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Road fuel prices and taxation

This paper looks at trends in fuel prices and other motoring costs and at changes to road fuel taxes over the last 10 years. The particular situation faced by rural communities is also considered.

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Summary of main points

- Between January 1999 and June 2000 the typical price of a litre of unleaded petrol in the UK rose from 62.9 pence to 84.1 pence – a rise of 21.2 pence or 34%.

- In June 2000 the typical price of 84.1 pence included 48.8 pence in excise duty, 12.5 pence in VAT and a pre-tax price of 22.7 pence.

- The price of petrol in the UK has gone from being among least expensive in the EU in the early and mid-1990s to around average in 1997, and the most expensive in 1998 and 1999.

- By April 2000 the overall cost of motoring was 5.6% higher, in real terms, than in 1987. Although the real cost of motoring has increased, it has risen less than the costs of using public transport.

- Those living in rural areas have a higher dependency on car usage.

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I Introduction

Between January 1999 and June 2000 the typical price of a litre of unleaded petrol in the UK rose from 62.9 pence to 84.1 pence – a rise of 21.2 pence or 34%. The price of petrol includes the raw material cost, distribution costs, wholesaler and retailer margins, excise duty and VAT. In June 2000 the typical price of 84.1 pence included 48.8 pence in excise duty, 12.5 pence in VAT and a pre-tax price of 22.7 pence. Based on the spot market price for unleaded petrol in London, the raw material content of the price was around 18-19 pence. Petrol prices in the UK are currently the highest in the EU.

The rise in petrol prices since January 1999 has reflected a combination of increases in excise duty in the March 1999 and March 2000 budgets and higher world prices for crude oil. In December 1998 the price of crude oil reached a low point of just under US$10 per barrel. Fourteen months later, in February 2000, it averaged nearly US$28 per barrel. On some days in June 2000, the spot price in London exceeded US$30 per barrel.

The rise in petrol and diesel prices over the past 18 months has resulted in complaints from both motorists and hauliers. For example, a *Dump-the-Pump* campaign is currently advocating a boycott of petrol stations on 1 August 2000 and every Monday thereafter.[1]

This paper looks at trends in fuel prices and other motoring costs and at changes to road fuel taxes over the last 10 years. The particular situation faced by rural communities is also considered. The costs faced by the road haulage industry were considered in a Library Research Paper in April 1999.[2]

II Fuel prices and the cost of motoring

A. Fuel prices

1. Trends in prices

Between January 1989 and May 2000 the average retail price of unleaded petrol increased by 130% and diesel by 144%.[3] This represents price rises over and above the increase in the general price level of 49% for petrol and 59% for diesel. The chart below illustrates the change in the price of fuel over this time.

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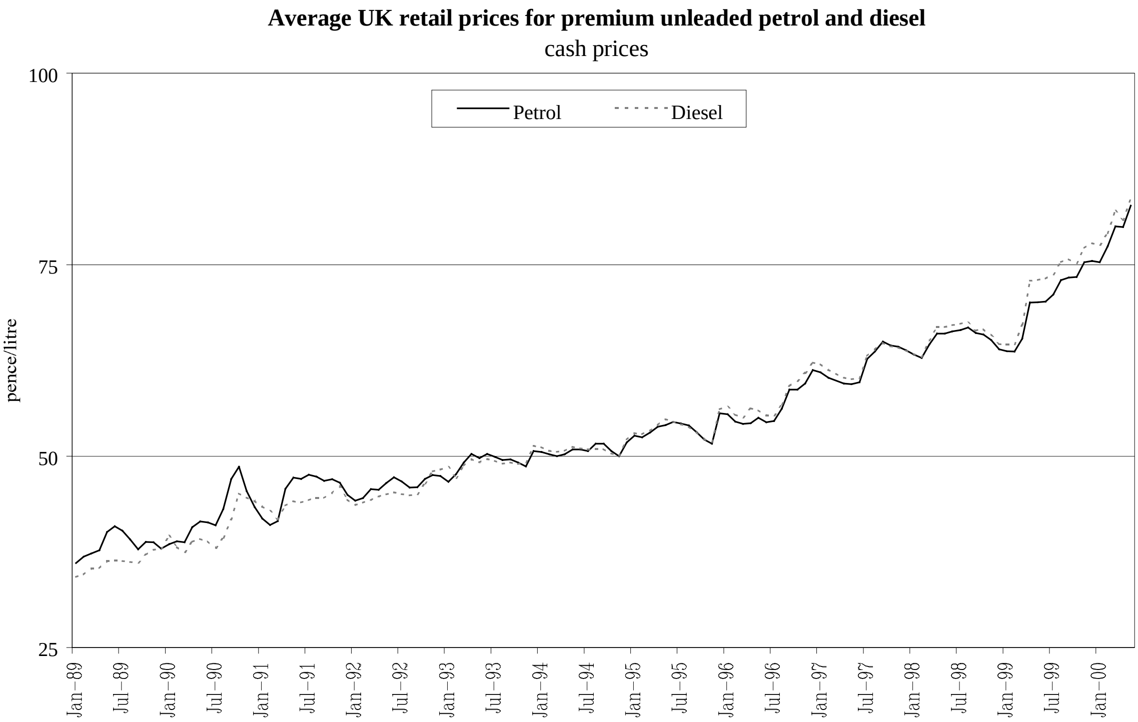
1 For details see: http://www.boycott-the-pumps.com/index.php

2 *The Road Haulage Industry: costs and taxes*, Research Paper 99/42. Available at: http://www.parliament.uk/commons/lib/research/rp99/rp99-042.pdf

3 *Oil datasheet 12*, Institute of Petroleum



The following chart shows index values for petrol, diesel, crude oil[4] and the Retail Prices Index (RPI). There were only small real increases in road fuel prices between 1989 and 1992. Since then, despite some monthly falls, they have increased faster than the RPI. The especially large increases since January 1999 are partially due to the increase costs of crude oil. The price of oil has varied dramatically over this time. This is reflected, to a limited degree, in changes to road fuel prices. The price of crude oil increased by nearly 200% between early 1999 and May 2000.[5] This resulted in an increase of around 13 pence/litre and 11 pence/litre for petrol and diesel respectively.[6]

4 North Sea crude prices

5 *Oil datasheet 14*, Institute of Petroleum

6 Includes additional VAT

Index of petrol, diesel and crude oil prices and the RPI
January 1989=100

2. Motorists' views

Not surprisingly, surveys of motorists show a strong feeling against the recent increases in the price of fuel. Different surveys have put the net support for the fuel duty escalator at -82%[7] and -89%.[8] Only a minority of motorists thought that higher prices would change their driving behaviour. Research by the RAC found that, faced with a 25 pence increase in the price of a litre of petrol, 24% of motorists would drive less and only 10% would use other forms of transport more. A further 14% would change the type of car they drove. 39% of drivers would not change their driving behaviour.[9]

Research by the AA shows that the cost of fuel is the issue of greatest concern to motorists – as drivers and users of cars. The amount of tax-take in fuel was next most important. The cost of fuel was deemed relatively more important by people who live in rural areas, those with lower incomes and younger people.[10]

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7 *The 1999 Lex report on motoring*, Lex Service plc
8 *RAC report on motoring 2000*, RAC
9 ibid.
10 *The Great British motorist 2000*, AA

3. International Comparisons

The latest fuel prices for EU states are shown below. The UK has the highest road fuel prices. The price of petrol and diesel were 18% and 56% higher than the EU average respectively. The price was also almost 3 times that in the US.[11] In 1999 the UK had the highest diesel price of all OECD countries and the second most expensive petrol, after Norway.[12]

Road fuel prices, EU members, 3 July 2000

£/litre

	Premium unleaded (95 RON) petrol	Diesel
Austria	0.62	0.48
Belgium	0.70	0.47
Denmark[(a)]	0.74	0.54
Finland[(a)]	0.77	0.52
France	0.72	0.52
Germany	0.66	0.48
Greece	0.54	0.42
Ireland	0.58	0.53
Italy[(b)]	0.71	0.55
Luxembourg	0.56	0.41
Netherlands	0.77	0.52
Portugal	0.56	0.39
Spain	0.53	0.43
Sweden[(a)]	0.74	0.55
United Kingdom[(a)]	0.85	0.84
EU average	0.72	0.53

Notes: Prices converted to sterling on basis of exchange rates on 3 July 2000
Comparisons between countries require care because of differences in product quality, marketing practices, market structure sales of other types of fuel.
(a) Ultra low sulphur diesel (less than 0.005%)

Source: *EU Weekly oil bulletin*

The next table shows trends in petrol prices in EU states since 1992. The price of petrol in the UK has gone from being among least expensive in the EU in the early and mid-1990s to around average in 1997, and the most expensive in 1998 and 1999.

