them. Most of them are only too familiar and have been specifically rejected by Ministers.

G W MONGER

ANNEX

Relief from excise duty on oils used in research, development and manufacture of internal combustion engine

Pressed by SMMT. Cost about £6m a year. Rejected mainly because it would provoke pressure for a similar concession for other industries.

VED relief for international hauliers for time spent abroad

A DTp official starter, but not pressed by their Ministers. Cost about £5m in a year. Would be difficult to police and require additional Customs manpower. Now too late to devise a scheme before the Budget.

Car tax relief on cars supplied to Motability for leasing

Cost about £4m a year. Some risk of abuse. Ministers interested but decided that it should be reconsidered for 1987. Probably too late now to devise a scheme in time.

Heritage maintenance funds to be able to update CGT base value of their assets on settler's death

Cost £1-2m a year if it can be confined to maintenance funds. The right "lollipop" flavour but possibilities of avoidance and would lead to pressure for similar concession to other trusts. Rejected as recently as 10 February.

CTT 'douceur' concession

Present CTT concession applies to sales of heritage assets to specified, generally public, bodies. Proposal to extend it to non-public nature conservancy bodies. Cost unquantifiable but could be significant. Rejected by Ministers as a lollipop.

Blind allowance

Increase in line with RPI since last raised in 1981 would cost £2m. Ministers were attracted, but earlier decided to reconsider in 1987.

CGT: relief on land sales to repay farming debts

Would be helped by extension of the limits on the current relief for part disposals of land, under which CGT charge is deferred until remainder is sold. Cost depends on size of increase in limits. Still under consideration.

CONFIDENTIAL

Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

From: P Jefferson Smith

28 February 1986

MINISTER OF STATE

cc Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Mr Monger
Mr Cropper
Mr Lord
Mr H J Davies

Worth considering for 1987?

C/ To see.
Final sentence is the clincher this year.
R 28/2

MARINE DIESEL OIL

1. You asked for a report on a point raised by the Secretary of State for Transport about the untaxed use of marine diesel oil in pleasure craft, and associated misuse in land vehicles.

2. It is not quite right that marine diesel oil is untaxed. Only fuel for foreign going ships and heavy oil for use as fuel in ships in home waters is fully relieved from the duty charge. Fuel for pleasure yachts is specifically excluded from the home waters relief. Duty-free oil for foreign going pleasure craft is available only if the voyage is to a destination outside "home trade limits" i.e. to a place South of Brest or North of the River Eider (near Hamburg). This excludes most journeys by pleasure craft.

3. The rate of duty charged on marine diesel is, however, much lower (3 1/2p a gallon) than that on diesel oil (derv) used in road vehicles (about 69p a gallon). Derv and marine diesel are two of the many similar oils which are essentially gas oil. Much more gas oil is consumed than derv (in agriculture, on the railways, in construction and in large central heating systems). When the high rate of duty on derv was introduced fifty years ago to protect the revenue from petrol it was decided to limit the charge to fuel used in road vehicles, and this has been the position ever since.

Internal circulation:

CPS	Mr McGuigan	Mr Boardman
Mr Knox	Mr Wilmott	

518/2/86

CONFIDENTIAL

4. Gas oil chargeable at the 3 1/2p rate of duty is chemically marked and dyed to enable Customs to control misuse on the road. Pleasure yachts generally use marked oil and do not normally have access to unmarked duty-free supplies. We are not aware of problems through unmarked duty free diesel being obtained by yacht-owners and diverted to road use. The marked oil which they normally use would, if diverted to road use, be subject to detection by our road fuel testing vans. Although we make several thousand detections each year we do not regard yachts as a source of such oil. Marked gas oil is freely available for a wide variety of uses and there is no revenue restriction on its sale.

5. It would be possible to extend the full-rate road use duty charge to fuel for pleasure craft. It would, however, require extensive amendment of primary law as well as secondary legislation. In some areas it might create short-term difficulties in supply because separate storage tanks would become necessary. Customs would have to exercise control through the sampling of fuels in the tanks of the craft. Because craft can so easily go abroad e.g. to the Republic of Ireland, and could pick up fuel containing the statutory markers used in the UK, there could well be legal problems which we have not had time to explore. The best estimate we have been able to obtain, and we must emphasise that it is a very rough one, of the number of engined pleasure craft in the UK is of the order of 500,000. Most of these will be petrol-engined or have auxiliary engines only. We do not know what is the annual consumption of diesel-engined craft. We have not been able to estimate the administrative cost to Customs of ensuring use of the full rate fuel, but there would undoubtedly be one, and there would be "value for money" issues to be faced.

6. An additional tax on pleasure boating would be unlikely to provoke serious opposition. Our "guesstimate" of the extra revenue would be £5m-£10m. A charge could not be introduced immediately after a Budget without chaos because all fuel tanks would contain marked gas oil which would become illegal. There could be continuing legal problems because marked fuel could be put into tanks outside UK limits. If you are minded to continue to explore the possibility we would ask for more time to study the full implications and to report further. But it could not be a starter for this year.

P Jefferson Smith

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

FROM: MRS C B HUBBARD

DATE: 3 MARCH 1986

1. MR BATTISHILL

2. FINANCIAL SECRETARY

BS 170: NORTH SEA OIL COMPANIES: ACT AND RING FENCE PROFITS

1. You agreed (Miss Life's minute of 26 February) that it was necessary to close the newly-found loophole which could allow S.16 to be frustrated.

2. The loophole identified arises because the definition of associated company for the purposes of the ring fence provisions in OTA 1975 does not bring in "control" as part of the test, but relies on a simple definition of a 51% subsidiary and ordinary share capital. The associated company link can therefore be broken by the creation of another company X with ordinary shares which carry no voting rights and negligible dividend rights. More than 50% of the shares of company X are held by a third party, who is essentially a stooge. Company X, in turn, holds 49% of the equity in the ring fence company. The ring fence company can then pay dividends to X, account for ACT and set the ACT against its mainstream liability, as S.16 does not apply (X is not an associated company in terms of the S.19(3) definition), and company X will thereby have franked investment income which can be passed up the chain to obtain relief for non-ring fence losses.

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cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Mr Cassell
Mr Robson
Miss Sinclair
Ms Leahy
Mr Cropper
Mr Wilson
Mr Graham - Parliamentary Counsel

Mr Battishill
Mr Pollard
Mr Painter
Mr Pitts
Mr Elliss - OTO
Mr Beauchamp - OTO
Mrs Hubbard
Mr Reed
Mr Cleave
Mr Whitear
Mr Pang
Mr I Stewart
PS/IR

3. The actual definition of associated company, which we wish to amend, is not in S.16 itself, but in S.19(3) (Interpretation) which provides the definitions for all the ring fence provisions. On reflection, we feel that if we add a different, tighter, definition of associated company for S.16, it might draw attention to a potential weakness which could be exploited in the other ring fence provisions to which the general definition applies. We are not aware that the defect has ever been exploited, but we feel that it would be preferable to amend the definition across the board. It is very unlikely that it will have any effect on existing liabilities. (Amending S.19 rather than S.16 has the minor advantage that it will not automatically provide a vehicle for an amendment to the rest of S.16, although it will not, of course, prevent the substance being debated at the same time.) Because this is an anti-avoidance provision, we think that the change should be made with respect to dividends or other payments paid or made after Budget Day.

