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3 May 1988

The Rt Hon Douglas Hurd CBE MP
Secretary of State
Home Office
50 Queen Anne's Gate
London SW1

A handwritten signature in dark ink, appearing to read 'Douglas Hurd'.

ITV LEVY FOR CONTRACT EXTENSION PERIOD

Thank you for your letter of 18 April setting out your proposals for the form of the ITV levy to operate in the contract extension period from 1990 to the end of 1992. Our officials have discussed the details in the attachment to your letter.

I welcome your agreement that we should move away from the existing profits-based levy, to secure an increase in the total amount of revenue raised by the levy and, above all, to increase incentives to cost efficiency. While I understand your concern to minimise the risks that existing contractors will decline an extension to their contract, I do not find the arguments in favour of a mixed revenue and profits levy as convincing as you do. The further work which our officials have undertaken suggests that, while there is a risk that under certain combinations of revenue and cost growth some companies might go into deficit in the contract extension period, it does not appear that a revenue only scheme would increase this risk significantly. At the same time, a revenue only scheme has clear advantages in terms of reducing marginal effective tax rates, and thus encouraging contractors to improve their efficiency.

I do not believe, moreover, that the analogy between a mixed levy and the combination of competitive tendering and revenue levy which we envisage for 1993 is as close as you suggest. The purpose of the competitive tendering element is to encourage innovative bids and to ensure that monopoly profits are as far as possible eliminated. As we know from past experience, a profits levy has other effects:



if anything, it discourages innovation and its role as part of a mixed scheme would be more in the nature of a profits safeguard, although it is not clear that it will even fulfil this role very effectively. There is also the risk that if we adopted a mixed levy in 1990 it would be more difficult to move to a revenue levy in 1993 than otherwise.

I am, therefore, led to the conclusion that we should move direct to a straight revenue levy in 1990. As for the risks of instability feared by the IBA, many of the problems experienced in the early 1970s with the revenue levy then in force arose because of the very much higher levels of inflation then than now. With inflation at its current level, it should be possible to keep rates stable for at least the three years of the contract extension period, but if this was thought a problem then the thresholds could be indexed, as we envisage for the levy to apply from 1993.

On a more general note, it would be helpful to know more about the way the IBA will be conducting the contract extension exercise. I understand, for example, that they intend to give contractors, in the draft contracts, only a preliminary indication of the levy rates to be applied, with the precise rates being determined later. It would be helpful to know when we will actually need to determine the rates. We ought also to know what the IBA is intending to tell the contractors about the likely development of the broadcasting environment over the period. And, although the presumption is that all contractors will be awarded an extension, what would the position be if other potential contractors expressed interest in any of the franchises, or if any of the existing contractors declined to renew?

I am copying this letter to the Prime Minister, other members of MISC 128, and to Sir Robin Butler.

A handwritten signature in black ink, appearing to read 'Nigel Lawson', written over a large, stylized flourish.

NIGEL LAWSON

BROADCASTING: Finances pt 6.