11 May 2000 figures. *Oil Market Report*, International Energy Agency
12 *Energy prices & taxes, quarterly statistics, fourth quarter 1999*, International Energy Agency

Petrol[a] Prices in EU states, average annual values 1992 to 1999

£ per litre

	1992	1993	1994	1995	1996	1997	1998	1999
Austria	0.51	0.56	0.58	0.71	0.69	0.59	0.55	0.54
Belgium	0.51	0.57	0.60	0.66	0.71	0.63	0.58	0.59
Denmark	..	..	..	..	0.71	0.62	0.58	0.64
Finland	0.50	0.54	0.57	0.70	0.76	0.65	0.63	0.66
France	0.54	0.60	0.62	0.71	0.75	0.65	0.62	0.63
Germany	0.51	0.56	0.63	0.69	0.69	0.59	0.55	0.58
Greece	0.43	0.55	0.50	0.52	0.54	0.48	0.42	0.43
Ireland	..	0.55	0.54	0.57	0.59	0.56	0.51	0.49
Italy	0.68	0.65	0.64	0.67	0.74	0.66	0.61	0.63
Luxembourg	0.36	0.44	0.50	0.53	0.54	0.46	0.43	0.46
Netherlands	0.60	0.65	0.68	0.75	0.76	0.67	0.64	0.66
Portugal	0.57	0.59	0.59	0.65	0.66	0.57	0.54	0.53
Spain	0.53	0.53	0.52	0.54	0.56	0.49	0.45	0.46
Sweden	..	0.66	0.63	0.67	0.75	0.66	0.61	0.62
United Kingdom	0.46	0.50	0.52	0.54	0.56	0.62	0.65	0.70

Notes: Prices converted using exchange rates

(a) Premium unleaded petrol (95 RON)

Source: *Energy prices and taxes, fouth quarter 1999*

UK diesel prices were among the most expensive in the EU in 1992 and have been the most expensive since 1997.[13]

B. Motoring costs

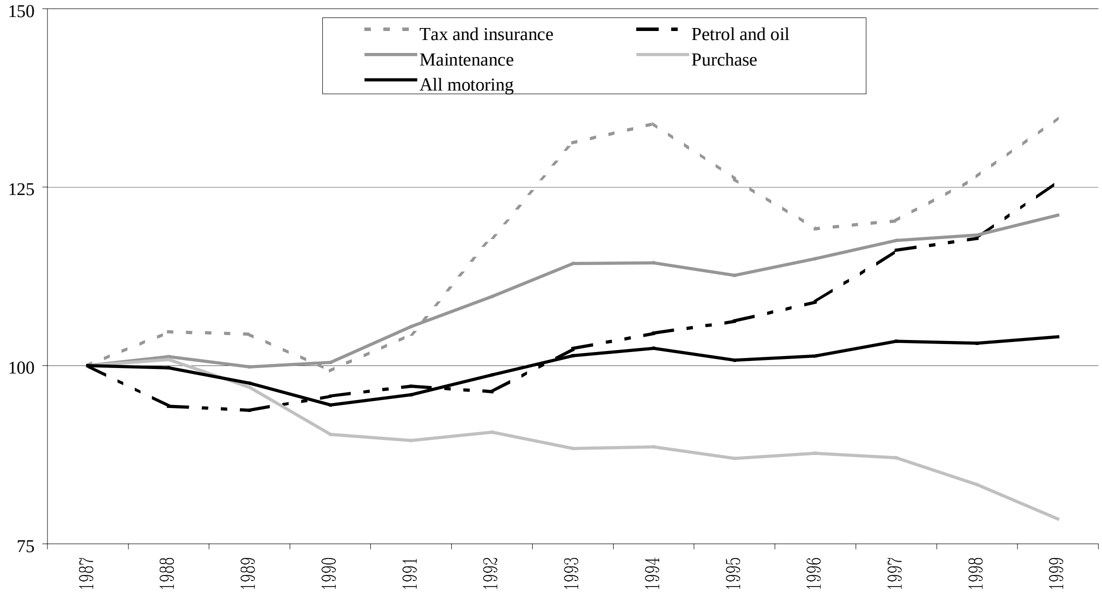
1. Trends in the UK

National Statistics data on the motoring elements of the RPI can be used to measure changes in the costs of motoring. The following chart show index values, where 1987 equals 100, of the real cost of various aspects of motoring. These are adjusted for general price rises, so a value of less than 100 represents a fall in real terms, and vice versa.

The cost of all elements of motoring combined fell in the late 1980s, but has risen, albeit rather gradually, in most of the following years. By April 2000 the overall cost of motoring was 5.6% higher, in real terms, than in 1987.

13 Based on annual averages; ibid.

Real index of motoring costs, by type, average annual figures 1987 to 1999
1987 =100



There are very different trends in each component of motoring costs. The purchase price is the only single element that has consistently fallen over this time. Petrol and oil prices increased by almost 45% in real terms over the last 10 years. Vehicle tax and insurance costs increased by more than 40% over the whole period. Much of the recent increase in this category is attributable to the dramatic rise in the cost of insurance premiums. According to the AA's *British Insurance Premium Index* the average comprehensive policy cost £538 in April 2000.[14] This has increased by over 46% in 3½ years.[15]

The AA also constructs an index of the cost of motoring. This is based on a 1,401-2,000 cc car that travels 10,000 miles a year. This index shows a slightly larger cash increase since 1994, around 22% compared to 17% using RPI figures.[16]

Although the real cost of motoring has increased, it has risen less than the costs of using public transport. The cost of rail and bus/coach fares, as measured by the travel components of the RPI, more than doubled between January 1987 and April 2000.[17] The real increases over this time were 18% for bus/coach fares and 21% for rail fares compared to 7.2% for motoring.

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[14] Includes Insurance Premium Tax
[15] British *insurance premium index, April 2000*, AA
[16] *The Great British motorist 2000*, AA
[17] ONS database, series DOCW, DOCX

2. International comparisons

The International Road Federation produces annual information on the annual taxation of five 'common' categories of vehicles. While this does not account for all costs of motoring it does include all taxes on acquisition, ownership and use. Estimates are available for a limited number of European states and are shown below. For passenger cars, the UK had among the highest levels of taxation of the EU countries. Both Iceland and the Netherlands had higher levels for each category. Taxation of Heavy Goods Vehicles (HGVs) was significantly higher in the UK than elsewhere in the EU, although Iceland had slightly higher taxation for the largest HGV category.

Examples of average taxation for 5 common types of vehicles
£ per year, 1998

	Passenger Cars			Goods vehicles	
	I	II	III	IV	V
Austria	457	636	1,417	7,038	13,416
Denmark	639	805	1,434	6,833	13,325
Finland	689	837	1,435	6,212	13,080
France	669	1,016	2,456	5,760	12,620
Hungary	440	535	865	824	10,437
Iceland	1,169	1,493	4,000	11,839	28,330
Netherlands	1,025	1,304	1,736	6,276	12,112
Norway	811	974	1,626	8,909	18,188
Sweden	458	651	1,028	4,951	11,058
UK	785	1,010	1,696	14,075	27,518

I 1,000 cc engine travelling 15,000 km and consuming 1,200 litres of petrol per annum

II 1,500 cc engine travelling 15,000 km and consuming 1,500 litres of petrol per annum

III 4,500 cc engine travelling 15,000 km and consuming 2,700 litres of petrol per annum

IV Goods vehicle of 16 tonnes laden weight operating at 75% capacity, travelling 50,000 km per annum and consuming 40 litres of diesel fuel/100 km

V Goods vehicle of 32 tonnes laden weight operating at 75% capacity, travelling 80,000 km per annum and consuming 50 litres of diesel fuel/100 km

Source: World roads statistics 2000, IRF

There are a number of limitations to this data that restrict its applicability. Estimates are not available for a large number of countries. The values are only indicative of likely taxation that would be faced. The categories used are necessarily limiting and the figures are based on tax rates from 2 years ago.