4. We would be grateful to know whether you agree that the change proposed should be made to S.19(3) rather than to S.16 itself, and starting after Budget Day.

CHubbard

MRS C B HUBBARD

BP/39

CONFIDENTIAL

1 R

2 - RP

FROM: P WYNN OWEN

DATE: 3 MARCH 1986

PS/MINISTER OF STATE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Monger
Mr Cropper
Mr Lord
Mr H J Davies
PS/C&E
Mr Jefferson Smith C&E

MARINE DIESEL OIL

The Chancellor has seen Mr Jefferson Smith's minute of 28 February to the Minister of State. He thinks this is worth considering as a starter for 1987.

Rs.

P WYNN OWEN

CONFIDENTIAL

b/f with FST's response (or 7/3)(p)

FROM: A W KUCZYS
DATE: 4 March 1986

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Mr Robson
Miss Sinclair
Miss Leahy
Mr Cropper
Mr Graham OPC
Mr Battishill IR
PS/IR
Mrs Hubbard - IR

NORTH SEA OIL COMPANIES: ACT AND RING-FENCE PROFITS

The Chancellor has seen your note of 26 February. He has asked which oil companies will suffer from the Financial Secretary's recommendations, and by how much? And do Department of Energy know anything about this?

A W K

A W KUCZYS

CONFIDENTIAL

Ref: 21J
Copy: 25 of 28

FROM: MRS R LOMAX
DATE: 4 March 1986

MR CASSELL

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Monck
Mr A Wilson
Mr Monger
Mr Scholar
Mr Culpin
Miss O'Mara
Mr Pratt
Mr Cropper
Mr Lord
Mr H Davies
Sir L Airey - IR
Mr Isaac - IR
Mr Battishill - IR
Mr Mace - IR
PS/IR

GREEN PAPER ON PERSONAL TAX: INCOME TAX DECISIONS

The Chancellor told you this morning that he had not yet reached a decision as between the two income tax options discussed at yesterday's overview meeting. But since both options involve statutory indexation of the main personal allowances that could now be regarded as a firm decision.

2. He recognised that today is the last date for taking account of income tax changes in the preparation of charts for the Green Paper. Accordingly he proposed that you should update the charts to take account of statutory indexation of allowances only, leaving the basic rate of tax unchanged at 30 per cent. If he subsequently decides to cut the basic rate, he accepts that it will not be possible to make further changes to the Green Paper.

3. The Chancellor asked you to confirm that this would raise no serious problems. Your provisional view was that a decision to cut the basic rate would affect some of the figures in the Green Paper, but these could readily be updated after publication for the benefit of eg the Treasury Select Committee.

4. The Chancellor would be grateful for early advice from Inland Revenue on the latest date for taking decisions about income tax for operational reasons. It would also be useful if Central Unit could provide advice on the wider implications (eg. for the Budget Red Book) of delaying final decisions about the package (and therefore maybe about the PSBR and oil price assumptions) beyond this weekend.

RL.

RACHEL LOMAX

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

FROM: MRS C B HUBBARD

DATE: 5 MARCH 1986

1. MR PITTS It is these smaller, independents, which are the concern here. In assessing whether to do anything for them on this point, you may like to know that only one, and that to a very small extent, is likely to be affected by the "onshore" point (on which Mr Peter Walker has now written to the Chancellor), but all are likely to be affected by the PRT instalment problem (Miss Life's minute of 3 March). Tricentrol have written on it.

2. PS/FINANCIAL SECRETARY

6/3

BS 170: NORTH SEA OIL COMPANIES: ACT AND RING FENCE PROFITS

1. The Chancellor has asked (Mr Kuczys's minute of 4 March) which companies will suffer as a result of the Financial Secretary's recommendations (ie which are currently suffering stranded ACT as a result of the operation of S.16 OTA 1975), and the amounts involved.

2. The BRINDEX companies involved are LASMO (who wrote to the Financial Secretary on 11 February setting out their problem), the Thomson Organisation and Tricentrol. As you know, the problem arises because of the difficulty of matching distributions with taxable profits in any year. Oil companies may have had ring fence profits in excess of their distributions in some years, giving rise to spare ACT capacity which, because

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cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Mr Cassell
Mr Robson
Miss Sinclair
Ms Leahy
Mr Cropper
Mr Wilson
Mr Graham - Parliamentary Counsel
Mr Battishill
Mr Pollard
Mr Painter
Mr Pitts
Mr Elliss - OTO
Mr Beauchamp - OTO
Mrs Hubbard
Miss Hill
Mr Cleave
Mr Reed
Mr Whitear
Mr Pang
Mr I Stewart
PS/IR

of the operation of S.16, can not be utilised in later years when their taxable profits are insufficient to cover the distributions which they feel compelled to make. Depending on their distribution policies, we estimate that the effect of S.16 on these three companies (based on their representations) is a disbenefit which, if relieved along the lines we proposed, would cost the Exchecquer in the first year something of the order of £5-10m, some of which could affect revenues in 1986-87, depending on how quickly the repayments could be made. The second year cost would probably be of the same order as the first year, and the total cost over the next five years would be about £30m for these three companies.

3. If no relief is given, the companies will have to carry forward the surplus ACT until such time that they have sufficient ring fence liability to obtain full set off. (LASMO have argued that they will have £26m unrecovered ACT by 1990 unless the restrictions are relaxed.) The effect on the companies is therefore a cash-flow disadvantage which imposes a financing cost. In addition, unless they can show that the ACT carried forward can be recovered in the next accounting period, the stranded ACT has to be written off in their balance sheets. This in turn affects their market ratings and exacerbates their vulnerability to predators, making it more imperative, in their view, to maintain the level of their dividends. (This point was made in an article (copy attached) in the Sunday Times of 2 March about Tricentrol's inability to pay a dividend out of current earnings, but their need nevertheless to pay a dividend to avoid a bid.)

4. The threat of takeover is not, of course, relevant to the major companies. Nevertheless, some of the major oil companies could also find themselves in the same position of having spare ACT capacity in previous years, and having insufficient cover for their future dividends. Hence the potential cost of any relaxation of S.16 of £50-100m, but this is, of course, subject to the various factors set out in paragraph 14 of my minute of 17 February.

. The Chancellor has also asked whether Department of Energy are aware of the problem. BRINDEX included this item in their general Budget representations before Christmas, which were copied to Department of Energy, and we know that at least one of the BRINDEX companies has since written on the subject to Department of Energy officials. Department of Energy have, however, taken the view to date that this is primarily a Revenue matter for decision by Treasury Ministers, and does not come into the category of structural questions affecting the future development of the North Sea, unless the companies can demonstrate that the impact of S.16 will have an adverse effect on their activities, which, so far, they have not done. On those grounds they have not brought it directly to Mr Walker's attention.

