

cc PTH
QUEEN ANNE'S GATE LONDON SW1H 9AT

12 September 1988

Dear Chancellor of the Exchequer,

ITV LEVY FOR CONTRACT EXTENSION PERIOD

.... As you know, I wrote to the Chairman of the IBA on 6 June putting to him proposals for changing the levy from a profits to a revenue base from 1990. I enclose a copy of his reply. As expected, it sets out the Authority's concern that the change will produce a number of damaging consequences for the industry and for viewers. This view is also taken by the ITV companies themselves, who have complained to me in strong terms about our proposal to secure a substantial increase in the levy yield: the only support for the changes comes, not surprisingly, from TV-AM, the sole beneficiary of our proposal.

There is obviously a strong element of special pleading in all this and I can see no grounds for changing my view that the levy yield in 1990-92 should be no less than it would have been, other things being equal, had the structure not been modified in 1986. But it does seem to me that some of the points made by the IBA about the structure of the levy are valid, and lend support to my earlier view that we should, in what will be a short period of transition from the present ITV system to the much more competitive conditions of 1993, change to a levy based in part on revenue and in part on profits.

There are two points in particular to which I want to draw your attention. First, the redistributive effect on individual ITV companies. The IBA have worked out how the levy proposals in my letter of 6 June would affect ITV on a company basis. It is clear that the five largest ITV companies would be severely penalised, and this at a time when they will be taking most of the impact of the networking reforms and the moves to independent production which we have urged on them; but at the same time they will still be subject to fixed costs flowing from the obligations laid on them by the IBA when awarding their contracts.

Second, we need to bear in mind that the ITV companies will be operating against the background of legislation to create new competition from 1993 and to put all franchises to competitive tender. In these circumstances they will obviously have very strong incentives to maximise profits while they can. This could involve, as well as desirable increases in operating efficiency, attempts to cut back on programme standards which would in turn lead to dissatisfaction on the part both of viewers, since there will not yet be new competing services on the 5th and other channels,

The Rt Hon Nigel Lawson, MP.

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and of advertisers who already think that ITV does not do a good job of attracting audiences. A levy based on revenue alone could distort the balance of incentives for ITV while it still occupies a monopoly position on terrestrial services. It could also produce the result that the yield would be less in proportion to profits during this period than if the present levy - which is after all specifically directed to excess profits - had remained in force. This could in turn expose us to further criticism by the Public Accounts Committee.

..... A levy based in part on revenue and in part on profits would, I think, strike a better balance. The Annex to this letter sets out a simplified scheme which my officials have discussed with the IBA. The yield will be commensurate with that of the pre-1986 levy; and since the revenue element will make up a major part of the yield, the pressure on costs will be strong. However, the adverse redistributive effects will be mitigated by the profits-based element and, if there is a profits bonanza, the Government will extract its due share in this way.

David Young may want to comment on the extent to which a mixed scheme would also go some way towards meeting the concerns put to him as well as me about the effect of levy changes on the UK film industry.

I hope that you and colleagues can agree that I should announce a scheme on the lines of the Annex, subject of course to any necessary adjustment of the rates before proposals are included in next year's Finance Bill. On this basis I would also conclude that there is no need to bring BSB within the scope of a levy scheme which governed only the period 1990-92.

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

Yours sincerely,

AP
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Approved by the Home Secretary and
signed in his absence abroad.