III Taxation of road fuel

A. Background

Excise duty is charged on most types of hydrocarbon oil - that is, leaded, unleaded and super-unleaded petrol, ordinary diesel and ultra low sulphur diesel, gas oil and fuel oil, aviation gasoline (but not aviation kerosene used in jet engines) and road fuel gas. Following the March 2000 Budget, the rate of duty on unleaded petrol and ultra low sulphur diesel is 48.82 pence per litre. In the first five months of 2000 these two fuels represented around 94% of all road fuels released for consumption.[18] The rate of duty on lead replacement petrol rate is 54.68 pence per litre and on conventional diesel the rate is 51.82 pence per litre.[19]

As with other excisable goods, VAT is charged on the full selling price, excise duty included. The table below shows the tax component – both duty and VAT – of the price of a typical litre of unleaded petrol. In June 2000 taxes represented around 73% of the price compared to 85% in January 1999. This fall reflects the rapid increase in the world oil price since February 1999, which has increased the proportion of the retail price that relates to the raw material cost.

Premium unleaded petrol

pence per litre

Mid-month	Typical retail price	Pre-tax price	Duty	VAT	Total tax Amount	Total tax % of price
Jan 1992	43.43	14.55	22.41	6.47	28.88	66.5%
Jan 1993	47.13	16.69	23.42	7.02	30.44	64.6%
Jan 1994	50.83	14.94	28.32	7.57	35.89	70.6%
Jan 1995	53.44	14.16	31.32	7.96	39.28	73.5%
Jan 1996	55.93	13.30	34.30	8.33	42.63	76.2%
Jan 1997	61.09	15.13	36.86	9.10	45.96	75.2%
Jan 1998	63.13	13.45	40.28	9.40	49.68	78.7%
Jan 1999	62.87	9.52	43.99	9.36	53.35	84.9%
Jan 2000	75.38	16.94	47.21	11.23	58.44	77.5%
June 2000 (b)	84.08	22.74	48.82	12.52	61.34	73.0%

Note: (a) Includes raw material and refining costs, distribution charges and traders' margins.
(b) Provisional.

Sources: DTI, *Digest of UK Energy Statistics*, 1999 table 9.15
DTI, Advance *Energy Statistics*, July 2000 table 4
HM C&E, *Annual Report 1998/99*, Cm 4447 table K1
HM C&E, *Budget Notice*, BN 62/00 21 March 2000

18 HM Customs & Excise, *Hydrocarbon Oils Bulletin*, 2 June 2000
19 HM Customs & Excise Budget Notice BN62/00, 21 March 2000

B. Revenues

The following table shows the trend in receipts of hydrocarbon oil duties. Between 1992/93 and 2000/01 receipts will have risen by around two-thirds in real terms and will represent some 2.5% of GDP this year compared with 1.9% in 1992/93. The rapid increase in revenues largely reflects the operation of the fuel duty ‘escalator’ originally announced in March 1993 (see section IIIC below). However, other changes have also contributed to the increase. For example, changes in the timing of the budget resulted in eight duty increases in the six years 1993 to 1998 inclusive.

Net Receipts of Hydrocarbon Oil Duties

Financial year	At cash prices (£ billion)	At 1999/00 prices (a) (£ billion)	Percent of GDP
1992/93	11.4	13.7	1.9%
1993/94	12.7	14.9	2.0%
1994/95	14.3	16.4	2.1%
1995/96	15.7	17.6	2.2%
1996/97	17.2	18.6	2.2%
1997/98	19.5	20.5	2.4%
1998/99	21.6	22.1	2.5%
1999/00	22.5	22.5	2.5%
2000/01 (b)	23.3	22.8	2.5%

Notes: (a) Revalued using the GDP deflator.
(b) Budget forecast.

Sources: NS - CSDB database
HM Treasury, Budget 2000, HC 346 1999-2000 tables C3 & C9

Oil duties only represent one form of taxation on road users. In addition to the £22½ billion raised by oil duties in 1999/00, the Exchequer also collected:

- some £5¾ billion in VAT relating to motor vehicles and road fuel[20]
- some £5 billion in vehicle excise duty[21]
- some £2½ billion in income tax on company cars and fuel[22]
- some £¾ billion in employers’ class 1A national insurance contributions on company cars and fuel[23]

These elements total over £36 billion. This total has been contrasted with the level of public expenditure on roads, which is estimated to have been some £5 billion in

[20] Source: Library estimate based on NS – CSDB database series CDDY & CCQI
[21] Source: HM Treasury, *Budget 2000*, HC 346 1999-2000 table C9
[22] Source: Inland Revenue, *Inland Revenue Statistics*, 1999 table 4.5
[23] Source: GAD, *Report by the Government Actuary on the draft up-rating orders*, Cm 4587 appendix 6

1999/00.[24] Of course, public expenditure on roads only represents a part of the overall cost to society of road transport. One might also include a charge for the cost of capital tied-up in the road infrastructure and the environmental costs in terms of CO_2 and other emissions and noise.[25]

C. The duty 'escalator' and recent changes

1. Introduction of the escalator

In the March 1993 Budget the then Chancellor, Norman Lamont, announced a 10% increase in road fuel duties, partly to compensate for the revenue loss from the abolition of car tax in November 1992. He went on to state that it was the Government's intention to increase duties on average by at least 3% a year in real terms in future Budgets.[26] With the imposition of VAT on domestic supplies of fuel and power, this long term strategy sought to return greenhouse gas emissions in the UK to 1990 levels by the year 2000, as agreed at the United Nations convention on climate change at Rio.

In the following Budget, the then Chancellor, Kenneth Clarke, increased road fuel duties by 3p per litre, representing an increase of between 8% and 10%, and announced that all road fuel duties would be increased on average by at least 5% in real terms in future Budgets.[27] Mr Clarke reaffirmed the 5% target in his 1996 Budget:

> I firmly believe that motorists should bear the full costs of driving - not only wear and tear and congestion on the roads, but the wider environmental costs. Even those of us who frequently have to drive - and, contrary to rumours that Ministers always travel in limousines, that includes most hon. Members - can take steps to cut fuel consumption and we all ought to consider carefully the use of our car. I intend to stick to my 1993 Budget commitment to raise motor fuel duties by an average of at least 5 per cent. each year in real terms.[28]

The decision to increase fuel duties well in excess of inflation over this period raised considerable sums for the Exchequer, as a written answer from 1998 set out:

> **Mr. Nicholas Winterton:** To ask the Chancellor of the Exchequer what revenue would have been foregone since 1992 from duty in petrol and diesel fuel excise duties if those duties had been increased in line with the retail price index.

24 Source: HM Treasury, PESA 2000/01, Cm 4601 table 4.5
25 For further discussion of these issues see, for example, David M Newbery and Georgina Santos, "Road Taxes, Road User Charges and Earmarking", *Fiscal Studies*, June 1999 pp103-132
26 HC Deb 16 March 1993 c183
27 HC Deb 30 November 1993 c937
28 HC Deb 26 November 1996 c167

Dawn Primarolo: HM Customs and Excise's estimate of the revenues that would have been forgone since 1992 had petrol and diesel fuel excise duties been increased in line with the retail price index is shown in the table.