CHubbard

MRS C B HUBBARD

Morgan takes on the world

SOMEBODY, somewhere, must love Morgan Grenfell, the merchant bank that writes the rules as it goes along. It might be a shorter list than those who have reason to be upset, which would appear to be, in no particular order, the Office of Fair Trading, the Independent Broadcasting Authority, the Stock Exchange, the National Association of Pension Funds, and the Bank of England.

It's quite a list. Friday's public rebuke from the Bank is as hard a rap on the knuckles of a leading merchant bank as I can remember, and is a direct response to the swashbuckling tactics Morgan is developing to avoid losing takeover tussles.

The statement followed Morgan's spending of £360m on buying shares in Imperial Group for its client United Biscuits, as part of UB's attempt to swallow Imps. Neither UB nor Morgan can afford this sort of money, but an indemnity given by UB to Morgan enabled the bank to keep it off the balance sheet. The Bank does not name names in its circular – that would surely be the ultimate humiliation – but clearly does not approve of this tactic, despite what Morgan told us a week ago.

Next, the OFT. Graham Walsh, Morgan's head of corporate finance, assures me there is no conflict here, however much it might appear otherwise. Sir Gordon Borrie, says Walsh, is perfectly happy with the new proposals to get round the problems both with the Imps bid, and the other one powered by Morgan, that from Guinness for Distillers.

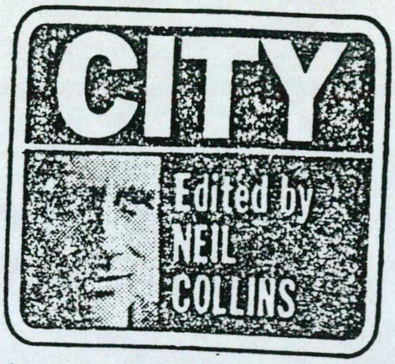
I'm sure he's right. But his colleague Roger Seelig was similarly confident that the original bid for Distillers would escape a referral to the Commission. It didn't.

Next, the Stock Exchange. On Friday a flurry of letters between Sir James Hanson and Sir Nicholas Goodison failed to persuade the Exchange to treat the UB market purchases as "super class one" transactions, requiring shareholders' permission rather than merely their forgiveness. The Exchange managed to draw a distinction between the acquisition of assets (which would need permission) and the assumption of liabilities (which do not). It's too clever for me. Even if the Exchange really believes in the distinction, it cannot much like having to split this hair.

Then, the NAPF. It is getting twitchy at the thought of all that [illegible] on Guinness' behalf, and Distillers' expense. The costs are [illegible] over £50m, and while their [illegible] like the commissions, they [illegible] it is they, the shareholders, who are really paying.

Finally, the IBA. Morgan's client, [illegible] Organisation, has now threatened the IBA with legal action if it [illegible] reconsider its decision to [illegible] Rank bid for Granada, [illegible] of the Coronation Street [illegible]. At last, here is something Morgan is doing that I can agree with. As I wrote last week, the IBA thoroughly deserves to lose this one, and it will make a splendid court case if it ever gets that far.

But one out of five is almost as poor a score as Morgan has managed in its last takeover battles. It is not a set of circumstances to inspire confidence that the City can look after its own affairs. Each deal that ends up in court devalues self-regulation, and brings statutory controls that little bit closer.



Reaction time

THE BATTLE for control of Beecham Group seems to be about to commence. Last week saw extraordinary activity in traded options, which are rapidly becoming the preferred way of getting aboard likely bid victims. We also saw the unusual spectacle of Sir John Harvey-Jones, the chairman of ICI, at a loss for words on the subject.

Next, we shall see some cracking figures from Fisons, the pharmaceuticals company that has been transformed under the hand of John Kerridge. The expectation has been for profits of about £67m for 1985, but I suspect Kerridge has a pleasant surprise up his sleeve and that profits to be revealed on Tuesday will surpass £70m, perhaps by quite a useful margin.

If all this sounds rather unconnected, perhaps it is. But the City is becoming increasingly alarmed at the lack of anything sensible coming out of the West London headquarters of Beecham since Lord Keith made history by becoming the first non-executive director to boot out an executive chairman.

At the end of a distinguished career, Keith is running Beecham, part-time and seemingly alone, through John Robb, the man he put in to replace Sir Ronald Halstead.

Among Halstead's faults, in Keith's eyes, was a failure to come to grips with the pharmaceuticals business – though presumably an enthusiasm for sinking a bottle of Lucozade a day did not count against him.

Faced with uncertainty, not to say eccentricity, at the top, Beecham has found itself losing intermediate executives, while the shareholders worry about what was not so long ago, one of their star investments.

Keith is conscious of their worries, but outsiders fear that he may do something spectacular to solve the problems. Says one: "I worry that he is capable of doing anything."

Among the front-runners are a takeover from ICI or a reverse takeover of Fisons, a business with a sense of purpose that makes Beecham look rudderless.

There is a huge gap between the value of Beecham and Fisons, even given Beecham's depressed state and the City's love affair with Fisons.

The dependence of Fisons on a single specialist family of drugs, once seen as a weakness, is now viewed as a strength.

Says Kerridge: "We are far ahead of anyone else in our own area, and we have a basic drug (the anti-asthmatic Intal) that is not only marvellously efficacious, but seems to disappear without trace after use."

But Keith, in response Friday night to stories that he will bid for Fisons in an attempt to get Kerridge and the Fisons team into the Beecham boardroom, said: "That's the first I've heard of it." It shows which newspapers he reads, if nothing else.

Practically nobody is happy with the current set-up at Beecham, but the current wave of mega-bids will not go on indefinitely. In time we may marvel that it ever was allowed at all.

If a Beecham deal is to be done, it must be done quickly.

Out in cold

COLD, isn't it? The only people who seem not to have noticed are the traders in the stuff that keeps us warm, oil. Smaller oil companies are hoping that the traders will take note of the weather soon, because the companies cannot make money with oil at $17 a barrel and the pound nudging $1.50.

The pain is not evenly spread. The big oil companies are making far too much from refining and selling the products (where taxation is light) to worry about the losses on production (where taxation is heavy). After the stock losses have passed through the system, the profitability of the likes of Shell and BP should not be seriously impaired. Prices would have to sink below $10 before North Sea production was threatened.

It's a different story for the independents. **Tricentrol**, for instance, is not making enough money to pay its dividend at present. Studies late last year showed that the company would be squeezed should oil prices fall below $22 and the pound rise above $1.40. Worse still, at $20 a barrel, profits on oil disappear unless the pound falls below $1.10 (because higher sterling devalues income).

The next dividend will be paid, because to do anything else would be asking for trouble, or at least a bid. But don't place too much weight on a yield of 11% at Friday's 128p.

