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Den David

|| B/F 12/6

TV LICENCES: PAY-AS-YOU-GO

Thank you for your letter of 12 May requesting further information on the proposals set out in the Home Secretary's letter of 1 May to the Chancellor of the Exchequer.

The cash flow problems which pay-as-you-go licences would create for the BBC result from the fact that at present the licence fee must be paid in full before a licence can be issued. There are, of course, already schemes for spreading the cost of a licence over a year, including television licence savings stamps and instalment payment by direct debit. But these are, in effect, savings schemes in which participants pay for the cost of their next licence (and in which the BBC benefits from the interest on the payments). There is at present no way, apart from borrowing, that a licence holder can spread the cost of his licence over the period of its validity. The Home Secretary's proposals would allow this. The result would be that, with quarterly payments, three-quarters of the fee would be paid, on average, six months later than at present. At 10% interest, £58 paid on this basis has a net present value of about £2.18 less than £58 paid in full on the issue of the licence. A premium of this level would therefore be sufficient to offset the interest cost to the BBC of borrowing to make good the revenue shortfall as people switched to the new method of payment. As explained in the Home Secretary's letter, this borrowing could be as much as £170 million. However, a premium at that level would not be sufficient to repay the principal; and the BBC has made it clear that it would not be prepared to carry borrowing liability indefinitely.

A higher premium, as suggested in the Home Secretary's letter, would enable the borrowing requirement to be gradually reduced over a period of time, and eventually eliminated. In broad terms, the quarterly payment scheme proposed would, given the colour fee of £62 likely to apply in the first year of operation, result in an average borrowing requirement of £23.25 per licence ($£62 \times 0.75 \times 0.5$), which would be fully eliminated after about 9-10 years by a total premium of approximately £4.50 a year. The calculations do, of course, vary with differing interest rates, and the enclosed analysis shows the differing effects. You will see that Table 2, which shows the effect of a £3 premium, leaves the BBC with a substantial borrowing requirement even after 12 years.

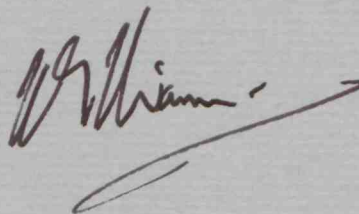
It would of course be possible, if the licence fee system was then still operational, to reduce or eliminate the premium once the borrowing had been repaid since it would then no longer be needed.

It is not possible to make a fair comparison with gas and electricity budget payment schemes since the conventional billing arrangements for these services have always involved quarterly payments in arrears. The budget payment schemes now available at worst spread negative cash flow effects over a much shorter period, but in many cases involve a degree of advance payment with consequent cash flow benefits. In contrast, as explained above, all television licence fees are now payable in full in advance.

In relation to general and water rates, there is a more realistic basis for comparison as these payments have traditionally been required in advance either in full or in half yearly instalments. Their payment in monthly or quarterly instalments must therefore have some adverse cash flow effects, but to the extent that these are not offset by reduced collection and enforcement costs there is (except in the case of rate-capped authorities) scope for the shortfall to be recovered through overall levels of charges, rather than through a separately identifiable premium.

The scheme proposed by the Home Secretary can be regarded as in some respects analogous to the facility to obtain a Vehicle Excise Duty licence valid for six months. The fee for such licences is 55% of that for twelve month licences. In this case the premium is intended to cover additional administrative rather than borrowing costs, but the principle is the same.

I am copying this letter to the Private Secretaries to members of MISC 128, and to Sir Robert Armstrong.

Yours ever


W R FITTALL

D R Norgrove, Esq.,

BEC CUMULATIVE DEFICIT
BY QUARTER (£M)

TABLE 1: £4.50 PREMIUM

Year	8%	10%	12%	Interest rate
1.00	57.81	57.81	57.81	
	95.49	95.76	96.02	
	112.66	113.38	114.10	
	108.91	110.19	111.44	
2.00	127.45	129.26	131.06	
	138.13	140.59	143.03	
	140.80	143.97	147.13	
	135.31	139.22	143.13	
3.00	153.76	158.40	163.07	
	163.73	169.20	174.73	
	165.06	171.43	177.90	
	157.58	164.88	172.32	
4.00	154.11	162.33	170.74	
	149.05	158.19	167.59	
	142.36	152.42	162.82	
	134.01	144.98	156.38	
5.00	129.83	141.69	154.09	
	123.97	136.73	150.13	
	116.41	130.06	144.48	
	107.11	121.64	137.06	
6.00	102.13	117.52	133.95	
	95.41	111.64	129.08	
	86.89	103.97	122.42	
	76.56	94.45	113.91	
7.00	70.71	89.39	109.85	
	63.02	82.49	103.95	
	53.47	73.70	96.15	
	42.00	62.97	86.41	
8.00	35.19	56.86	81.26	
	26.45	48.82	74.17	
	15.76	38.78	65.09	
	3.06	26.71	53.95	
9.00	(4.81)	19.42	47.57	
	(14.70)	10.10	39.14	
	(26.65)	(1.32)	28.60	
	(40.69)	(14.87)	15.90	
10.00	(49.73)	(23.48)	8.11	
	(60.88)	(34.24)	(1.85)	
	(74.19)	(47.19)	(14.02)	
	(89.69)	(62.39)	(28.49)	
11.00	(100.01)	(72.47)	(37.89)	
	(112.54)	(84.81)	(49.57)	
	(127.34)	(99.47)	(63.60)	
	(144.43)	(116.49)	(80.06)	
12.00	(156.16)	(128.22)	(91.28)	
	(170.21)	(142.33)	(104.91)	
	(186.62)	(158.87)	(121.04)	
	(205.46)	(177.91)	(139.73)	

TABLE 2: £3 PREMIUM

8%	10%	12%	Interest rate
58.30	58.30	58.30	
96.98	97.25	97.52	
115.66	116.40	117.12	
113.95	115.25	116.53	
134.75	136.62	138.46	
147.93	150.47	153.00	
153.34	156.64	159.94	
150.84	154.94	159.04	
172.54	177.44	182.38	
186.02	191.86	197.75	
191.14	197.99	204.94	
187.72	195.64	203.69	
188.44	197.43	206.62	
187.68	197.77	208.13	
185.41	196.62	208.19	
181.59	193.95	206.76	
182.08	195.59	209.65	
181.02	195.71	211.07	
178.38	194.27	210.98	
174.13	191.25	209.33	
174.35	192.70	212.18	
172.96	192.56	213.49	
169.91	190.81	213.22	
165.20	187.39	211.33	
165.12	188.62	214.11	
163.35	188.20	215.28	
159.87	186.08	214.81	
154.63	182.23	212.64	
154.21	183.21	215.32	
152.04	182.45	216.33	
148.07	179.93	215.62	
142.27	175.60	213.14	
141.48	176.28	215.71	
138.85	175.15	216.52	
134.35	172.18	215.54	
127.94	167.31	212.71	
126.72	167.65	215.12	
123.59	166.10	215.71	
118.51	162.62	214.41	
111.43	157.16	211.19	
109.75	157.11	213.41	
106.07	155.08	213.72	
100.34	151.03	212.07	
92.54	144.92	208.41	
90.33	144.42	210.39	
86.04	141.85	210.38	
79.62	137.18	208.33	
71.02	130.34	204.17	

Assumptions:

1. Maximum take-up of 50% after 3 years.
2. Scheme available only for colour licences, at £62 fee likely for 1988-89.
3. Quarterly instalment payments, not rising in line with any licence fee increase during the relevant year.

BROADCASTING — BBC Financing
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