Financial year	£ billion Revenues forgone
1992-93	0.2
1993-94	1.4
1994-95	2.7
1995-96	3.9
1996-97	5.0

The estimates include VAT and take account of expected changes in the pattern of consumers' expenditure as a result of the lower duty increases.[29]

2. Changes to the escalator since 1997

In his July 1997 Budget, Gordon Brown announced a significant increase in duty rates as part of a wider reform in tax policy:

> A country equipped for the future should also have a modern tax system based on principle. The tax system sends critical signals about the economic activities that a society wishes to promote and deter. Today I shall start to put those principles into practice by demonstrating our commitment to the environment. As the statement of environmental principles […] - published today - shows, we are determined that our tax system and economic policies as a whole encourage the good and discourage the harmful. […]
>
> Existing taxes, including our excise duties, must also advance the Government's environmental objectives. So to reduce pollution, lorries and buses that meet low emission standards will, from next year, attract a reduction of vehicle excise duty by a maximum of £500. Rises in vehicle excise duty, broadly in line with inflation, will take place from 17 November. In line with the environmental objectives that I have set out, road fuel duties will increase by an extra 1 per cent. every year over and above the annual 5 per cent real rate of increase established by the previous Government. Petrol will go up by the equivalent of 4p a litre from 6 pm this evening.[30]

Further details on the Government's aim in increasing its commitment to raise duty rates were given in a press notice issued at the time:

> The increased commitment to 6 per cent recognises the environmental and other costs attached to road use. Road traffic is the fastest growing source of carbon

[29] HC Deb 25 March 1998 cc207-208W

[30] HC Deb 2 July 1997 c311

> dioxide and the increased commitment will therefore provide a significant contribution to meeting the Government's target for a 20 per cent reduction in emissions of carbon dioxide by the year 2010. Assuming that such 6 per cent increases are made for the lifetime of this Parliament, this will produce additional savings, by the year 2010, of around 2½ million tonnes of carbon annually. Increased road fuel taxation meets the general principles for good taxation set out in the Government's Statement of Intent on Environmental Taxation.[31]

The Government's statement of intent, mentioned by the Chancellor, is reproduced below:

> The Government's central economic objectives are the promotion of high and sustainable levels of growth and high levels of employment. By that we mean that growth must be both stable and environmentally sustainable. Quality of growth matters; not just quantity. Delivering sustainable growth is a task that falls across government. It will be a core feature of economic policy under this administration. The Treasury is committed to that goal. How and what governments tax sends clear signals about the economic activities they believe should be encouraged or discouraged, and the values they wish to entrench in society. Just as work should be encouraged through the tax system, environmental pollution should be discouraged.
>
> To that end, the Government will explore the scope for using the tax system to deliver environmental objectives - as one instrument, in combination with others like regulation and voluntary action. Over time, the Government will aim to reform the tax system to increase incentives to reduce environmental damage. That will shift the burden of tax from "goods" to "bads"; encourage innovation in meeting higher environmental standards; and deliver a more dynamic economy and a cleaner environment, to the benefit of everyone.
>
> But environmental taxation must meet the general tests of good taxation. It must be well designed, to meet objectives without undesirable side-effects; it must keep deadweight compliance costs to a minimum; distributional impact must be acceptable; and care must be had to implications for international competitiveness. Where environmental taxes meet these tests, the Government will use them.[32]

In his spring 1998 Budget speech the Chancellor confirmed the Government's commitment to increasing fuel duties by at least 6% in real terms each year:

> The previous Government introduced a road fuel escalator, the principle of which we supported. They set it at 5 per cent, and since July it has been 6 per cent. There is agreement that only with the use of an escalator can emission levels be reduced by 2010 towards our environmental commitments. As a result of the escalator, road fuel tax will rise by 4.4p a litre for unleaded petrol and for ultra-

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[31] HM Customs & Excise press notice, *Increases in fuel duties to help the environment*, 2 July 1997

[32] HM Treasury press notice, *Tax measures to help the environment*, 2 July 1997

> low sulphur diesel. As is normal, that change will take effect on Budget day at 6 pm.
>
> To encourage all diesel users to switch to cleaner fuels, ordinary diesel will increase by 1p more than that. These increases will reduce carbon emissions by 1.7 million tonnes of carbon. Of course, the price of petrol will also be affected by movements in oil prices. The oil price has fallen by 25 per cent. in the past six months: a benefit enjoyed by oil companies which has yet to be passed on to consumers, especially consumers in rural areas, who already pay higher fuel prices, which is something the Office of Fair Trading is already investigating. Whatever the short-term changes in oil prices, however, the Government have a duty to take a long-term and consistent view of the environmental impact of emissions, and that is what we have done.[33]

The environmental impact of the fuel escalator was estimated in a written answer given in March 1999:

> **Mr. Whittingdale:** To ask the Chancellor of the Exchequer what plans he has to continue to implement the road fuel duty escalator in future years; and if he will set a final date for implementation of the duty escalator.
>
> **Ms Hewitt:** The road fuel escalator, which provides for duty increases on road fuels of at least 6 per cent above inflation, shows the Government's continuing commitment to the environment and to the 'polluter pays' principle. It will help the Government to deliver the UK's share of the EU target to reduce emissions of greenhouse gases by 8 per cent by 2008-2012. Our environmental assessment shows that the escalator, if continued at its present level until 2002, will improve urban air quality and reduce greenhouse gases by between 2 and 5 million tonnes of carbon a year by 2010. The future of the road duty escalator will be considered each year in the Budget.[34]

3. The withdrawal of the escalator and the April 2000 increase

In its 1999 *Green Budget*, the Institute for Fiscal Studies made the following observations on the long-term viability of a duty escalator:

> Revenue from excise duties has grown rapidly in recent years – more quickly than revenue from income tax and corporation tax. Most of this growth has come from large real increases in duties on tobacco and petrol. There is an economic justification for duties on these goods if there are additional costs to society from their consumption. This is not to say that the amount of social cost associated with smoking and driving is reflected exactly in the level of duty each year. But

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33 HC Deb 17 March 1998 c1110

34 HC Deb 24 March 1999 cc257-258W. Following the withdrawal of the escalator these estimates have been scaled back. It is now estimated that the escalator over the period 1996 to 1999 will result in carbon savings of around 1 to 2.5 million tonnes of carbon by 2010 and small reductions in emissions of local air pollutants. Source: HM Treasury, *Budget 2000*, HC 346 1999-2000 table 6.2

> the fact that smoking and driving are known to have harmful consequences makes them soft targets for a government reluctant to raise income taxes.
>
> One question is whether the large real duty increases can continue, particularly given the distributional consequences of high excise duties. Tobacco taxes are becoming more regressive to the extent that smoking is increasingly concentrated among poorer households, while high taxes on petrol have a greater impact on those with little access to public transport. There are also the revenue effects of higher excise duties to consider. Cross-border shopping has led to some debate over the revenue consequences of further increases in alcohol duties, although, as we show, cutting duties on beer and wine would probably lead to a loss in revenue rather than an increase. Cross-border trade in cigarettes appears to be less about the revenue effects of shopping than the revenue effects of smuggling, for which changes to excise duties are not the most appropriate response. A greater threat to future revenue from tobacco duties comes from the government's aim of cutting the number of smokers for health reasons.
>
> Equally, duties on petrol have been raised in the hope of reducing car use for environmental reasons. This is the contradiction that lies at the heart of excise duties. They are targeted at changing behaviour. They are also good sources of revenue. In the long run they cannot be both.[35]

An analytical piece in the *Financial Times*, published in September 1999, argued that the Government's policy to use the price of petrol to deter road use was fundamentally flawed, drawing an analogy with the impact of tobacco taxes on smokers' decision to give up tobacco:

> Cars, you could say, are like cigarettes. They pollute the air we breathe; they kill large numbers of people; and they are associated with high levels of dependency among users. But does it follow that governments should treat drivers like smokers, portraying their habit as anti-social and trying to discourage it with punitively high taxes? In Britain, where traffic congestion has become a troublesome political issue, the response of governments has been to try to price motorists off the roads …
>
> The idea of using price to regulate people's behaviour grew in popularity in the 1980s, when - at least in the US and UK - free market economics replaced government regulation as the favoured means of achieving social objectives … An attractive precedent appeared to have been set by attempts to control smoking, another habit with high social costs. In the 1980s, big rises in cigarette taxes had been accompanied by a gradual decline in smoking, and the government was praised by anti-smoking advocates for discouraging socially undesirable behaviour.

[35] IFS, *The IFS Green Budget*, Commentary *76*, January 1999 p90

But, with hindsight, it seems likely that smokers who quit were motivated more by concerns about their health than by the government's price signal. In Britain, smoking also declined in the 1970s, even though the real price of cigarettes fell during the decade [...] Moreover, in the 1990s, the long decline in smoking has ended in Britain in spite of further big tax increases. It seems that smoking has now settled at a level where those who indulge in it cannot or will not give up. Each successive tax increase simply results in higher levels of criminal activity: namely, soaring imports of contraband tobacco, now said to account for at least 10 per cent of the UK market.