Me[illegible] sto[illegible]

PROFITS from Conran's new group, the combin[illegible] Mothercare an[illegible] Home Stores gia[illegible] put together in a deal, will bar[illegible] progress this year[illegible]

In the past tw[illegible] Scrimgeour Vic[illegible] group's joint bro[illegible] twice downgraded dropping more tha[illegible] £104m against £[illegible] time.

The Storehouse s[illegible] slipped to 308p c[illegible] below the debut pr[illegible] combined group. T[illegible] recovered to be unc[illegible] 313p valuing the g[illegible] billion.

Scrimgeour, whose analysts consistently veys of investment concerned that othe[illegible] ing the company grading their foreca[illegible]

For the year wh[illegible] next month, most br[illegible] forecasting profits o[illegible] £120m.

But the firm now both British Hom[illegible]

Schr[illegible]

GET SOME SHA[illegible] Schroders ahead of sults next week. O[illegible] profits are likely to b[illegible] by about a third a[illegible] shares have been left in the recent ru[illegible] merchant banking sto[illegible] £11[illegible] they may be hea[illegible] they yield only 2.2[illegible] Schroders' corporate side is reviving strong[illegible] the Templeton issu[illegible] focused attention o[illegible] value of funds under m[illegible] ment. Schroders m[illegible] more than £10 billior[illegible]

☐ WATCH for a thr[illegible] fight with English Clays in the middle. sights is Rugby Po[illegible] Cement, a third its whose shares have rise[illegible] in 12 months to 165p. shares, at 335p, are record level on per[illegible] rumours of a bid Tarmac (denied) or the ing group Rio Tinto- which refuses to comm[illegible]

☐ AZIL Nadir fans switching from **Polly**

BUDGET CONFIDENTIAL

FROM: P WYNN OWEN
DATE: 5 March 1986

MR S A ROBSON

cc PS/Financial Secretary
Sir P Middleton
Mr Cassell
Mr Monck
Mr Moore
Mr Monger
Mr Scholar
PS/C&E

BGC PRIVATISATION: HEAVY FUEL OIL DUTY

The Chancellor has seen your minute of 4 March.

2. The Chancellor is not prepared to agree to an increase in the duty on heavy fuel oil in the Budget. He thinks Rothschilds are talking nonsense. He has noted that obviously profits growth from 1985/86 to 1986/87 will be hit by the oil price collapse to some extent. But this will not have any effect at all on the trend of profits thereafter, which is of key interest to potential investors. He notes that you and the Financial Secretary will have to do what you can to bump up profits <u>without</u> an HFO duty increase, and then float BGC at the best price available. It remains <u>eminently</u> saleable.

R.

P WYNN OWEN

CONFIDENTIAL

FROM: A W KUCZYS

DATE: 7 March 1986

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Mr Cassell
Mr Robson
Miss Sinclair
Miss Leahy
Mr Cropper
Mr Wilson
Mr Graham - Parliamentary Counsel
Mrs Hubbard IR

NORTH SEA OIL COMPANIES: ACT AND RING FENCE PROFITS

The Chancellor has seen Mrs Hubbard's further note of 5 March. In the light of this he now agrees with the Financial Secretary's recommendations in your minute of 26 February.

AWK

A W KUCZYS

CONFIDENTIAL

Pps A

RJP

FINANCIAL SECRETARY TO THE TREASURY

FROM: VIVIEN LIFE
DATE: 7 March 1986

MRS HUBBARD

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Mr Cassell
Mr Robson
Miss Sinclair
Ms Leahy
Mr Cropper
Mr Graham OPC
Mr Pitts IR
PS/IR

BUDGET STARTER 170: NORTH SEA OIL COMPANIES: ACT AND RING FENCE PROFITS

1. The Financial Secretary has read your minutes of 3 March and 5 March and Mr Kuczys' minute of 7 March. He would therefore like you to proceed with closing the newly found loophole in the 1986 Finance Bill.

2. On the specific question raised in your minute of 3 March, he agrees that the change proposed should be made to S.19(3) rather than to S.16 itself and starting after Budget Day.

VL

VIVIEN LIFE

FROM: P WYNN OWEN
DATE: 11 MARCH 1986

MR D N WALTERS

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Mr R Butler
Mr Monck
Mr Scholar
Mr Turnbull
Miss Noble
Miss O'Mara
Mr Culpin
Mr Pickford
Mr Pratt
Mr Haigh
Mr Romanski
Mr Porteous
Mr Fray
PS/Inland Revenue
PS/Customs & Excise

BUDGET DAY PRESS NOTICES BY OTHER DEPARTMENTS

We have now had all the replies we are likely to get to the second paragraph of my letter of 6 March to Sarah Straight.

2. The Department of Transport plan to issue three, or maybe four, press notices:

(i) VED;
(ii) VED Trade Licensing System;
(iii) Shipping;
(iv) Doubling VED back duty (still to be decided).

The Transport contact point is Paul Houston (212 8268).

2. The Department of Employment will issue one press notice on the employment package. Their contact point is John Pugh (213 7439).

Ro.

P WYNN OWEN

BT/50

PERSONAL AND BUDGET CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Mr Monger
Mr Romanski
Mr Cropper
Mr Lord
Mr H J Davies
Mr Jefferson-Smith C&E
PS/C&E

11 March 1986

The Rt Hon Kenneth Baker MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
LONDON SW1

Dear Kenneth

UNLEADED PETROL

In your letter of 30 December 1985 you suggested that there might be some fiscal benefit for unleaded petrol in the Budget. As you know, I am anxious to do what I reasonably can to assist its introduction. I am therefore glad to be able to tell you, on a personal basis, that I shall be announcing in the Budget my intention to create a duty differential in favour of lead-free petrol, though I will not be indicating a specific figure. My officials will be discussing with the oil companies how this can best be achieved in time for next year's Budget.

I am copying this letter, also on a personal basis, to Peter Walker.

Yours

Nigel

NIGEL LAWSON

BT/50

PERSONAL AND BUDGET CONFIDENTIAL

1. ~~Philip~~
2. ~~Rachel~~
3. RWP

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Mr Monger
Mr Romanski
Mr Cropper
Mr Lord
Mr H J Davies
Mr Jefferson-Smith C&E
PS/C&E

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

11 March 1986

The Rt Hon Kenneth Baker MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
LONDON SW1

Dear Kenneth

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Yours

Nigel

NIGEL LAWSON

BUDGET CONFIDENTIAL

Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

From: P Jefferson Smith

11 March 1986

CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Mr Monger
Mr Romanski
Mr Cropper
Mr Lord
Mr H J Davies

Ch/ better to come? Cropper to write?
Ke 11/3

Yes pse.
also add, @ the end of the other Baker letter, "I am writing separately on the question of lead-free petrol". N.

UNLEADED PETROL

1. The Secretary of State for the Environment wrote to you on 30 December 1985 with a number of taxation points. One concerned unleaded petrol, where he suggested that you consider leaving the excise duty on it unchanged in the Budget, even if other road fuel duties were raised. In view of your decision to announce a duty differential in favour of unleaded petrol, to take effect in 1987, after consultations in 1986, you may wish to let Mr Baker know the position: a draft letter is attached, which could also be copied to the Secretary of State for Energy.

2. We have now received from DoE at official level the summary of responses to their November discussion paper on unleaded petrol. This will be discussed by officials after the Budget, with the benefit of knowledge of your decision on the duty differential. The summary shows a wide measure of support for a fiscal incentive from oil companies, the car industry and consumer and environmental groups. Not surprisingly, oil companies are coy on just how large a duty differential is needed to secure a given price effect, but that is a matter which we can examine with them in the course of the consultations.

P J

P Jefferson Smith

Internal circulation:

CPS	Mr Knox	Mr McGuigan	Mr Wilmott
Mr Boardman			

171/3/86

PERSONAL AND BUDGET CONFIDENTIAL

A Lyre

~~DRAFT~~ LETTER, CHANCELLOR TO SECRETARY OF STATE FOR THE ENVIRONMENT

UNLEADED PETROL

In your letter of 30 December 1985 you suggested that there might be some fiscal benefit for unleaded petrol in the Budget. As you know, I am anxious to do what I reasonably can to assist its introduction. I am therefore glad to be able to tell you, on a personal basis, that I shall be announcing in the Budget my intention to create a duty differential in favour of lead-free petrol, though I will not be indicating a specific figure. My officials will be discussing with the oil companies how this can best be achieved in time for next year's Budget.

I am copying this letter, also on a personal basis, to Peter Walker.

NL

MS

14 MAR 1986 -28

BR

Urgent and Important

FP reply today plse

From the Director General

Motor Agents Association

In Association with the Scottish Motor Trade Association
201 Great Portland Street
London W1N 6AB
Telephone 01·580·9122
Telex 261962

CC APS/CHX
cc PS/MST

~~CHX~~ MST
15503/86

13 March 1986

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1P 3AG

Dear Chancellor

In view of widespread speculation that you may be thinking of increasing the excise duty on petrol and derv in your Budget next week, we would like to draw your attention to an important problem that would in that event arise from the change in the point at which duty is charged (from despatch from oil company depots to delivery ex-refinery).

This change means that on an increase in duty there will be a considerable gallonage of duty paid fuel in storage at oil company depots. The resulting retailer competition for the duty paid fuel must significantly disrupt oil company delivery schedules, which will in any event come under increasing pressure towards the beginning of the Easter holiday period, only ten days later.

Speaking, therefore, on behalf of some 7,000 members of this Association concerned with the retail sale of petrol and derv, I would ask you in announcing any increase in the rate of excise duty to those products to make it clear that:

a. the increase will apply to fuel in store at oil company distribution depots at midnight on Budget day;

b. you will therefore be requiring the oil companies to advise you of the gallonage in store at their distribution depots at that time so that the increased duty can be charged on it; but

c. in the event of it becoming possible at any time to reduce the rate of duty on petrol or derv, it would be the Government's intention to apply the same system in reverse and offer the appropriate rebate on fuel then in store at oil company depots.

It is our belief that most oil companies would also welcome such action. It would certainly help to avoid inequity as between petrol retailers and their customers and possible chaos in the distribution system between Budget day and the Easter holiday.

I am sending a copy of this letter to the Chairman of the Board of Customs and Excise. I apologise for only raising an important matter at such a late stage, but we had not previously recognised the extent of the potential problem.

Yours sincerely

David Gent

BUDGET CONFIDENTIAL

FROM: P WYNN OWEN
DATE: 13 March 1986

PS/CUSTOMS AND EXCISE

TOBACCO TAXATION

The Chancellor has asked whether the Budget changes will leave pipe tobacco and cigar (both together and separately) more lightly taxed than cigarettes, less taxed than cigarettes or taxed at exactly the same level as cigarettes.

2. He would be grateful for a note by close today. Perhaps it could include both the pre- and post-Budget position.

Rs.

P WYNN OWEN

BT/55

BUDGET CONFIDENTIAL

PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr Cassell
Mr Monger
Mr Scholar
Mr Robson
Mr Battishill
Mr Pitts
Miss Hill
Mr A Waklker
Mr Hill
PS/IR

Treasury Chambers, Parliament Street, SW1P
01-233 3000

S R Sklaroff Esq
Private Secretary to
The Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON
SW1P 4QJ

14 March 1986

Dear Stephen

... As promised when we spoke on the telephone, I now enclose the passage of the Budget Speech relating to oil taxation. Your Secretary of State was particularly interested in what the Chancellor is going to say on incrementals.

I would emphasise that the extract is not necessarily in its final form. The Chancellor will be working further on his speech over the weekend.

Yours ever

Tony

A W KUCZYS

I propose only minor technical changes to the taxation of North Sea oil; but I am continuing to keep the economics of incremental investment under review, and shall not hesitate to introduce at the earliest opportunity any changes which may prove necessary.

RT8.29

BUDGET CONFIDENTIAL

cc PS/FST
PS/MST
Mr Monger
Miss Sinclair
Mr Cropper
Mr Lord
PS/IR
Mr Prescott - IR

CHANCELLOR OF THE EXCHEQUER

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

17 March 1986

The Rt. Hon. Paul Channon MP
Secretary of State for Trade and Industry

Dear Paul

TAXATION OF FRINGE BENEFITS - COMPANY CARS AND FREE FUEL FOR PRIVATE MOTORING: 1987/88

As in recent years I am writing to you and colleagues concerned with details of the changes I propose to the scales for taxing these benefits, and which I shall be announcing in my Budget. These scales are set a year in advance, so the changes this time relate to 1987/88. The changes this year are also a little more complex than usual.

In response to representations from the SMMT and others, supported by Leon Brittan and by Nick Ridley, my main proposal is to change the present 1300cc and 1800cc engine-size breakpoints in both the car and car fuel benefits scales to 1400cc and 2000cc respectively, to align with those in the proposed EC Directive on motor exhaust emissions. This change will apply from April 1987.

Changing the engine-size breakpoints will place a significant number of company car users in a lower charge band than previously, and would therefore result in a loss of revenue. To prevent this, the scale charges themselves will also be adjusted so as to achieve broad revenue neutrality. In addition, I propose to increase the restructured car benefit scale charges by 10 per cent in 1987/88 in continuation of our policy gradually to increase these charges towards a realistic measure of the benefit.

There will, however, be no general increase in the car fuel scale for 1987/88. This will be kept at broadly the 1986/87 level, but with restructuring. From 1987/88, therefore, the car fuel scale will no longer be the same as the car benefit scale, recognising that the car fuel scale already comes close to a realistic measure of benefit.

I also propose that, from April 1987, the income tax car fuel scale should be used to assess VAT due on petrol provided out of business resources for private motoring by registered traders and their employees. This will simplify the present arrangements for restricting the amount of input tax that can be offset against VAT where petrol is provided for private motoring.

Finally, I also propose to increase by 10 per cent the scale charges for more expensive cars, and cars without a cubic capacity, but I do not propose to increase the cash breakpoints for these scales.