The same sort of resistance to price increases is evident in people's driving behaviour. According to Britain's office for national statistics, motoring costs for the average household rose 96 per cent in the 10 years to financial year 1997-98, or 27 per cent in real terms. But the rise was not accompanied by a fall in traffic: the number of miles travelled by people in cars rose 24 per cent over the same period. It is also interesting to note that people's ability to absorb higher motoring costs is not just a side-effect of rising incomes. Instead, it has come at the expense of spending in other areas. The percentage of household expenditure taken by motoring rose from 12.6 per cent to 14.2 per cent over the decade to 1997-98: so it seems people would rather economise on food, heat or holidays than cut down on their driving.

At this point, economists usually start talking about elasticity of demand, pointing to neat charts tracking the relationship between price and consumption. This is fine when applied to goods for which an acceptable alternative exists, or that do not involve a high level of dependency. It is less successful at predicting outcomes when governments use taxes to stop people using things they cannot or will not go without. In theory, economists are right: there is a point at which price will cut demand for road transport. The trouble is that such a price is by definition unacceptable. If it were not, it would fail to cut consumption […]

So if the government cannot tax traffic growth out of existence, what is the alternative? Some people think better public transport is a panacea. Unfortunately, it is not. Motorists like governments to spend money on public transport because they think it will encourage the idiot in the car in front to catch the train instead. But for most drivers, public transport is like the nicotine free cigarette: it's nice to know it's there, but you would never want to use it. Instead, the first priority should be to recognise that, contrary to popular perceptions, traffic growth is not inexorable. It will cease when everybody is driving 24 hours a day, and probably long before that. In the meantime, better traffic management will help absorb the extra traffic, and roads should be built or widened where environmental considerations permit.

But there is no magic bullet that will end traffic jams. Congestion is a part of modern life: we find it at the supermarket, the airport, the burger bar and the hospital, and the art of modern life is to learn how to deal with it. Motorists are already doing this quite well. No new roads have been built in central London for decades, yet traffic speeds in the capital have not fallen greatly. Instead, the rush-hour has expanded to the point where it lasts all day, and is now stretching into the night. Drivers themselves are the best judges of how to deal with congestion.

> They will adjust their journey times to maximise the use of the available road space, or they will change their lifestyles to minimise their travel needs. Eventually, like smokers, they may even decide to quit. But if they do, it will be when they are ready, not when the government tells them to.[36]

In his Pre-Budget Statement to the House on 9 November 1999 the Chancellor, Gordon Brown, announced that the 6% fuel escalator would not apply in future Budgets:

> Since 1997, the escalator has been needed to reduce the £28 billion deficit that we inherited, as we put in place our new measures to protect the environment. Those who have opposed the escalator - including some of those who originally imposed it - have to explain how, without it, they would have cut the deficit, made money available for public services and met our environmental commitments in the past two years. Having cut the deficit and introduced our new environmental policies, we are now in a position - instead of the pre-announced 6 per cent escalator - to make our decisions Budget by Budget, with the following commitment: if there are any real terms rises in road fuel duties, they will be lower and the revenues will go straight to a ring-fenced fund for the modernisation of roads and public transport.[37]

Further details were given in the *Pre-Budget Report* published at this time:

> **6.59** Road transport accounts for over 20 per cent of carbon dioxide and almost 50 per cent of nitrogen oxide emissions. In October 1998, the EU concluded an agreement with ACEA, the European car manufacturing industry group, to reduce average carbon dioxide emission levels from the new car fleet. Under the terms of the agreement, all European car manufacturers are required to reduce average emissions from their new cars to 140 grams per kilometre (down from 186g per kilometre) by 2008. The Government's package of tax incentives for cleaner cars will support this historic agreement by giving an incentive for individual motorists to demand more fuel efficient models. The agreement has recently been extended to Korean and Japanese car makers.
>
> **6.60** Since 1997, the Government has maintained and increased the fuel duty escalator introduced by the previous Government in 1993. This has given a clear signal to motorists and manufacturers to design more fuel efficient vehicles, avoid unnecessary journeys and consider alternatives to the car. Increases in fuel duties since 1996 are estimated to produce carbon savings of between 1 and 2.5 million tonnes of carbon by 2010.
>
> **6.61** The Government is committed to meeting its environmental targets. The time has now come to review the way that any increases in the fuel duties are determined. **The Chancellor has, therefore, decided that the appropriate level of fuel duties will be set on a Budget by Budget basis, taking account of the**

[36] "Taxation road to nowhere", *Financial Times*, 2 September 1999
[37] HC Deb 9 November 1999 cc889-890

> **Government's economic and social objectives as well as the UK's environmental commitments.**
>
> **6.62 The Chancellor has decided that the revenues from any real terms increases in fuel duties will, in future, go straight in to a ring-fenced fund for improving public transport and modernising the road network.**
>
> **6.63** The environmental signals from the significant increases in fuel duty over recent years will be reinforced by the reforms announced in Budget 99 to Vehicle Excise Duty and company car taxation. These are intended to provide incentives to purchase and use cleaner, more fuel-efficient cars.[38]

The Government also announced at this time that the duty escalator on tobacco, also introduced in 1993, would be withdrawn as well, and that any additional revenue raised from real increases in tobacco duties in future would be spent on improved health care.[39]

For its part the Institute for Fiscal Studies has been critical of this proposal to allocate the resources from future duty increases to specific ends (a term known as 'hypothecation'):

> One argument made in support of hypothecation is that it makes people more willing to pay tax, so that more revenue would be collected if hypothecation were used more widely. But if the reason why people are more willing to pay tax is that they believe the government is required to spend a minimum amount in those areas as a result, the fact that this is difficult to guarantee even in the short term, and even harder in the longer term, should be made clear.
>
> Even if the government could guarantee that allocating revenues in this way would lead to an increase in spending in these areas, it is still not clear that it is a good idea. Although there are some links between smoking behaviour and health spending, for example, the optimal levels of tobacco taxation and health spending are determined by a wide range of different factors. In addition, if spending in the absence of the hypothecation were fixed, and revenue from tobacco and road fuel duties were lower than expected, it is unlikely that people would be happy that spending on health and transport would be lower than expected as a result.
>
> Equally, if revenue from tobacco and road fuel duties were higher than expected, people might prefer the extra funds to be spent oil areas other than health and transport, such as education for example. Also, the fact that the government is trying to reduce the consumption of tobacco and road fuel to meet health and environmental targets might imply lower revenue in future. Under genuine hypothecation, any reduction in consumption would lead to lower spending on health and transport, which does not seem sensible.

38 HM Treasury, *Pre-Budget Report* Cm 4479 November 1999 p106

39 *op cit*, p94

> Hypothecation of tobacco and road fuel taxes cannot guarantee higher spending on health and transport, particularly in the long term. Since it is not clear that it is desirable to link taxation on tobacco to spending on health or taxation on road fuel to spending on transport, even if it were possible to guarantee higher spending, this new development in taxation policy is not very appealing.[40]

In his March 2000 Budget the Chancellor announced that duty rates would be increased in line with inflation:

> I said last November that I would, in future, make an annual Budget decision on one matter: real-terms rises in road fuel duties--the money to go to a new ring-fenced fund for roads and public transport. Since the pre-Budget report, world oil prices have risen rapidly from $23 to $30 a barrel. So, in this Budget I have decided that, beyond the automatic inflation rise of 2p a litre, there will be no real-terms rise in road fuel duties.[41]

Not unexpectedly, the Chancellor's announcement was reportedly welcomed by motorists organisations – such as the AA and RAC – but sharply criticised by environmental groups, such as Friends of the Earth.[42] This year's duty increases were legislated for in clause 4 of the *Finance Bill 2000*, which amends the *Hydrocarbon Oils Duties Act (HODA) 1979*. The clause was considered in Standing Committee H on 9 May 2000.[43]

4. Summary

The following table summarises changes in duty on unleaded petrol over the last decade.

In the years 1993 to 1996 the escalator was seen as a minimum increase. The increase of 9.9% in November 1993 was actually around 8 percentage points above the September 1993 inflation rate of 1.8%.