The main scales for 1987/88 resulting from these proposed changes are summarised below (1986/87 figures in brackets):

	Car Benefits	Car Fuel Benefits
1400cc(1300cc) or less	525 (450)	480 (450)
1401cc(1301cc) - 2000cc(1800cc)	700 (575)	600 (575)
Over 2000cc (1800cc)	1,100(900)	900 (900)
£19,250 - £29,000	1,450 (1,320)	Scale for relevant
Over £29,000	2,300 (2,100)	engine size applies

These proposals will be the subject of Treasury Orders during April.

I am copying this letter to the Prime Minister, and to Peter Walker and Nicholas Ridley.

Yours
Nigel

NIGEL LAWSON

2652/18

FISCAL ASPECTS OF UNLEADED PETROL

A. BACKGROUND

The Department of the Environment have recently issued a Consultation Paper in order to obtain the views of industry, motoring organisations and other interested bodies on possible measures to implement an EEC Directive (85/210/EEC) on the introduction of unleaded petrol throughout the Community by 1 October 1989. This decision was agreed at the EC Environmental Council in March of this year. EC Member States are required to inform the Commission of measures taken to implement the Directive by 1 January 1986.

The Directive states that Member States should "take appropriate measures to ensure as far as possible that leaded petrol is not used in motor vehicles designed to run on unleaded petrol". One possible measure, to overcome the cost disadvantage of unleaded petrol which is likely to be reflected in higher prices, is the introduction of excise duty differentials to favour unleaded petrol. The DOE Consultation Paper asks for views on this possibility, but it does state that "decisions on tax levels are a matter for the Chancellor's overriding discretion, in the light of his Budget judgement", and also points out that "relative prices at the pump would not necessarily reflect the full extent of the duty differential, and could vary from one forecourt to another".

UNLEA-
DED
PETROL

B. AA'S VIEWS

Lord Erroll stated last year the need for the Government to proceed with any move to unleaded petrol with caution. We understand that the AA have been sent several copies of this Consultation Paper. According to DOE they have yet to comment substantively although DOE have had informal discussions with the AA on the proposals contained in the Paper.

C. LINE TO TAKE

Any decision on the introduction of any measures to implement the EEC Directive must await the outcome of the DOE Consultation Paper. Although, any decisions on petrol duty levels are, of course, a Budgetary matter.

2811/17

PS/CX

NOTE OF A MEETING IN THE FINANCIAL SECRETARY'S ROOM IN HM TREASURY ON THURSDAY 13 FEBRUARY 1986 WITH CONSERVATIVE SMALL BUSINESS BACKBENCH COMMITTEE TO DISCUSS THEIR 1986 BUDGET RECOMMENDATIONS

Those Present: John Browne MP
John Townend MP
Peter Thurnham MP
William Cash MP
Henry Bellingham MP
Murray Charlton - Advisor to the Committee

Robina Dyall IR
Peter Michael IR

The members of the Committee raised the various points contained in the summary of their Budget Recommendations.

(1) Profits of Unincorporated businesses;

Mr Browne said that the tax treatment of unincorporated businesses should be the same as for smaller companies. Onerous audit expenses should also be reduced. He said that unincorporated businesses were currently at a disadvantage.

(2) Government R&D Bonds

Mr Cash thought that a bond payable to the Government would be very attractive to small companies especially in the high technology field. He stressed the telecommunications industry in particular and said that ideas from small companies' R&D programmes could benefit not only these companies but larger ones such as GEC.

The Financial Secretary wondered from which other sector of the business community the money for this would come since he assumed that the Committee favoured a revenue neutral package.

Mr Cash said that the Government would get the money spent on R&D bonds back through a general growth in industry and a consequent increase in tax revenues.

3(a) Capital Gains Tax

Mr Thurnham said that rollover relief should be extended to investment in equity shares of unquoted companies as another aid to the unquoted company sector.

3(b) **BES relief against tax on capital gains realised in the same year.**

Mr Thurnham said that small businesses should be able to receive the same treatment as farmers.

4. **Tax-free band for businesses**

Mr Townend said that many companies' biggest problems came in their second and third years when they needed cash for expansion. A tax free band of £5000 per annum would be a help. The measure could be revenue neutral by increasing corporation tax rates on company profits over £100,000. He said that this measure could perhaps be confined to the first three years of a small company's life.

5. **BES**

Mr Browne stressed the Committee's support for BES and agreed with the general idea of tightening up BES rules once in place rather than at the outset.

On this particular point he thought we should follow the example of the US where in equivalent schemes there was no intermediary between the investor and the entrepreneur. He said that paid directors, employees and their families investing in a BES company should be allowed to obtain tax relief and also that the various time periods contained within the BES rules should be shortened.

BES relief should also be allowed on "loan capital" when invested with an equity investment. He saw this as a good means of running a slightly subsidised lending scheme and getting low interest rate loans into BES companies.

The Financial Secretary said that it was good to hear the general support for the BES. On the families point he remarked that to implement what the Committee wanted would in effect give double tax relief creating a low-risk high relief situation.

Mr Townend favoured more spending on the BES but said that the wine trade should be excluded, together with other high asset-backed trades. Mr Bellingham wanted the bloodstock industry excluded.

Mr Charlton said that the Committee would very much like to be able to read the Peats Report.

6. **BES**

Mr Browne said that the BES fund managers were not interested in investments under £100,000 and if investment trust status could be aimed at smaller companies.

The Financial Secretary said that this would break the link between risk and relief and he wondered why others could not follow the St Helens example and work within the existing scheme. He was concerned at losing the impact of the basic thrust of the BES by introducing a measure of this kind.

7. **Loan Guarantee Scheme**

Mr Bellingham said that the premium to be paid was 'penal' and as a result there had been virtually no take-up in the last year. He said that Local Enterprise Agencies should be used more and the premium most come down to 2% at the most.

The Committee seemed divided on how helpful the Banks were in this area. Mr Cash thought that they were often unable to properly assess the risks involved due to a lack of competence at the appropriate level. He said that the LGS was doomed unless there was a change in the bank's attitude together with lower real interest rates.

Mr Browne, however, thought that it was unrealistic to force the banks to do the monitoring.

The Financial Secretary added that from experience of his constituency the attitude of the banks to small businesses was very much improved from that of six years ago.

8. **Stamp Duty**

Mr Thurnham pointed to the iniquity of the sudden cut-off at £30,000 and suggested a slice scale instead.

CONFIDENTIAL

The Financial Secretary noted the point and said that he would send a note to the Committee after the Budget showing the geographical variation in house prices and how the majority of people in the North in consequence did not face Stamp Duty.

N Williams

N WILLIAMS

17 FEBRUARY.

cc PS/Chancellor
PS/Chief Secretary
PS/Minister of State
PS/Economic Secretary
Mr Murray
Mr Cunningham
Mr Walker IR
Mr Michael IR
Miss Dyall IR
PS/IR

CONFIDENTIAL

VEHICLE EXCISE DUTY ABOLITION

A. AA'S VIEWS

In discussion with you last year Lord Erroll said that the AA were strongly against abolishing Vehicle Excise Duty (VED) and transferring the tax to the price of petrol. The AA believe that this move would create more injustices than exist at present and would unduly punish both high mileage and large car drivers. They also believe that if VED were abolished and replaced by a registration fee of, say, £10 it would encourage young people to run old unroadworthy cars and more generally there would be no adequate control over registration, insurance and MOT requirements. It is the AA's view that it would be far better to impose substantial penalties under the existing system for evasion of VED.

B. BACKGROUND

VEHICLE EXCISE DUTY ABOLITION

The Government looked at the possibility of abolishing VED as part of a wide-ranging review of the operation of the tax undertaken in 1979 and decided then that on balance the benefit did not justify such a major change.

One of the recommendations of the recent Public Accounts Committee report about VED enforcement and evasion was that, if a new survey of evasion to be undertaken by Department of Transport confirmed that evasion was still a major problem, further consideration should be given to alternative taxation systems and into ways of overcoming impediments to their adoption. The Government's response to the PAC report stated that this recommendation would be taken into account in the Government's consideration of the survey results.

In fact, the survey showed that evasion probably amounted to some £70 million to £110 million in 1984/85, representing between 3½ and 5 per cent of the total VED revenue. This is less than previously thought - the estimate given to the PAC by the Comptroller and Auditor-General was £135 million to £175 million, or 7 to 9 per cent of the total yield in 1982/83.

The Financial Secretary stated, in the debate on the PAC report on 24 October 1985, that "possible alternative forms of taxation have been examined, but none has been found to be preferable to the form that we have, even with its acknowledged disadvantage. I put that clearly on record".

Abolition of VED would mean additional tax of about 38p on each gallon of petrol to recoup the lost revenue.

C. **LINE TO TAKE (if raised)**

Although the possibility of shifting taxation from VED to petrol duty is kept under regular review, the Government have no immediate plans to abolish VED. They would only do so if the benefits of such a move were clearly greater than the disadvantages.

TOLLS

Background

NOTE NOT TO BE COMMUNICATED. The Secretary of State for Transport wrote to the Chancellor suggesting a review of tolls with a view to abolition. The Chief Secretary replied, ruling out the possibility of abolition.

TOLLS

1. Tolls are confined to estuarial crossings. There are 11 tolled estuarial crossings (see table). Tolls are set to cover the repayment of the debt, interest, and maintenance costs.

2. The accumulated debts of the tolled estuarial crossings total more than £500 million. The total is still rising, as tolling authorities continue to finance interest payments by further borrowing.

3. The local authorities, who own most of the crossings, have long campaigned for the Government to write off debts. They are supported by an organised anti-tolls lobby. This lobby includes the AA, the RAC, the Freight Transport Association, the Road Haulage Association, the local authorities themselves, and a group of about 30 MPs with a mainly constituency interest.

4. The AA gave oral evidence to a Transport Select Committee which is investigating tolls.

DEFENSIVE

Arguments raised by the AA in evidence to the Transport Select Committee Investigation on Tolled Estuarial Crossings

(i) Tolls policy is inconsistent.

Answer. Tolls are only charged when there are no counter arguments on the grounds of traffic diversion or congestion.

(ii) Tolls cause delay.

Answer. The Department of Transport has evidence that this is only so at the Dartford Tunnel where £7 million is being spent by the Department to double the capacity of the toll booths to match the capacity of the tunnel.

(iii) Debts are too large to be repaid through tolls.

Answer. This is possibly so at the Humber, but yet to be demonstrated elsewhere. Dartford debts will be repaid by mid 1990s. The Department gave evidence at the 1984 Severn Bridge inquiry that a proposed tolls increase would repay debts in 20 years. At Tyne an increase of only 20p would be needed to start repayment of the capital debt.

(iv) Government policy of 'user pays' for tolls is not applied elsewhere.

Answer. Tolls are paid at estuarial crossings because of the exceptional cost.

(v) Not only the user benefits from tolled crossings.

Answer. This is true, but there is no way to quantify and recover the benefits that non-users receive from the crossings.

(vi) Motorists already pay enough taxes without incurring further toll charges.

Answer.

(1) Taxation is not hypothecated because

(a) taxpayers do not generally receive benefits directly proportionate to their contribution to the Budget: all tax entails some redistribution.

(b) flexibility in both planning public expenditure and raising tax revenue would be reduced.

(2) Motorists pay £10 billion in tax. £3 billion is spent on roads. The extra £7 billion is not spare money. If tolls were abolished extra taxation would be needed to cover the £500 million debt incurred, or other areas of Government expenditure would need to be cut.

POSITIVE

Arguments for Tolls

(i) Tolls have enabled substantial and useful additions to be made to transport infrastructure which otherwise might have been delayed, or not provided at all.

(ii) Tolls enable journeys to be made which could otherwise be too time consuming or too expensive.

(iii) Tolls have not been imposed on crossings for which alternative routes exist, and where the effect would be to cause unacceptable levels of traffic to divert to unsuitable roads.

(iv) Tolled crossings are mostly used by local residents (over 70% of users of the Mersey Tunnel live in either Liverpool or the Wirral) and they help to pay for it.

(v) If tolls were abolished, alternative methods of handling both the principal and interest of the debts, and the maintenance and operating costs of the crossings, would need to be established by legislation. They are unacceptable (see arguments againsts tolls (vi)).

MAJOR TOLLED CROSSINGS

	SEVERN	ERSKINE	CLEDDAU	DARTFORD	FORTH	HUMBER	MERSEY	TAY	TYNE
OPENED	1966	1971	1975	1963 (1st tunnel) 1980 (2nd tunnel)	1964	1981	1934 (1st tunnel) 1974 (fully open)	1966	1967
OWNERS	Secretary of State for Transport	Secretary of State for Scotland	Dyfed County Council	Kent & Essex County Councils	Forth Road Bridge Joint Board	Humber Bridge Board	Merseyside County Council	Tay Road Bridge Joint Board	Tyne & Wear County Council
TRAFFIC	11.9 Million	4.0 Million	1.6 Million	16.0 Million	11.6 Million	2.9. Million	19.2 Million	5.1. Million	7.6 Million
TOLLS: Cars HGVs	50p £1.00	30p 80p	50p £1.00	60p £1.60	(Proposed) 30p (40p) 80p (£1)	(From 1 Jan 1986) £1 (£1.20) £4.50- (£5.20- £7.50 £[illegible].00)	(Proposed) 40p (50p) £1.00 (£1.20)	30p 75p	40p 80p
[illegible] INCREASE DATE	23 June 1985	1 November 1981	1 October 1985	1 January 1984	2 August 1982	30 July 1980	21 September 1981	30 August 1984	4 July 1982
TOTAL DEBT	£46.1m	£47.7m	£7.3m	£66.2m	£21.8m	£210.0m	£88.6m	£6.7m	£21.2m
EXCHEQUER DEBT	£46.1m	£47.7m	£3.6m	£6.5m	£21.8m	£160.5m	£27.7m	£3.0m	£14.7m
OPENING DEBT	£14.4m	£0.7m.	£11.8m	£51.3m (1980)	£14.1m	£140.6m	£39.3m (1974)	£5.6m	£13.0m
INCOME	£2.8m	£1.2m	£0.6m	£10.4m	£3.8m	£4.5m	£8.2m	£1.1m	£3.3m
OPERATING EXPENSES	£3.2m	£0.7m	£0.3m	£2.8m	£1.5m	£1.0m	£4.7m	£0.6m	£1.7m
OPERATING SURPLUS	- £0.4m	£0.5m	£0.3m	£7.6m	£2.3m	£3.5m	£3.5m	£0.5m	£1.6m
INTEREST CHARGES	£6.5m	£7.0m	£0.6m	£8.1m	£2.2m	£24.5m	£9.6m	£0.5m	£2.0m
ANNUAL DEFICIT	£6.9m	£6.5m	£0.3m	£0.5m	+ £0.1m	£21.0m	£6.1m	£0.0m	£0.4m