One of the consequences of the change in the timing of the budget is that in 1997, 1998, 1999 and 2000 the escalator was based on a forecast of inflation for the following September rather than the outturn for the previous September.

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[40] IFS, *The IFS Green Budget*, Commentary 80, January 2000 pp109-110
[41] HC Deb 21 March 2000 c 868.
[42] "Drivers see light at end of tunnel as taxes are cut back", *Times*, 22 March 2000
[43] cc43-60

Excise duty on Premium Unleaded Petrol

Date of change	New rate (p/l)	Change in duty	Effect on price incl. VAT (p/l)	Basis for increase
20.3.90	19.49	n.app.	n.app.	n.app.
19.3.91 (a)	22.41	15.0%	3.4	No stated basis.
10.3.92	23.42	4.5%	1.2	Increase in RPI in year to December 1991
16.3.93	25.76	10.0%	2.7	No stated basis.
30.11.93	28.32	9.9%	3.0	3 pence per litre. (At least RPI+3%)
29.11.94	30.44	7.5%	2.5	2.5 pence per litre. (At least RPI+5%)
1.1.95	31.32	2.9%	1.0	Ad hoc 1p/l increase following defeat on VAT on domestic fuel.
28.11.95	34.30	9.5%	3.5	3.5 pence per litre. (At least RPI+5%)
26.11.96	36.86	7.5%	3.0	3 pence per litre. (At least RPI+5%)
2.7.97	40.28	9.3%	4.0	4 pence per litre. (At least RPI+5%)
17.3.98	43.99	9.2%	4.4	Expected increase in RPI to September 1998 plus 6%
9.3.99	47.21	7.3%	3.8	Expected increase in RPI to September 1999 plus 6%
21.3.00	48.82	3.4%	1.9	Expected increase in RPI to September 2000

Note: (a) Pence per litre change refects increase in VAT from 1.4.91.

Sources: HM Treasury, *Budget Red Books*
HM Customs & Excise, *Annual Report* , 1998/99 table K1
HM Customs & Excise, *Hydrocarbon Oils: Increased excise duty* , Budget notice BN62/00 21 March 2000

D. European comparisons and harmonisation

As a consequence of both the present and the previous Government's policies, the levels of road fuel duties in the UK are particularly high. The following table sets out the position in the EU15 at mid-May 2000.

Road Fuel Duties: End-May 2000

Country	Duty (pence/litre) (a) Unleaded petrol	Diesel	VAT
Austria	25.05	17.51	20.0%
Belgium	30.66	17.53	21.0%
Denmark	31.36	20.83	25.0%
Finland	33.83	18.42	22.0%
France	35.62	23.69	19.6%
Germany	34.00	22.87	16.0%
Greece	17.61	14.91	18.0%
Ireland	22.89	19.95	21.0%
Italy	31.45	23.07	20.0%
Luxembourg	22.49	15.28	12%/15%(b)
Netherlands	36.07	21.27	17.5%
Portugal	22.34	14.87	17.0%
Spain	22.47	16.31	16.0%
Sweden	32.67	21.36	25.0%
United Kingdom	48.82	48.82	17.5%

Note: (a) Converted at £1= Euro 1.654.
(b) 12% on unleaded petrol and 15% on diesel.

Source: EC, *Oil Bulletin* , 14 June 2000

The next table illustrates the incidence of tax on a litre of unleaded petrol in each country:

Premium unleaded petrol: 15 May 2000

pence per litre

County	Typical retail price	Pre-tax price	Duty	VAT	Total tax Amount	% of price
Austria	56.14	21.74	25.05	9.36	34.41	61.3%
Belgium	62.35	20.87	30.66	10.82	41.48	66.5%
Denmark	67.02	22.25	31.36	13.40	44.77	66.8%
Finland	68.29	22.14	33.83	12.31	46.15	67.6%
France	65.25	18.94	35.62	10.69	46.32	71.0%
Germany	58.43	16.37	34.00	8.06	42.06	72.0%
Greece	47.17	22.37	17.61	7.20	24.80	52.6%
Ireland	55.03	22.59	22.89	9.55	32.44	59.0%
Italy	64.19	22.04	31.45	10.70	42.15	65.7%
Luxembourg	50.20	22.33	22.49	5.38	27.87	55.5%
Netherlands	70.91	24.28	36.07	10.56	46.64	65.8%
Portugal	53.67	23.53	22.34	7.80	30.14	56.2%
Spain	49.24	19.98	22.47	6.79	29.26	59.4%
Sweden	68.78	22.35	32.67	13.76	46.43	67.5%
United Kingdom	79.58	18.91	48.82	11.85	60.67	76.2%

Note: (a) Converted at £1= Euro 1.654.

Source: EC, *Oil Bulletin* , 24 May & 14 June 2000

There is a degree of harmonisation in duty rates across the EU, though European law in this area only specifies minimum duty rates, which has allowed Member States a considerable degree of discretion in their approach to taxing fuel. The current agreement on excise duties across the EU is incorporated in a number of EC directives adopted on 19 October 1992. From 1 January 1993 Member States were allowed to set duty rates appropriate to their own circumstances, provided they were not lower than the minimum levels specified in the relevant directive; for mineral oils, directive 92/82/EEC establishing these minimum rates, and its companion directive 92/81/EEC which defines those oils to be charged duty.[44] Without any subsequent agreement, these minimum rates remain in force, and, as yet, no changes have been made to them. The table below shows these rates, along with the current duty rates in the UK with effect from Budget day (21 March 2000):[45]

Rate of duty per 1,000 litres

Product	Minimum rate (ECU)	Minimum rate (a) (£)	Current UK rate (£)	
Leaded petrol	337	212.31	546.80	
Unleaded petrol	287	180.81	488.20	
Diesel (DERV)	245	154.35	518.20	
Heavy fuel oil (b)	13	8.19	27.40	(b)
Kerosene for heating purposes	Nil	Nil	Nil	
Heating gas oil	18	11.34	31.30	

Notes: (a) Converted at a rate of 1 ECU = £0.63
(b) Minimum EU Duty rate on heavy fuel oil is per tonne.
Duty on fuel oil in the UK is charged per 1,000 litres

Under Article 10 of directive 92/82/EEC the European Commission had to report, with appropriate proposals, before 31 December 1996 on the minimum rates of duty on mineral oils. In March 1997 the Commission published a draft Directive to restructure the EC framework for the taxation of energy products, which proposed uprating the minimum duty rates on mineral oils and extending this regime to other energy products, such as natural gas, solid fuels and electricity.[46] The implications of the draft directive for the current minimum rates were set out in an explanatory memorandum issued by HM Customs & Excise in May 1997, from which the following text is taken:

> In relation to mineral oils the proposal retains the existing structure of taxation but would introduce more flexibility for Member States to adapt that structure to fit national policies and priorities. Provided that minimum rates are respected, the directive would permit Member States to introduce differential rates of duty

[44] This legislation is complemented by Council Decision 99/880/EC, which provides for individual exemptions & reduced rates of duty for certain mineral oils when used for specific purposes in Member States.