FINANCIAL INFORMATION FROM 1983-84 ACCOUNTS

2505 18/6

ROADS PROGRAMME

Background

1. There is continued pressure from the road construction lobby (CBI, TUC and the British Road Federation) for increased spending on roads.

2. They argue that increasing levels of traffic, including more and heavier goods vehicles, mean that existing roads require structural repair sooner than anticipated, new roads must be built to higher standards and the bypass programme must be stepped up. It is also well known that the GLC and the Metropolitan counties have neglected road building.

3. The AA argue for increased spending on bypasses. (15% of AA members want more motorways, while 60% prefer more bypasses).

ROADS PROG

Spending

(i) In 1985-86 £825 million will be spent on motorways and trunk roads in England of which £744 million is capital spending. This year nearly £1½ billion was allocated for spending on local roads in England; of which some £500 million was for capital spending.

(ii) In 1986/87 roads spending will increase by 10%, which is twice the overall average rise in next year's Public Expenditure.

(iii) There will be additional spending on local and national roads:

(a) Planned expenditure in 1986/87 on motorways and trunk roads in England will reach £900 million which is a £40 million increase over the plans in last year's Public Expenditure White Paper.

(b) In 1986/87 there will be an extra £37 million for national roads, of which £10 million will be for new construction and £27 million for capital maintenance.

(c) In 1987/88 there will be an extra £52 million for national roads, of which £24 million will be for new construction and £28 million for capital maintenance.

(d) There will be about an extra £20 million each year for local roads.

(e) In 1986/87 there will be an extra £630 million for local authority road maintenance funding.

(f) Since 1978/79 capital expenditure on motorways and trunk roads has increased by almost 30%.

Construction

(i) Since July 1983 168 miles of new or improved roads have been added to the national network, representing an investment £687 million.

(ii) 16 bypasses and relief roads have been opened since July 1983. Currently, 20 bypasses are being built and the revised programme contains 150 bypasses and relief road schemes in preparation.

(iii) In 1984/85 26 major construction schemes were completed, of which 16 finished early. At the end of that year a further 15 schemes in construction were running ahead of schedule.

(iv) There have been successful attempts to minimise disruption caused by road repair. As an experiment 4 contracts for major repairs in 1984 were let on a lane rental basis, under which penalties were imposed for overruns on contracts and bonuses awarded for early completions. In 1985 the scheme is being extended to 12 more contracts in view of initial success.

Local Roads

(i) Although we do not have the full economic appraisal for local roads, it is reckoned that the net benefits are £1.5 for every £1 spent.

(ii) Local authorities have traditionally underspent because of the anti-roads attitude of the GLC and the Metropolitan counties. The abolition of the met authorities will transfer responsibilities to districts.

(iii) There will be an additional £20 per annum in 1986/87 and 1987/88 for local authority roads capital spending.

(iv) Local road conditions have improved by about 10% since 1977.

(v) In 1983 the National Road Maintenance Condition Survey showed that, apart from urban principal roads, all classes of local authority roads were in a better condition than in 1977, the first year of the Survey. In terms of the measures used, defects had decreased by 7%.

BUDGET - SECRET

COPY NO. 1 OF 14

Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

From: P Jefferson Smith

17 March 1986

CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Mr Monger
Mr Cropper
Mr Lord
Mr H J Davies

C/ To note. Reassuring. RS 17/3

HYDROCARBON OILS : LETTER FROM MOTOR AGENTS ASSOCIATION (MAA)

1. Mr Gent, Director General of the MAA, wrote to you on 13 March expressing concern about possible disruption in the delivery of petrol to garages immediately after the Budget. He thinks there may be competition between retailers for pre-Budget duty-paid stocks and suggests that any duty increases should also be imposed on stocks held by oil comapnies in duty-paid tanks. The logic of his proposal is difficult to follow, but he may fear that oil companies will favour their own tied outlets with deliveries of pre-Budget dutied product and give them a competitive advantage against MAA independent garages.

2. To accept Mr Gent's proposal to tax duty paid stocks would involve complex legislation, would be impossible to administer with any degree of certainty without adequate preparation, and would almost certainly cause more chaos in the distribution chain than that feared by Mr Gent. In any case we do not believe that the difficulties envisaged by the MAA will arise. Adequate supplies should be available to meet demands.

Internal circulation:

CPS Mr Knox Mr Wilmott Mr McGuigan

BUDGET - SECRET

266/3/86

3. There is, it is true, undoubtedly more duty paid storage available under our new system of control than formerly, but we believe that Mr Gent's fears are really created by widespread expectation of a very substantial increase in the petrol duty, with competition between garages to obtain lower dutied supplies. If the MAA concern were justified this could have happened under the old system, except that competition for supplies would have taken place just before the Budget, rather than just after it. Mr Gent's surprising solution would ensure that all his members pay the post-Budget duty rate, rather than that they, or their customers, should have the benefit of lower dutied stocks.

4. We believe there will be adequate supplies of petrol available to meet any demand from garages, many of which will be "stocking-up" in any case. The emphasis in your Budget speech on the capacity of the companies to absorb the Budget increase should also smooth the change from one duty rate to another. We do not believe that Mr Gent's fears will be realised, and we recommend that you do not reply to him until after Budget Day, when we will submit a suitable draft.

PJ

P Jefferson Smith

FROM:- MRS M. HENSON

DATE:- 18 MARCH 1986

MR JEFFERSON-SMITH C&E

HYDROCARBON OILS: LETTER FROM MOTOR AGENTS ASSOCIATION (MAA)

The Chancellor has seen and was grateful for your minute of 17 March.

Meena Henson

Ms/3

FROM: MRS M HENSON
DATE: 18 March 1986

MR JEFFERSON SMITH - CUSTOMS AND EXCISE

HYDROCARBON OILS: LETTER FROM MOTOR AGENTS ASSOCIATION (MAA)

The Chancellor has seen and was grateful for your minute of 17 March.

Meena Henson
MEENA HENSON