[45] HM Customs & Excise Budget Notice BN 62/00, 21 March 2000

[46] EC draft 6793(97) 21 March 1997

> within a particular category of product to reflect policy concerns (such as the UK's higher rate for super-unleaded petrol) without needing to seek express Community approval. The current separate minima for leaded and unleaded petrol are replaced by a single minimum rate, together with a requirement that leaded petrol be taxed more heavily than unleaded, although the differential is not specified […]
>
> Minimum rates of duty for the different categories are increased to reflect environmental concerns and to encourage a greater degree of harmonisation in the interests of the smooth functioning of the Single Market. The proposal includes a programme of further rate increases in the year 2000 and target rates for 2002, with actual rates after 2002 to be determined by unanimous decision of the Council before the end of 2000. A notable feature of the proposal is the significant increases proposed in the minimum rates on motor fuels.
>
> However, this reflects the fact that actual national rates of duty already significantly exceed the current Community minima, so that (according to the Commission) only three Member States would be obliged to increase their rates on unleaded petrol by 1 January 1998, while seven Member States would have to increase their diesel rates. The proposal also replaces the zero minimum rate for kerosene and LPG used in heating by a positive minimum rate, which is relatively low in 1998 but rises sharply in 2000 and 2002. Minimum rates for heavy fuel oils also rise significantly. There is a separate, lower minimum rate for low-sulphur heavy fuel oils.[47]

The memorandum went on to point out that if adopted as drafted, the proposal would not require real increases in UK rates of duty on motor fuels, nor any increases in the rates on heating gas oil or heavy oils until after 2000. The Commission had proposed that the draft directive come into force on 1 January 1998, but as the then Financial Secretary – now Paymaster General, Dawn Primarolo – explained in Customs' memorandum, "this is subject to the unanimous agreement of the Council. Achieving unanimity in this area is likely to be a long drawn-out process and, as the fate of the Commission's carbon/energy tax proposals indicates,[48] there is no guarantee that unanimity will be achieved. It is therefore very unlikely that this directive (or a modified version of it) will come into force by the date the Commission proposes."[49]

In a subsequent explanatory memorandum published in December 1997, the Government gave more details of its attitude to the draft proposal, including its views on the proposed increases in minimum duty rates on oil and petrol:

> There are some elements of the proposal which the Government can support. For example, there is a good Single Market and environmental case for increasing

[47] HM Customs & Excise explanatory memorandum, 21 May 1997 paras 8-10

[48] The Commission proposed an EU-wide energy/carbon tax in October 1991 [EC draft 7018/92]. Despite considerable negotiation over the next three years, the proposal was dropped entirely in December 1994.

[49] HM Customs & Excise explanatory memorandum, 21 May 1997 para 20

minimum rates of duty on road fuels. It would moreover be desirable to see the differential between minimum duty rates on diesel and unleaded petrol reduced to reflect current knowledge of the relative environmental effects of the two fuels. The proposal also includes increases in existing minimum duty rates for mineral oils, with a programme of further increases in 2000 and 2002. The Government supports the principle of a programme of rate increases over the short/medium term, with longer term rates set as targets which should be converted to legally binding minima nearer the time in the light of developments.

The proposed increases in minimum levels of taxation on heating oils are, with exception to those on kerosene and LPG heating, acceptable. Positive tax rates above the proposed minimum rate are already applied to heating gas oils in the UK. Kerosene and LPG however are currently zero rated and are used in some cases for domestic oil-fired central heating in the UK. The Government would want to consider carefully the social consequences of any increase in duty.[50]

Since then there do not appear to have been any developments at a European level, though the draft was the subject of a short debate in European Standing Committee B on 29 October 1999. On this occasion Stephen Timms, Financial Secretary to the Treasury, summarised the Government's position on this proposal:

The Government's position on the directive is straightforward. We are strongly in favour of higher minimum rates on mineral oils, especially road fuels. Wide variations in rates do distort the proper operation of the single market, not only from the UK's point of view, but also from that of other member states that place a premium on the environment but which have lower taxing neighbours. We also welcome the ability to introduce differential rates of duty on road fuel for environmental reasons without having to apply, as we currently do, for a derogation. Committee members may recall the great success of the differential in favour of ultra-low sulphur diesel, which has resulted in almost 100 per cent. take up of the ultra low sulphur variant. We will no longer have to seek the agreement of other member states to what is and should be a matter for subsidiarity.

As for the taxation of coal, gas and electricity, we are prepared to see progress made on the draft directive, subject to the inclusion of a permanent exemption for domestic consumption of all energy products. We are encouraged by the work of the German presidency in particular and believe that our concerns can be met and that the UK will be able to continue to work constructively towards the resolution of this long-running issue.[51]

E. Road fuel duty paid by households

National Statistics conducts a regular analysis of the 'effects of taxes and benefits on household income' that enables some conclusions to be drawn about the burden of particular

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[50] HM Customs & Excise supplementary explanatory memorandum, 10 December 1997 paras 5-6

[51] European Standing Committee B 27 October 1999 cc2-3

taxes on different types of household and on households with different income levels. The latest results were published in the April 2000 edition of *Economic Trends* and this source should be consulted for details of the methodology. In broad terms, the analysis combines data on the incomes and expenditure patterns of households from the Family Expenditure Survey with details of tax revenues and public spending to produce estimates of the average amounts that various quantiles of the income distribution pay in taxes and receive in benefits. (Indirect taxes include an estimate of the extent to which intermediate taxes on businesses are passed on to consumers in the form of higher prices.)

The latest analysis, which relates to 1998/99, suggests that households paid some £10.5 billion in hydrocarbon oil duties (mainly on road fuel). This was equivalent to around £420 per household before VAT. The following table analyses the results by decile (ie tenth) of households ranked by equivalised disposable income.[52] Over most of the income range payments of hydrocarbon oil duties represented around 2½% of disposable income. However, the proportion was noticeably higher for the lowest decile and lower for the highest decile.

Hydrocarbon oil duties paid by households
1998/99

Decile of equivalised household disposable income	Average amount per household		
	£ per year	Percent of disposable income	Share of total
Lowest	208	3.7%	5.0%
Second	199	2.5%	4.7%
Third	233	2.5%	5.5%
Fourth	299	2.5%	7.1%
Fifth	394	2.6%	9.4%
Sixth	430	2.4%	10.2%
Seventh	510	2.5%	12.1%
Eighth	594	2.4%	14.1%
Nineth	638	2.2%	15.2%
Highest	696	1.4%	16.6%
All households	420	2.2%	100.0%

Source: NS, *Economic Trends* , April 2000 p62

IV Rural communities

It has been argued for some time that increases in fuel duties have a disproportionate impact on rural communities. This contention is supported by an analysis by the Institute for Fiscal

[52] Equivalisation adjusts income for family composition so that income is a better reflection of living standards. For example, a single person with a particular disposable income would generally be considered to have a higher standard of living than a family of four with the same income.

Studies.[53] This concluded that, amongst car-owing households, the impact of increases in fuel duty falls hardest (as a percentage of their cost of living) on poorer households and particularly on those in rural areas. When faced with an increase in petrol prices those in urban areas tend to reduce the number of miles that they drive by a larger proportion than those in rural areas.

Information from the *National Travel Survey* illustrates the rural dependence on the car. This is shown in the following table.

Indicators on car ownership and usage, by area type, 1995/97

	Rural	London	Metropolitan	Large urban[(a)]	Great Britain
Percentage of households with a car[(b)]	83	61	59	69	69
Annual car mileage	10,200	7,800	9,000	9,200	9,600
Public transport as a percentage of all journeys	4	20	14	9	9

(a) Over 250,000 residents
(b) 1996/98 data

Sources: Focus on personal travel 1998, DETR
National Travel Survey: 1996-98 update, DETR

This issue has been a particular in Scotland where petrol prices in rural areas are above the national average. The *Rural Scotland Price Survey* produced by Mackay Consultants for Highland & Islands Enterprise suggests that in winter 1999/2000 the price of unleaded petrol in the Highlands and Islands was 9.5% higher than in Aberdeen with diesel being 11.3% more expensive. Of course, these differences reflect factors other than excise duty. Further background on issues in Scotland is available from the Scottish Parliament Information Centre.[54]

Concern about the impact of increases in fuel duties on rural communities lead to one of the very few occasions in recent years that a tax change announced in a Budget was reversed: the proposed increase in excise duty on diesel by the equivalent of 20p per gallon in 1981. In his Budget speech of that year the then Chancellor Geoffrey Howe had stated: "the duties on petrol and derv will be increased from 6pm tonight by the equivalent, including VAT, of 20p per gallon. These increases should yield an additional £910 million from petrol and £270 million from derv in 1981-82 and the same in a full year."[55] The proposal was debated

[53] Laura Blow & Ian Crawford, *The distributional effects of taxes on private motoring*, IFS Commentary No65, 1997
[54] *European Petrol Retailing*, Research Paper 00/38. Available at: http://www.scottish.parliament.uk/whats_happening/research/pdf_res_notes/rn00-38.pdf
[55] HC Deb 10 March 1981 c773

on the floor of the House on 30 April (cc 916-1006). Cross-party opposition was such that the Government supported an amendment, moved by Trevor Skeet, to cut the excise duty increase by 10p:

> Although the reduction does not meet all the points that have been urged on me by my hon. Friends, it will be of particular benefit to rural areas and to the Scottish economy. It will also meet the concern widely expressed about the distribution cost of many commodities, ranging from food for livestock to beer and petrol, which is not unimportant.[56]

As a consequence, on 6 July 1981 the Conservative Government moved a number of Ways and Means resolutions, to increase the excise duty on tobacco products, and on gaming taxes, with effect from the following day, to recoup the estimated £85 million it had lost from the cut in derv duty.[57] The resolutions were passed, and suitable amendments were made to the Finance Bill on 14 July, introducing these new rates of tobacco, betting and gambling duties, and bringing the new, lower, rate of duty on derv into effect from 2 July.[58]

This issue was debated at some length in January 1995, following the Conservative Government's decision to introduce a second increase in fuel duties - on top of those announced in the November 1994 Budget. The then Government introduced a second round of duty increases, after it was defeated in its intention to extend VAT from 8% to 17.5% on domestic supplies of fuel and power. At the time, Dawn Primarolo argued, "people living in rural areas will be badly affected. They will find it difficult to understand why they must pay for the Government's taxes while receiving little in return in public transport. Pitching the tax and the tax rise as an environmental measure is cynical."[59] Alex Salmond went on the emphasise how important private transport was for rural communities: "In many rural communities the car is not a luxury, but a necessity; it is often the only form of transport available. If the Government continue to pursue them, the measures will impact on transport costs in rural communities and they will hit rural industries by pricing them out of the market."[60]

One of the principles behind excise duties is that they be charged in a universal fashion, on all those who purchase a particular good. In the case of fuel duties, the principle cannot fail to have distribution effects, given the greater reliance in rural areas on transport, both private and public. Even so, exemptions or reliefs tailored to particular areas would, from one perspective, subsidise - through the tax system - someone's decision to live in a given place, without attention to the circumstances in which they do so. One could argue that compensation for living in these areas, and support for businesses located there, could be better targeted through the benefits system, or by the provision of regional aid.

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56 HC Deb 30 April 1981 c937. This measure was implemented as section 4 of the *Finance Act 1981*.
57 HC Deb 6 July 1981 cc72-235
58 HC Deb 14 July 1981 cc1127-1136
59 HC Deb 23 January 1995 c99
60 *op cit* c100

A wider point, and one made by the then Paymaster General, David Heathcoat-Amory, in the debate referred to above, is that fuel costs represent one cost of living in a rural area:

> Petrol and fuel costs are but one component in the budgets of those who live in rural areas. Plenty of other things are cheaper in rural areas - certainly in Scotland, where housing costs are generally lower than they are in my constituency. I am not asking for the Government to intervene to try to correct that imbalance; it would be impossible for the Government to lay down by some prescriptive formula what petrol and fuel companies should charge in various parts of the country ... I accept that some things are more expensive in rural areas. Some things are more expensive in urban areas. That is the interplay of a market and the inheritance of the past.[61]

Mr Heathcoat-Amory went on to argue that the current structure of taxes on motoring represented a fair balance, between environmental objectives and recognising the costs to living in the country. A number of commentators have argued that Vehicle Excise Duty should be abolished, and fuel duties be raised to compensate for this. The main advantage with doing so would be that it would encourage fuel efficient and environmentally friendly vehicles. According to estimates made by the Institute for Fiscal Studies,[62] the change from taxing ownership to taxing the use of cars would cut car use by 8 per cent in one year. This would immediately effect the amount of fuel consumed, the damage done to the environment and the crowding on the roads. In the longer term, fuel-efficient cars would become more popular.

An argument over fairness is also put forward. If one taxes motorists through duty on petrol, or through road pricing, rather than the VED, those who use most fuel and cause most pollution will be taxed most. Of course, the counter argument is that such a move would increase the costs of firms with high mileage costs. This would include those who live in rural areas, many business users, and lorry and van users and the impact on this group, particularly in the current economic climate is a reason for the retention of VED. There would also be inflationary consequences. For these reasons, Mr Heathcoat-Amory suggested that VED should remain: "[Abolishing VED with a transfer to fuel tax] would equate costs more closely with usage. Precisely for the reason that it would disproportionately damage and hit the rural motorist, we have resisted that approach."[63]

The issue was raised with the then Financial Secretary in a written question in April 1998, when she gave the following response:

> **Mr. Nicholas Winterton:** To ask the Chancellor of the Exchequer if he will make a statement on the impact of the increase in fuel tax on motorists in rural areas.

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61 *op cit* c104
62 M Pearson & S Smith, *Taxation & Environmental Policy : Some Initial Evidence*, IFS 1990
63 HC Deb 23 January 1995 c 104

> **Dawn Primarolo:** The Government recognise that many people, especially in the more isolated rural areas, have become increasingly dependent on car ownership. But all motorists must also make a contribution in tackling global warming caused by greenhouse gases. To help provide alternatives to the car, the Government are spending an extra £50 million a year on rural transport. They are also spending an additional £40 million to increase the rebated paid to bus operators.[64]

The Chancellor had announced this increase in funding to rural transport in his 1998 Budget speech. In addition, he recognised the value in shifting the tax burden by reforming VED:

> Road transport is the fastest growing source of carbon emission, so we need a more balanced transport policy. The Government therefore propose to make two major environment-led changes to long-term transport policy. The quality and quantity of public transport must be improved. I am pleased to announce that, over the coming three years, as a result of this Budget, a total of over £500 million additional money will be invested in public transport. My right hon. Friend the Deputy Prime Minister will announce details later this week. I can announce today a £50 million a year rural transport fund. Three quarters of rural parishes and communities have no bus service. Our aim must be to extend the range of transport services throughout the country. The fund will invite applications from rural communities that want to improve their local transport services. As an added incentive, I shall increase the rebate on fuel paid to bus operators to help to keep bus fares down.
>
> The Government recognise that, for many people, especially in isolated areas, car ownership is not a choice but a necessity, so I now want to rebalance car taxation so that it falls less on car ownership. I want to make the change in an environmentally sensitive way. From January next year, I am cutting the licence fee for lorries and buses with clean engines by up to £500. But I also want to make a major reform of the licence fee for cars. From next year, I plan to reduce the licence fee for cars with the lowest emissions. For the cleanest and the smallest cars, I plan to cut the licence fee by £50. As we make the preparations for this long-term environmental change, for this year I propose, at a cost of £145 million, to freeze the licence fee for all vehicles.[65]

On the subject of rural transport, it is worth noting that in November 1998 the Deputy Prime Minister John Prescott announced that a Rural White Paper would be drawn up, setting out how new policies would be tailored and integrated to meet rural concerns. In his statement Mr Prescott said that the White Paper would amongst other things “explore how policies on the economy, health, transport, education, housing, crime, agriculture,

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64 HC Deb 7 April 1998 cc 149-150W

65 HC Deb 17 March 1998 cc1109-1110. Details of how this extra funding would be spent were given in DETR Budget press notice 1, 17 March 1998.

energy efficiency and planning will support sustainable communities in the future."[66] The expected publication date of the White Paper is within 12 months of the most recent written answer on 27 July 1999.[67]

The 1999 Budget confirmed that new cars registered would be placed in one of four VED rate bands, according to their carbon dioxide emissions. In the 2000 Budget it was announced that the new scheme would be introduced from 1 March 2001. All cars registered for the first time will be placed into one of four VED bands based on their rates of carbon dioxide emissions. Within each band, there will also be a discount rate for cars using cleaner fuels and technology and a small supplement for diesel cars. Existing cars will continue to be charged a flat rate.[68]

The impact of fuel duties on rural communities was discussed at the Committee stage of the *Finance Bill 2000*, when the Financial Secretary, Stephen Timms, noted, "We have always recognised that for many people, especially in rural areas, car ownership is a necessity rather than a luxury. That lies behind the proposed changes to VED, such as reductions for smaller and fuel-efficient cars with low emissions, which will be especially welcome for people who must have a car and people in rural areas."[69]

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66 DETR press release No 1007, 27 November 1998
67 HC Deb 27 July 1999 c 348W
68 HM Treasury/DETR Budget press notice HMT/DETR1, 21 March 2000
69 Standing Committee H 9 May 2000 c57